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CHRISTOPHER W. PETERSON\*

## Piercing the Corporate Veil by Tort Creditors

*The long-standing equitable remedy of piercing the corporate veil has evolved over the past century as courts have become cognizant of the costs to society of limited liability. Over the last few decades, many courts have acknowledged a distinction between the justifications for piercing the veil by a tort creditor and those for a contract creditor. Nearly all such courts that have acknowledged the distinction have concluded that tort creditors should have an easier path to piercing the corporation's veil of limited liability.*

*This Article reviews the tests courts are increasingly using to grant leniency to tort creditors and the justifications that are most likely to predict veil piercing success by such creditors. This Article concludes that courts tend to use the same veil piercing test for both contract and tort creditors, but re-weigh the factors that are influential in predicting such veil-piercing outcomes. Courts tend to focus on the equitable nature of the veil piercing remedy and on the policy considerations unique to tort creditors in re-weighing the veil-piercing factors in favor of tort creditors. According to the prevailing jurisprudential trend, tort creditors are granted an easier path to veil piercing because of the policy considerations that tort victims should not be required to bear the costs of risky corporate behavior when they neither chose to deal with the corporation nor had the opportunity to protect themselves from the risk of corporate insolvency.*

### I. INTRODUCTION

Considered the hallmark of corporate status, limited liability shields an investor's personal assets from the reach of a business entity's creditors, reducing the investor's personal exposure.<sup>1</sup> Limited liability has many benefits.<sup>2</sup> It allows business entities to aggregate large amounts of capital from numerous small investors, many of whom

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\* Associate Attorney, Wolfe, Snowden, Hurd, Luers & Ahl, LLP. J.D. University of Nebraska College of Law, M.B.A. University of Nebraska-Lincoln, B.S. Brigham Young University. I would like to thank Elizabeth Cano for her very helpful comments on and comprehensive review of this Article.

1. See David Millon, *Piercing the Corporate Veil, Financial Responsibility, and the Limits of Limited Liability*, 56 EMORY L.J. 1305, 1309 (2007).

2. *Id.* at 1312–1313.

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would be reluctant to risk their personal wealth if there was a possibility of being held liable for substantial corporate obligations.<sup>3</sup> It allows investors to hold diversified portfolios in a number of companies without exposing themselves to ruin.<sup>4</sup> “Limited liability therefore encourages investment that otherwise would not occur.”<sup>5</sup> Moreover, for the rest of society, the increase in capital and business activity increases employment and wages.<sup>6</sup>

Despite its myriad of benefits, limited liability is not without its costs.<sup>7</sup> When a business entity invokes the principles of limited liability, it typically means that some other party is bearing costs.<sup>8</sup> These costs impact both parties that voluntarily contract with business entities and individuals who involuntarily become creditors of business entities.<sup>9</sup> One category of costs stems from the imperfect information available to parties deciding whether to engage in a contractual relationship with a business entity protected by limited liability.<sup>10</sup> Contracting parties may not accurately gauge the risks of transacting business with a company, either because of misrepresentations made by such company or because of lack of access to credit reports and other information about the company.<sup>11</sup> Additionally, a stark imbalance in bargaining power often precludes the contracting party from obtaining the information needed to gauge such risk.<sup>12</sup> The same imbalance in bargaining power also precludes the contracting party from negotiating, for example, guarantees from the shareholders or security interests in the company or shareholder’s assets.<sup>13</sup>

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3. *Id.* at 1312.

4. See Frank Easterbrook & Daniel Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89, 96 (1985).

5. Millon, *supra* note 1, at 1312.

6. See Easterbrook & Fischel, *supra* note 4, at 97 (expounding upon the many advantages of limited liability for companies and society as a whole).

7. See *generally id.* (discussing the costs and benefits of limited liability).

8. See *id.* at 103–04; see also Rachel Maizes, *Limited Liability Companies: A Critique*, 70 ST. JOHN’S L. REV. 575, 600 (1996) (detailing the various other parties that bear the costs).

9. See Easterbrook & Fischel, *supra* note 4, at 103–04; see also Maizes, *supra* note 8, at 600 .

10. 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 data to rank purchase options in the market); see *generally* Easterbrook & Fischel, *supra* note 4, at 106 (noting that voluntary creditors may not have the information or incentive to assess risk correctly).

11. See Easterbrook & Fischel, *supra* note 4, at 112. *But see* Roger E. Meiners, James S. Mofsky, & Robert D. Tollison, *Piercing the Veil of Limited Liability*, 4 DEL. J. CORP. L. 351, 362–63 (1979) (suggesting that investments in a corporation would not dramatically change even if there was unlimited liability).

12. See Robert B. Thompson, *Piercing the Veil: Is the Common Law the Problem*, 37 CONN. L. REV. 619, 628 (2005) [hereinafter Thompson, *Is the Common Law the Problem*].

13. See 1 WILLIAM MEADE FLETCHER ET AL., FLETCHER CYCLOPEDIA CORPORATIONS § 41.85 (2017) (stating that sometimes contracting parties are not experienced enough to negotiate adequately with a company and noting that in those instances courts will regard contract and tort creditors in the same way).

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Limited liability also creates a problem of moral hazard.<sup>14</sup> When a company is not required to pay for the risks created by its actions, the company will be more likely to engage in activities with social costs that exceed their social benefits.<sup>15</sup> This is particularly true in the case of involuntary creditors such as certain tort creditors, trade creditors, and employees.<sup>16</sup> These parties are not compensated for the increased risky behavior of the company.<sup>17</sup>

Recognizing these costs, courts have carved out certain exceptions to limited liability.<sup>18</sup> In an effort to reduce excessive corporate risk-taking and to compensate certain creditors for increased risk, under certain circumstances, courts of equity allow such creditors to reach beyond the four corners of the company's balance sheet to the assets of investors and affiliated companies.<sup>19</sup> In other words, the court may allow a creditor to pierce the corporate veil.<sup>20</sup>

However, the law regarding corporate veil piercing is notoriously murky.<sup>21</sup> Courts rely on equitable principles in balancing the need to protect the benefits of limited liability with the desire to curb corporate fraud, misrepresentation, and other wrongdoing and to protect involuntary creditors from recognizing the costs of the company's risky behavior.<sup>22</sup> Traditionally, this balancing has led to results that appear unquestionably confusing and incoherent;<sup>23</sup> indeed, it has become cliché to reference the countless ways commentators and courts have described the absolutely unpredictable nature of the veil-piercing doctrine.<sup>24</sup>

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14. See Easterbrook & Fischel, *supra* note 4, at 104.

15. *Id.* at 112.

16. See Millon, *supra* note 1, at 1355.

17. See *id.* (discussing the social costs imposed on involuntary creditors who must seek a judgment after the incident has occurred, and sometimes will be left to bear the cost themselves).

18. See generally Phillip I. Blumberg, *Limited Liability and Corporate Groups*, 11 J. CORP. L. 573 (1986) (discussing the development of limited liability in the history of American Law and the judicial decisions to begin to recognize exceptions to that rule).

19. See Robert B. Thompson, *Piercing the Corporate Veil: An Empirical Study*, 76 CORNELL L. REV. 1036, 1044–45 (1990-1991) (listing a variety of reasons offered by judges as to why they decided to pierce the corporate veil in certain cases) [hereinafter Thompson, *An Empirical Study*].

20. See *id.* at 1036 (explaining what piercing the corporate veil means in general terms).

21. See Cathy S. Krendt & James R. Krendl, *Piercing the Corporate Veil: Focusing the Inquiry*, 55 DENV. L.J. 1, 7 (1978).

22. See Thompson, *Is the Common Law the Problem*, *supra* note 12, at 628 (suggesting that courts will often provide a remedy for involuntary creditors who are hurt by fraud and other risky business practices).

23. Jonathan Macey & Joshua Mitts, *Finding Order in the Morass: The Three Real Justifications for Piercing the Corporate Veil*, 100 CORNELL L. REV. 99, 101 (2014).

24. See, e.g., *Amfac Foods, Inc. v. Int'l Sys. & Controls Corp.*, 654 P.2d 1092, 1097 (Or. 1982) (“Many judicial opinions contain alluring but largely unhelpful rhetorical devices which purport to state a rule, but generally state merely a result.”); ROBERT C. CLARK, *CORPORATE LAW* 38 (1986) (describing veil piercing as “intellectually disturbing”); Sam Halabi, *Veil Piercing’s Procedure*, 67 RUTGERS U.L. REV. 1001, 1026 (2015); Peter B. Oh, *Veil-Piercing*, 89 TEX. L. REV. 81, 84 (2010); Easterbrook & Fischel, *supra* note 4, at 89 (describing

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Despite the confusion that exists with general veil-piercing law, there is one emerging trend that business leaders should be aware of: courts are increasingly granting one group of creditors an easier path to the assets of investors and affiliates—involuntary tort creditors.<sup>25</sup> The classic example is the uninsured and insolvent transportation company whose driver negligently slams into the back of an unsuspecting individual, resulting in significant and life-altering injuries.<sup>26</sup> Although the company created the risk that resulted in the individual's injuries, unless the corporate veil is pierced, it will not bear the costs of such risk, which will instead be shifted to the injured individual, who neither chose to associate with the company nor had an opportunity to obtain compensation or other protections from the company's owners before getting injured.<sup>27</sup>

Increasingly, courts are finding that the equities weigh in favor of piercing the corporate veil for injured tort victims.<sup>28</sup> Commentators have long distinguished the varied policy justifications for piercing the corporate veil in voluntary contract cases and involuntary tort cases.<sup>29</sup> However, courts have been slow to recognize such a distinction,<sup>30</sup> with most of those courts that have acknowledged the distinction doing so only within the last 30 years.<sup>31</sup> Furthermore, although commentators have acknowledged that courts are more willing to disregard the corporate veil in the tort

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veil piercing as “freakish” and comparing it to lightning because it is “rare, severe, and unprincipled”); Millon, *supra* note 1, at 1311 (describing veil piercing as “incoherent” and is an “unprincipled hodgepodge of seemingly ad hoc and unpredictable results”).

25. See Oh, *supra* note 24, at 90. *But see* Thompson, *An Empirical Study*, *supra* note 19 at 1058 (concluding that contract creditors are more likely than tort creditors to be able to pierce the corporate veil).

26. See, e.g., *Giuffria v. Red River Barge Lines, Inc.*, 452 So.2d 793, 794 (La. Ct. App. 1984) (affirming the trial court's determination to pierce the corporate veil where an uninsured and insolvent transportation company's driver negligently hit the plaintiff's van).

27. See Millon, *supra* note 1, at 1316.

28. See Oh, *supra* note 24, at 141–43 (distinguishing voluntary and involuntary creditors and success on veil-piercing claims and the rationales used by courts to justify piercing the veil).

29. See, e.g., *Theberge v. Darbro, Inc.*, 684 A.2d 1298, 1303 (Me. 1996) (Lipez, J., dissenting) (explaining the court adopted the position that contract claimants trying to pierce the corporate veil must meet a more stringent standard of proof than tort creditors); William O. Douglas & Carol M. Shanks, *Insulation from Liability Through Subsidiary Corporations*, 39 YALE L.R. 193, 210–11 (1929) (discussing the difficulties faced by contract creditors compared to tort creditors in piercing the corporate veil).

30. See *Theberge*, 684 A.2d at 1303 n.1 (Lipez, J., dissenting); H. HENN, LAW OF CORPORATIONS §§ 143, 146 (1961); Michael Epperson & Joan M. Canny, *The Capital Shareholder's Ultimate Calamity: Pierced Corporate Veils and Shareholder Liability in the District of Columbia, Maryland, and Virginia*, 37 CATH. U.L. REV. 605, 633–34 (1988); Robert W. Hamilton, Comment, *The Corporate Entity*, 49 TEX. L. REV. 979, 985 (1971) (noting that the distinction between tort and contract is only dimly perceived by many courts).

31. Although the distinction could certainly have been discussed by courts, the Author did not find such distinction to regularly appear in appellate court cases until the mid-1980s.

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context,<sup>32</sup> the most influential studies have not analyzed the tests courts use to achieve these results.<sup>33</sup>

This Article provides a comprehensive comparison of how courts treat involuntary tort creditors relative to voluntary contract creditors and concludes that although most courts use the same test in tort and contract cases, they apply the test differently, and are more likely to allow tort creditors to pierce the corporate veil. Furthermore, courts *should* be more lenient in piercing the corporate veil for tort creditors because such creditors are truly unable to protect themselves from the inefficient harms of businesses. Part II reviews the doctrine of veil piercing, generally, as an equitable remedy and the policy reasons behind disregarding a business entity to reach the assets of the equity investors or other related entities. Part III discusses the distinction between tort and contract creditors and the economic considerations for piercing the veil in each such case. Part IV analyzes the various ways in which courts have treated tort creditors differently from contract creditors, and identifies how courts are in fact making it easier for tort creditors to pierce the veil by focusing on persuasive policy justifications unique to such creditors. Part V concludes that courts across the country applying different veil piercing tests reach the same conclusion with respect to tort creditors due to public policy concerns.

## II. VEIL PIERCING, GENERALLY

Under the doctrine of limited liability, investors in a corporation, LLC or other separate entity, are only liable for the amount they invested and not liable for all obligations of the business entity.<sup>34</sup> The justification for this basic concept of corporate law is that these entities “are distinct juridical entities separate and apart from their creditors, shareholders, directors, and other constituencies.”<sup>35</sup> As a judicially-created equitable remedy, veil piercing represents the circumstances under which a creditor may disregard the separate entity and force equity investors and other related parties to satisfy the entity’s debts.<sup>36</sup>

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32. See, e.g., 1 FLETCHER ET AL., *supra* note 13, § 41.85; Easterbrook & Fischel, *supra* note 4, at 112 (“Courts are more willing to disregard the corporate veil in tort than in contract cases”); Oh, *supra* note 24, at 90 (“[V]eil-piercing claims prevail more often in Tort than Contract, reversing the counterintuitive asymmetry found by Thompson’s study.”). *But see* Thompson, *An Empirical Study*, *supra* note 19, 1058 (concluding that courts pierce less often in tort than in contract contexts). Thompson’s conclusions have been upheld by Peter Oh’s 2010 study, concluding that courts are more likely to pierce the veil in tort than in contract. See *generally* Oh, *supra* note 24.

33. See Halabi, *supra* note 24, at 1033.

34. See Easterbrook & Fischel, *supra* note 4, at 89–90.

35. See Macey & Mitts, *supra* note 23, at 104.

36. See 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).

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One justification for veil piercing is that a business entity should be held liable for insufficient management and oversight.<sup>37</sup> However, this justification extends only to shareholders of close corporations, where ownership of the business entity is more closely tied to its management.<sup>38</sup> Conversely, the argument for limited liability is more compelling for shareholders of publicly held companies, for whom monitoring of management is generally not feasible or cost effective.<sup>39</sup> Such shareholders “manage risk by investing passively in a diversified portfolio of companies rather than attempting actively to involve themselves in management of one or a few companies.”<sup>40</sup>

*A. Veil Piercing is an Equitable Remedy*

It is imperative to note, first and foremost, that a request to pierce the corporate veil is equitable in nature, and as such, is accompanied by all the characteristics of equitable jurisprudence.<sup>41</sup> Equity, in a broad sense, is “the power to do justice in a particular case by exercising discretion to mitigate the rigidity of strict legal rules.”<sup>42</sup> It is “individualized justice,” or the power to adapt the relief to the circumstances of the particular case.<sup>43</sup> Equitable relief has always been subject to the discretion of the court, as opposed to a matter of right.<sup>44</sup>

Judicial discretion in equity is not, however, absolute.<sup>45</sup> Although granted significant discretion to “do justice” in a particular case, courts of equity are still constrained by well-settled principles that govern the circumstances under which such justice may be prescribed.<sup>46</sup> While equity has been criticized for being too flexible,<sup>47</sup> in reality, judges acting in equity lack the power to grant relief based simply upon principles of compassion and fairness.<sup>48</sup>

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37. See Macey & Mitts *supra* note 23, at 127.

38. See Lawrence E. Mitchell, *Close Corporations Reconsidered*, 63 TUL. L. REV. 1143, 1169 (1988-1989).

39. See Millon, *supra* note 1, at 1314.

40. *Id.*

41. See *All Star, Inc. v. Fellows*, 676 S.E.2d 808, 813 (Ga. Ct. App. 2009).

42. See Kevin C. Kennedy, *Equitable Remedies and Principled Discretion: The Michigan Experience*, 74 U. DET. MERCY L. REV. 609, 609 (1997).

43. *Id.*

44. *Id.* at 613.

45. *Id.* at 616.

46. *Id.* at 616–23 (elaborating on the established principles governing a court of equity).

47. *Id.* at 613 (“From equity’s earliest days, one can find biting criticisms about the flexibility of equity, probably the most famous of these being John Selden’s indictment that the chancellor’s conscience varied with the length of his foot.”).

48. See *Spoon-Shacket Co. v. City of Oakland*, 97 N.W.2d 25, 30 (Mich. 1959).

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As an equitable remedy, veil piercing is also subject to the established principles and maxims of equity.<sup>49</sup> Several of these maxims especially applicable to veil piercing include the following: (1) equitable relief is available only where there is no adequate remedy at law; (2) equity regards as done which ought to be done; (3) equity looks to the intent, rather than to the form; (4) equitable relief is extraordinary, not ordinary; and (5) equity only helps those who have done everything to help themselves.<sup>50</sup>

*1. No Adequate Remedy at Law*

A prerequisite to the granting of any equitable remedy is that there be “no adequate remedy at law.”<sup>51</sup> A plaintiff’s legal remedy is usually deemed inadequate if the plaintiff could have or already did recover a money judgment from the defendant, but the judgment is uncollectible because the defendant is insolvent.<sup>52</sup> A corollary to this maxim is the principle that wherever a legal right has been infringed, a remedy will be given.<sup>53</sup> If the law is not able to provide an adequate remedy, then equity steps in to provide the remedy.<sup>54</sup>

*2. Equity Regards as Done Which Ought to be Done*

Equity treats as done that “which in good conscience ought to be done.”<sup>55</sup> It applies to every case where an affirmative equitable duty to do some positive act devolves

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49. See, e.g., *Drury Dev. Corp. v. Found. Ins. Co.*, 668 S.E.2d 798, 800 (S.C. 2008) (“In general, equitable principles govern the veil piercing remedy.”); *All Star, Inc.*, 676 S.E.2d at 813 (Ga. Ct. App. 2009) (“The concept of piercing the corporate veil is based upon equitable principles.”) (quoting *Pantusco v. Wiley*, 616 S.E.2d 901 (Ga. Ct. App. 2005)).

50. See generally Kennedy, *supra* note 42; see also 1 CHARLES FISK BEACH, JR., MODERN EQUITY: COMMENTARIES ON MODERN EQUITY JURISPRUDENCE AS DETERMINED BY THE COURTS AND STATUTES OF ENGLAND AND THE UNITED STATES § 54 (1892); 27 SAMUEL WILLISTON & RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS § 69:34 (4th ed. 2003); Samuel L. Bray, *The System of Equitable Remedies*, 63 UCLA L. REV. 530, 582 (2016) (referencing a number of equitable maxims).

51. See Bray, *supra* note 50, at 580 (“For an equitable remedy to be given, there must be ‘no adequate remedy at law.’ That requirement applies to all claims for equitable remedies.”); see also Halabi, *supra* note 24, at 1029 (stating that veil piercing, as an equitable remedy, should only be available where there is no adequate legal remedy).

52. See, e.g., *In re Wal-Mart Wage & Hour Empl. Practices Litig.*, 490 F. Supp. 2d 1091, 1120 (D. Nev. 2007) (“[D]amages may be inadequate . . . when the defendant is insolvent . . . .”); *Harris v. Krekler*, 46 N.E.2d 267, 269 (Ind. Ct. App. 1949) (noting insolvency of the defendant as an instance when the legal remedy is inadequate); Kennedy, *supra* note 42, at 649. Some courts require the plaintiff to obtain a judgment at law and then show that the defendant is insolvent and the judgment is uncollectible before the remedy at law will be considered inadequate, as opposed to immediately requesting equitable relief before a judgment at law has been obtained. See, e.g., *Weinstein v. Aisenberg*, 758 So.2d 705, 709 (Fla. App. 2000).

53. 1 JOHN NORTON POMEROY, A TREATISE ON EQUITY JURISPRUDENCE § 423 (4th 1918).

54. See Bray, *supra* note 50, at 580.

55. POMEROY, *supra* note 53, § 364.



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upon one party, and a corresponding equitable right is held by another party.<sup>56</sup> Pomeroy, in his ageless treatise on equity and equitable remedies, noted that equity is able to treat as done which ought to be done by looking past the form to the intent<sup>57</sup> to get to the “real fact, the real beneficial truth” in order to make “its remedies more complete.”<sup>58</sup>

#### 3. *Equity Looks to Intent, Rather Than Form*

In looking past the external form of a transaction, equity seeks to determine the underlying substance, and to ascertain the rights and duties of the parties which spring from the *real* relations between such parties.<sup>59</sup> Equity “will never suffer the mere appearance and external form to conceal the true purposes, objects and consequences of a transaction.”<sup>60</sup> Instead, it “disregards names, and penetrates disguises to get at the substance beneath.”<sup>61</sup> With regard to piercing the veil, a court of equity “will examine the whole transaction, looking through corporate forms to the substance of things, to protect the rights of innocent parties.”<sup>62</sup>

#### 4. *Equitable Relief is Extraordinary*

It is well-established that an equitable remedy is an extraordinary, as opposed to ordinary, form of relief.<sup>63</sup> As applied to veil piercing, the equitable remedy “exists as a last resort, where there is no other adequate and available remedy to repair the plaintiff’s injury.”<sup>64</sup> Courts are “extremely reluctant” to pierce the veil without “exceptional circumstances” to support such an extraordinary remedy.<sup>65</sup>

#### 5. *Equity Only Helps Those Who Have Done Everything to Help Themselves*

Finally, equity will not interfere on behalf of one who had an opportunity to prevent an injury by due diligence but failed to do so.<sup>66</sup> For example, in the case of fraud, if

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56. *Id.*

57. *Id.* § 378.

58. *Id.* §365.

59. *Id.* § 378.

60. *Id.*

61. *Spencer v. Letland*, 59 So. 593, 594 (Ala. 1912) (citing JAMES W. EATON, HANDBOOK OF EQUITY JURISPRUDENCE, 83 (1901)).

62. *Medlock v. Medlock*, 642 N.W.2d 113, 126 (Neb. 2002) (quotation marks omitted).

63. *Sorenson v. Pyeatt*, 146 P.3d 1172, 1176 (Wash. 2006) (citing HENRY L. MCCLINTOCK, HANDBOOK OF THE PRINCIPLES OF EQUITY § 22, at 47 (2d ed. 1948)).

64. *Hambleton Bros. Lumber Co. v. Balkin Enters.*, 397 F.3d 1217, 1228 (9th Cir. 2005) (quoting *Amfac Foods, Inc. v. Int’l Systems & Controls Corp.*, 654 P.2d 1092, 1098 (1982)).

65. *Id.*

66. *See, e.g., Marcantel*, *supra* note 36, at 200 n. 48.

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the person relying on such misrepresentation had an opportunity to protect himself prospectively by engaging in self-help, equity can do nothing.<sup>67</sup>

*B. The Veil-Piercing Prongs*

Veil piercing law began as a direct application of established equitable maxims and principles,<sup>68</sup> but has since sprouted various state-specific tests to assist courts in furtherance of their equitable objectives.<sup>69</sup> Although there is some variation, courts generally require plaintiffs to satisfy two prongs in order to pierce the corporate veil: a “formalities” prong and a “fairness” prong.<sup>70</sup> The formalities prong, which has also been referred to as the control,<sup>71</sup> alter ego,<sup>72</sup> or unity of interest prong,<sup>73</sup> requires a showing of such unity of interest and ownership that the separate personalities of the corporation, LLC, or other separate entity, and of the individual shareholder(s) no longer exist.<sup>74</sup> The fairness prong generally requires a showing of fraud, illegality, injustice, inequity, or some other wrongdoing by the entity.<sup>75</sup>

The formalities prong is typically assessed through the lens of a number of factors used to help the court determine whether a sufficient unity of interest exists such that

67. See Marcantel, *supra* note 36, at 200 (explaining that courts would exercise less equity jurisdiction in contract cases since parties to a contract theoretically can engage “in self-help prospectively”).

68. See *supra* Part II.A.

69. 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).

70. See, e.g., *Laya v. Erin Homes, Inc.*, 352 S.E.2d 93, 99 (W.V. 1986) (citing *Automotriz del Golfo de California S. A. de C. v. Resnick*, 306 P.2d 1, 3 (Cal. 1951)); *Tower Inv’r, LLC v. 111 E. Chestnut Consultants, Inc.*, 864 N.E.2d 927 (Ill. App. 2007); *D’Elia v. Rice Dev., Inc.*, 147 P.3d 515, 522 (Utah App. 2006) (“Courts have referred to the first prong of the alter ego test as the ‘formalities requirement,’ . . . Courts term the second prong the ‘fairness requirement’”); *Labadie Coal Co. v. Black*, 672 F.2d 92, 96–99 (D.C. Cir. 1982); *Harvey Gelb, Piercing the Corporate Veil - The Undercapitalization Factor*, 59 CHI.-KENT. L. REV. 1, 2 n.10 (1982). Cases may also have a third, wrongdoing prong. See, e.g., *Phillips v. Englewood Post No. 322 Veterans of Foreign Wars of the U.S., Inc.*, 139 P.3d 639, 644 (Colo. 2006). However, this is often made part of the second fairness prong. See, e.g., *Norman v. Murray First Thrift & Loan Co.*, 596 P.2d 1028, 1030 (Utah 1979). At least one court has, on occasion, allowed plaintiffs to pierce the veil upon satisfying only one of the two prongs. See Phillip R. Strauss, *Control and/or Misconduct: Clarifying the Test for Piercing the Corporate Veil in Alaska*, 9 ALA L.R. 65, 69 n.21 (1992) (listing Alaska cases that use a “disjunctive” test allowing plaintiffs to pierce the veil upon a showing of either of the prongs).

71. See, e.g., *Dombroski v. WellPoint, Inc.*, 895 N.E.2d 538, 543 (Ohio 2008).

72. See, e.g., *Perpetual Real Estate Servs., Inc. v. Michaelson Props., Inc.*, 974 F.2d 545, 548 (4th Cir. 1992); *Phillips*, 139 P.3d at 644.

73. See, e.g., *Automotriz del Golfo de California S. A. de C.*, 306 P.2d at 3.

74. See, e.g., *Laya*, 352 S.E.2d at 99; *Automotriz del Golfo de California S. A. de C.*, 306 P.2d at 3; *Dombroski*, 895 N.E.2d at 543.

75. See *Dombroski*, 895 N.E.2d at 543 (discussing fraud or illegality, and injustice); *Automotriz del Golfo de California S. A. de C.*, 306 P.2d at 3 (discussing inequality); *Laya*, 352 S.E.2d at 99 (discussing inequality); *Phillips*, 139 P.3d at 644 (discussing fraud, defeat a rightful claim, shareholder impropriety).

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the business entity has no separate mind or will of its own.<sup>76</sup> These factors, although generally not presented as an exclusive and definitive list,<sup>77</sup> can include as many as nineteen different considerations.<sup>78</sup> Such considerations include whether funds and assets are commingled, the adequacy and maintenance of corporate records, the nature and form of the entity's ownership and control, whether the business is undercapitalized, the use of the corporation as a "mere shell," the disregard of legal formalities, and the use of corporate funds or assets for noncorporate purposes.<sup>79</sup> Courts provide little direction as to how the factors "are to be weighted or which ones are necessary or sufficient by themselves to support a piercing result."<sup>80</sup> One commentator likened these factors to an "unweighted laundry list that results in inherent vagueness . . . , giv[ing] the cases an ad hoc, fluky aspect."<sup>81</sup>

Even if a complaining party is able to show that the defendant shareholder had complete control over the corporation and that the entity was the alter ego of the shareholder, courts will generally also identify what is blameworthy about the defendant's use of that control.<sup>82</sup> The fairness prong looks to the fundamental issue of fairness under the facts and asks whether an inequitable result will occur if the business entity is not pierced.<sup>83</sup> The essence of this prong is that an investor cannot be allowed to "hide from the normal consequences of *carefree* entrepreneuring by doing so through a corporate shell."<sup>84</sup> Courts generally require a showing of some wrongdoing, such as fraud, illegality, inequity, or injustice.<sup>85</sup> Fraud, in this context and when required by such state's veil piercing law, is used more generally to mean bad faith or unfairness, rather than deliberate dishonesty designed to induce

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

77. See, e.g., *Cent. Bus. Forms, Inc. v. N-Sure Sys., Inc.*, 540 So. 2d 1029 (La. App. 1989) ("Proof of some factors tending to support the alter ego theory may not result in individual liability if the theory is negated by the totality of the facts and circumstances, including the creditor's willingness to contract with the debtor corporation as an entity distinct from its stockholders."); see *infra* Part II.C.

78. See, e.g., *Laya*, 352 S.E.2d at 98 (noting 19 factors to be considered); *Phillips*, 139 P.3d at 644 (stating 8 factors to be considered); *Evans v. Multicon Constr. Corp.*, 574 N.E.2d 395, 398 (Mass. App. 1991) (noting 12 factors for consideration).

79. *In re Phillips v. Englewood Post No. 322 Veterans of Foreign Wars of the United States, Inc.*, 139 P.3d 639, 644 (Colo. 2006).

80. *Millon*, *supra* note 1, at 1327.

81. *Id.* at 1330. This unweighted laundry list requires "courts to balance many imponderables, all important but none dispositive and frequently lacking in a common metric to boot." *Id.* (quoting Judge Easterbrook in *Secor Serv. Sys., Inc. v. St. Joseph Bank & Trust Co.*, 855 F.2d 406, 414 (7th Cir. 1988)).

82. See *id.* at 1333.

83. *Labadie Coal Co. v. Black*, 672 F.2d 92, 96 (D.C. Cir. 1982).

84. *Laya v. Erin Homes, Inc.*, 352 S.E.2d 93, 102 (W.V. 1986) (quoting *Labadie Coal Co. v. Black*, 672 F.2d 92, 100 (D.C. Cir. 1982)).

85. *Nat'l Labor Relations Bd. v. Greater Kan. City Roofing*, 2 F.3d 1047, 1052 (10th Cir. 1993).

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reliance.<sup>86</sup> Requiring plaintiffs to satisfy all the elements of a civil fraud claim would negate the need for veil piercing relief in the first place.<sup>87</sup> Notwithstanding the messy nature<sup>88</sup> of the veil piercing prongs, commentators agree that courts generally arrive at the correct result.<sup>89</sup>

*C. Totality of the Circumstances*

Although significant emphasis has been placed on the formalities prong factors,<sup>90</sup> the test used by courts to determine whether a sufficient unity of interest exists (i.e. whether the formalities prong has been satisfied) is more accurately described as a totality of the circumstances test, not a factor test.<sup>91</sup> A true factor test “explicitly limits relevancy, thereby partially constraining future judicial discretion and making the law more predictable.”<sup>92</sup> In other words, factor tests limit a judge’s discretion to a consideration and balancing of a certain closed set of factors.<sup>93</sup> This allows for more

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86. Million, *supra* note 1, at 334. This is also referred to as “constructive fraud.” See Castleberry v. Barnscum, 721 S.W.2d 270, 272 (Tex. 1986), *superseded by statute*, TEX. BUS. CORP. ACT. ANN. art. 2.21 (West 2010) (expired), *as recognized in* SSP Partners v. Gladstrong Invs. (USA) Corp., 275 S.W.3d 444, 455 (Tex. 2008) (“Actual fraud usually involves dishonesty of purpose or intent to deceive, whereas constructive fraud is the breach of some legal or equitable duty which, irrespective of moral guilt, the law declares fraudulent because of its tendency to deceive others, to violate confidence, or to injure public interests.”).

87. See Million, *supra* note 1, at 1334.

88. See, e.g., Strauss, *supra* note 70, at 89.

89. See Thompson, *An Empirical Study*, *supra* note 19, at 1037 (“[M]any believe that beneath this layer of unhelpful language courts are getting it right.”); Macey and Mitts, *supra* note 23, at 103 (noting that in the context of veil piercing decisions, judges “generally reach the correct results”); Glenn G. Morris, *Piercing the Corporate Veil in Louisiana*, 52 LA. L. REV. 271, 272 (1991) (“[R]egardless of their varying explanations of the actual results that they see, most commentators also seem to share the faith that what actually does happen in these cases is, for the most part, what ought to happen.”).

90. See Macey & Mitts, *supra* note 23, at 106–07 (“A sure sign of the state of confusion in this area of law is the existence of incoherent and inconsistent multifactored tests.”).

91. See Aron Bookman, *Transcending Common Law Principles of Limited Liability of Parent Corporations for the Environment*, 18 VA. ENVTL. L.J. 555, 575–76 (1999). Although factors are used, the court will look to the totality of the circumstances to determine whether the two prongs have been met. See *id.* (discussing that although courts look to a variety of factors, “piercing the corporate veil becomes a totality of the circumstances test”). The use of factors by courts has led some commentators to describe the test as a factor test. See, e.g., Marcantel, *supra* note 36, at 196–97 (“[M]ost states have settled for a factors test, permitting trial courts to consider, ignore, and weigh various factors as the situation necessitates.”). However, as courts have noted, the factors, although influential, are only a starting point and courts have the ability to (and often do) consider additional facts and circumstances in making veil piercing decisions. See *infra* Part IV.

92. James G. Wilson, *Surveying the Forms of Doctrine on the Bright Line Balancing Test Continuum*, 27 ARIZ. ST. L.J. 773, 800 (1995).

93. *Id.* For a true factor test, see Mathews v. Eldridge, 424 U.S. 319, 334–35 (1976), where the Supreme Court lists the only three, distinct factors that can be considered when determining the amount of process “due” a particular claimant under the Due Process Clauses.

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predictability because parties are not concerned with considerations outside of such factors.

A totality of the circumstances test, on the other hand, assesses all known and relevant information and “is an examination of [an issue] in the light of all known and conceivable circumstances, excluding nothing and giving no one fact, action, or condition a controlling influence upon the assessment.”<sup>94</sup> In the context of veil piercing, a court must at least review the various factors enumerated in prior cases, but also has the liberty of considering all other “known and conceivable circumstances.”<sup>95</sup>

The Utah Supreme Court aptly explained this idea when deciding whether to adopt certain factors used by the state’s Court of Appeals.<sup>96</sup> In *Jones & Trevor Marketing, v. Lowry*, the plaintiff asserted certain tort and contract claims, together with a request to pierce the corporate veil.<sup>97</sup> In reviewing the veil piercing request, the Court adopted the eight factors enumerated by the Court of Appeals in *Colman v. Colman*.<sup>98</sup> However, in adopting the factors, the Court emphasized the non-exclusive nature of such factors in the veil-piercing analysis:

*Courts have considered a wide variety of factors in determining whether to pierce the corporate veil. This suggests that, while helpful, the Colman factors should be viewed as non-exclusive considerations and not dispositive elements. Indeed, even the Colman court noted that the factors, while significant, were “not conclusive[] in determining whether [the alter ego] test has been met.”*

*We adopt the Colman factors as useful considerations to aid courts in determining whether to pierce the corporate veil. We emphasize, however, that they are merely helpful tools and not required elements. Indeed, “factors adopted as significant in a particular decision to disregard the corporate entity should be treated as guidelines and not as a conclusive test.” Rather, “a careful review of the entire relationship between various corporate entities and their directors and officers” is necessary. Thus, each alter ego case should be determined based on its*

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94. *Totality of the Circumstances (Totality of the Circumstances Test)*, BOUVIER LAW DICTIONARY (2012).

95. *Id.*; see also *Barnco Int’l v. Arkla, Inc.*, 684 So. 2d 986, 992 (La. App. 1996) (“[P]roving some of these factors may not result in individual liability if the totality of the circumstances negate the application of the alter ego concept.”).

96. See generally *Jones & Trevor Mktg. v. Lowry*, 284 P.3d 630 (Utah 2012).

97. *Id.* at 633.

98. *Id.* (citing to *Colman v. Colman*, 743 P.2d 782 (1987)).

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*individual facts by evaluating the entire relationship between the corporation and its shareholders.*<sup>99</sup>

The *Lowry* court's explanation refers to a totality of the circumstances analysis in all but name. The court reserved the right to consider other facts and circumstances outside the eight formalities prong factors.<sup>100</sup> Such analysis is not reserved for the formalities prong factors alone; such flexibility also allows courts to consider the totality of the circumstances, including all inequities, policy considerations, and other facts and circumstances, in assessing the fairness prong. The totality of the circumstances test is thus used as a means of analyzing both veil piercing prongs.<sup>101</sup> The test allows the court to consider more facts, circumstances, and policy so that it has a better chance of *getting it right*. As one court noted:

*Examination of the numerous relevant factors in a "totality of the circumstances" test provides a more enlightening analysis than merely applying metaphors, like "simulacrum," "alter ego," "instrumentality," etc., to describe the unity of the shareholder(s) and the corporation justifying, where equitable, the piercing of the corporate veil in the case. This totality of the circumstances approach also leads to a more informed balancing or weighing of the primary policy behind limited liability of the shareholder(s), specifically, a capital investment incentive, against the primary policy justifying piercing of the corporate veil, specifically, the avoidance of clearly inequitable consequences of not piercing.*<sup>102</sup>

The totality of the circumstances test also allows the court the flexibility to utilize its equitable powers to "do justice" in a given situation.<sup>103</sup> In this sense, courts should be viewing the veil piercing prongs as two separate totality of the circumstances tests.<sup>104</sup> Before such tests were even developed, courts relied almost exclusively on established equitable principles to determine whether to pierce the veil.<sup>105</sup>

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99. *Id.* at 636 (citations omitted); *see also* *Laya v. Erin Homes, Inc.*, 352 S.E.2d 93, 98 (W.V. 1986) ("Some of the factors to be considered in deciding whether to pierce the corporate veil are . . .").

100. *Jones & Trevor Mktg.*, 284 P.3d at 636 (citing 1 WILLIAM MEADE FLETCHER ET. AL., FLETCHER CYCLOPEDIA OF CORPORATIONS §41.30 (2006)).

101. *See, e.g., Laya*, 352 S.E.2d at 99.

102. *Id.* *But see* Frank Coffin, *Judicial Balancing: The protean Scales of Justice*, 63 N.Y.U.L. REV. 16, 25 (1988) (criticizing totality of the circumstances tests as creating "overly particularistic ad hoc decisions" that "could not stand as precedent for any future case except a clone").

103. *LFC Mktg. Grp. Inc. v. Loomis*, 8 P.3d 841, 845-46 (Nev. 2000) (the "essence" of piercing the corporate veil is to 'do justice' whenever it appears that the protections provided by the corporate form are being abused.").

104. *See* David H. Barber, *Piercing the Corporate Veil*, 17 WILLAMETTE L. REV. 371, 376-77 (1981).

105. *See supra* Part II.A.

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*D. Equitable Principles Applied to Veil Piercing*

At its center, veil piercing law firmly echoes governing principles derived from age-old equity jurisprudence.<sup>106</sup> Indeed, it reeks of equity, from the wide judicial discretion and adherence to ancient equitable maxims to its focus on mitigating strict legal rules (like limited liability) to “do justice.”<sup>107</sup> Even though courts often get caught in the minutia of the veil piercing prongs and factors,<sup>108</sup> the doctrine has been long rooted, in a broad sense, to the confines of equity.<sup>109</sup>

In fact, before complicated veil piercing tests were used, courts relied solely on these established principles of equity to pierce the corporate veil.<sup>110</sup> The 1937 case of *Nettles v. Sottile* is such an example.<sup>111</sup> Depositors of the Peoples State Bank of South Carolina brought suit against the sole shareholder of a corporate holder of 900 shares of the bank’s stock when the bank closed its doors as an insolvent banking institution.<sup>112</sup> The plaintiff receiver for the depositors obtained a judgment against the corporation and attempted execution on such judgment.<sup>113</sup> Upon finding the corporation also insolvent, the receiver brought suit against the individual shareholder of the corporation.<sup>114</sup> The plaintiff asked the court to look beyond the “legal owner” of the 900 shares of the bank stock to find the “true owner” of the stock.<sup>115</sup>

The Court noted that the action was, in effect, an equitable execution and was supplementary or auxiliary to the original action.<sup>116</sup> A court sitting in equity could take steps to assist the creditor in the collection of his obligation if such assistance was “in the interest of justice and for the protection of the judgment creditor.”<sup>117</sup>

In looking to the established principles of equity, the Court first referenced the requirement that there be no adequate remedy at law and found that the plaintiff had exhausted all such legal remedies.<sup>118</sup> The Court then expounded on its inherent equitable flexibility to balance competing interests and rights of the parties and of society:

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106. See *supra* Part II.A.

107. See *supra* Part II.A.

108. See *supra* Part II.B.

109. See *supra* Parts II.A, II.C.

110. See Douglas C. Michael, *To Know a Veil*, 26 J. CORP. L. 41, 55–56 (2000).

111. See generally *Nettles v. Sottile*, 191 S.E. 796 (S.C. 1937).

112. *Id.* at 796.

113. *Id.*

114. *Id.*

115. *Id.* at 796–97.

116. *Id.* at 798.

117. *Nettles v. Sottile*, 191 S.E. 796, 798 (S.C. 1937).

118. See *Id.*

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*As has been well said, equity has contrived its remedies “so that they shall correspond both to the primary right of the injured party, and to the wrong by which that right has been violated,” and “has always preserved the elements of flexibility and expansiveness, so that new ones may be invented, or old ones modified, in order to meet the requirements of every case, and to satisfy the needs of a progressive social condition, in, which new primary rights and duties are constantly arising, and new kinds of wrongs are constantly committed.”*<sup>119</sup>

The receiver argued that the corporation had obtained the bank stock in violation of South Carolina law precluding corporate entities from owning shares of bank stock.<sup>120</sup> The Court agreed, reasoning that a corporation is a “mere legal fiction” and may, in the furtherance of justice and pursuant to equity, be disregarded if used for the purpose of evading a statute or violating public policy.<sup>121</sup> The Court looked past the form of the corporation to the substance and intent of the defendant, which was to perpetrate a fraud and violate South Carolina law in an effort to evade liability.<sup>122</sup> The Court ruled that where a corporation is used “for fraudulent or perverted purposes, courts may properly disregard it and look to the responsible human beings, the living members, who compose the corporation and are hidden behind the juristic screen.”<sup>123</sup> By disregarding the corporate form and holding the individual shareholder liable, the court regarded its action as doing what ought to be done insofar as the “wrong” done to the receiver was “righted.”<sup>124</sup>

Veil piercing requires the kind of balancing that courts of equity are deemed authorized to administer.<sup>125</sup> It requires weighing the costs and benefits of limited liability, analyzing and comparing the primary right of the injured party with the legal rights and expectations of the defendant and the interests of and implications on society.<sup>126</sup> This helps explain why courts have not simplified the law by creating a checklist of elements to determine when the veil can be pierced or eliminating the doctrine of limited liability altogether.<sup>127</sup> Veil piercing, like other equitable relief,

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119. *Id.* (quoting *Reconstruction Fin. Corp. v. Cent. Republic T. Co.*, 11 F. Supp. 976, 982 (N.D. Ill. 1935)).

120. *Id.* at 801.

121. *Id.*

122. *Id.*

123. *Nettles v. Sottile*, 191 S.E. 796, 801 (S.C. 1937).

124. *Id.* at 798.

125. See Michael J. Gaertner, *Reverse Piercing the Corporate Veil: Should Corporation Owners Have it Both Ways*, 30 WM. & MARY L. REV. 667, 687 (1988-1989).

126. See Brett Trembly, *Does Piercing the Corporate Veil Work? A Look at Possible Alternatives*, TREMBLY L. FIRM (Sept. 24, 2017), <http://tremblylaw.com/does-piercing-the-corporate-veil-work-a-look-at-possible-alternatives/>.

127. Limited liability has served an important role in increasing people’s participation in the equity market and consequently, the availability of capital to further business growth. See Daniel R. Kahan, *Shareholder*



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seeks to bypass certain legal rights of a party (the right of shareholder protection from corporate debts), voiding such rights in that instance.<sup>128</sup> This is contrasted from a dispute at law between two parties alleging competing legal rights.<sup>129</sup>

### III. CONTRACT-TORT DISTINCTION

Although a “major fault line” currently exists in veil piercing law between contract and tort creditors,<sup>130</sup> such distinction has not always existed.<sup>131</sup> Courts’ equitable exception to limited liability has existed at least since the early twentieth century.<sup>132</sup> However, the overwhelming countervailing concern during most of this time was the protection of contractual creditors.<sup>133</sup> Consequently, such concern would have been evident in courts’ veil-piercing analysis, focusing on facts and circumstances that justify piercing the veil for contract creditors. When a company engaged in fraud or misrepresentation, contract creditors were misled into believing the risk of default was lower than it actually was.<sup>134</sup> Because creditors in these situations were not able to demand adequate compensation for such risk, some of the costs of the corporation’s risk-taking were shifted to the contract creditors.<sup>135</sup> Thus, piercing the veil was a means of reallocating risk back to the corporation’s shareholders under such circumstances.<sup>136</sup>

It was not until our conception of the doctrine of limited liability was challenged by large-scale corporate wrongdoing<sup>137</sup> that we began to understand the policy

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*Liability for Corporate Torts: A Historical Perspective*, 97 GEO. L.J. 1085, 1092–93 (2009). Notwithstanding such benefits, Henry Hansmann and Reinier Kraakman argued in their controversial 1991 article for pro rata unlimited liability for corporate torts. See Henry Hansmann & Reinier Kraakman, *Toward Unlimited Shareholder Liability for Corporate Torts*, 100 YALE L.J. 1879 (1991).

128. See Manuel F. Cahan, Joshua M. Newville & Lee Popkin, *Veil Piercing/Alter Ego Determinations - How Fund Managers Can Protect Themselves*, PROSKAUER ON PRIV. EQUITY LITIG. (Oct. 11, 2017), <http://www.privateequitylitigation.com/2017/09/veil-piercingalter-ego-determinations-how-fund-managers-can-protect-themselves/>.

129. See Sergiy Timokhov, *Parties to the Litigation*, TORONTO LITIG. LAW. (Oct. 11, 2017), [http://www.torontolitigationlawyer.ca/court\\_parties.htm](http://www.torontolitigationlawyer.ca/court_parties.htm).

130. Christina L. Boyd & David A. Hoffman, *Disputing Limited Liability*, 104 NW. L. REV. 854, 860 (2010), quoted by Halabi, *supra* note 24, at 1029.

131. See Kahan, *supra* note 127, at 1102.

132. See *Id.* at 1091–1095.

133. See David W. Leebron, *Limited Liability, Tort Victims, and Creditors*, 91 COLUM. L. REV. 1565, 1566–67 (1991).

134. See Easterbrook & Fischel, *supra* note 4, at 107; Thompson, *An Empirical Study*, *supra* note 19, at 107–72.

135. See Easterbrook & Fischel, *supra* note 4, at 107.

136. See Thompson, *An Empirical Study*, *supra* note 19, at 1071.

137. Kahan, *supra* note 127, at 1086. Such corporate wrongdoing included grotesque accidents, mass torts, environmental abuses and accounting frauds. *Id.*; see Ronald M. Green, *Shareholders as Stakeholders: Changing Metaphors of Corporate Governance*, 50 WASH. & LEE L. REV. 1409, 1414–20 (1993).

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justifications for allowing greater leniency in veil piercing for involuntary tort creditors.<sup>138</sup> Commentators, followed by courts, slowly became cognizant of these policy justifications, which included the protection of involuntary creditors from the costs of excessive risk-taking by companies.<sup>139</sup> The policy justifications had everything to do with a company's incentive to shift costs away from itself and toward unwary third parties.<sup>140</sup> Under the umbrella of limited liability, business entities have an incentive to undertake projects with an inefficiently high level of risk.<sup>141</sup> These companies capture all the benefits from such activities while internalizing only some of the costs, shifting the remainder to involuntary creditors, such as victims of corporate torts.<sup>142</sup>

Just as veil piercing for contract creditors was meant to protect such creditors from the costs of fraud and misrepresentation (on account of their inability to demand adequate compensation *ex ante*), veil piercing for tort creditors has come about, in part, due to such creditors' inability to negotiate adequate compensation for corporate activities that have social costs in excess of their social benefits.<sup>143</sup> Without the equitable remedy of veil piercing, tort creditors are, in effect, subsidizing corporations for their excessive risk-taking.<sup>144</sup>

The issue can also be viewed in terms of consent to transact with the corporation: a contract creditor consents to transacting business with the corporation.<sup>145</sup> This voluntary contract creditor has the ability, through requiring personal guarantees, security agreements, or similar mechanisms, to protect themselves from loss.<sup>146</sup> The contract creditor is also able to diversify to some extent, while tort creditors have, quite possibly, suffered a loss of significant proportion in comparison with their pre-injury wealth.<sup>147</sup> Furthermore, the contract creditor can better gauge the risk of loss by performing a credit check and reviewing a company's corporate organizational

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138. STEPHEN I. GLOVER, BUSINESS SEPARATION TRANSACTIONS: SPIN-OFFS, SUBSIDIARY IPOs AND TRACKING STOCK § 14.15 (2006).

139. See Douglas & Shanks, *supra* note 29, at 210–11.

140. See Easterbrook & Fischel, *supra* note 4, at 107.

141. *Id.* The limited liability shield therefore allows shareholders to engage in potentially profitable activities without regard for externalities. Millon, *supra* note 1, at 1355.

142. See Easterbrook & Fischel, *supra* note 4, at 107; Millon, *supra* note 1, at 1324.

143. See Easterbrook & Fischel, *supra* note 4, at 112; Millon, *supra* note 1, at 1324. By choosing to do business with the corporation and having the ability to assess the likelihood of default before a business undertaking (e.g. perform a credit check), contract creditors are able compensated for the increased risk of default. See Easterbrook and Fischel, *supra* note 4, at 112.

144. Millon, *supra* note 1, at 1324.

145. See *Cascade Energy & Metals Corp. v. Banks*, 896 F.2d 1557, 1577 (10th Cir. 1990); Easterbrook & Fischel, *supra* note 4, at 112; Millon, *supra* note 1, at 1324.

146. See *Cascade Energy & Metals Corp.*, 896 F.2d at 1577.

147. See Leebron, *supra* note 133, at 1602.

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documents.<sup>148</sup> A court of equity should be less willing to grant relief to a creditor that had the prospective ability to protect itself through verifying information and obtaining security interests and guarantees.<sup>149</sup> But in involuntary cases, there is little or no element of consensual dealing, and the question is whether investors should be able to transfer a risk of loss or injury to members of the general public.<sup>150</sup>

A creditor's consent to transact with the corporation also plays a role in whether undercapitalization will be a significant factor in the veil piercing analysis.<sup>151</sup> In contract cases, the extent of the corporation's capitalization is largely ignored.<sup>152</sup> This is because initial capitalization is usually disclosed in publicly-filed documents, allowing parties to assess the initial financing of the company.<sup>153</sup> The contract

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

149. See Millon, *supra* note 1, at 1324; Kenneth B. Watt, Comment, *Piercing the Corporate Veil: A Need for Clarification of Oklahoma's Approach*, 28 TULSA L.J. 869, 872–73 (1993) (arguing that in contract claims, the plaintiff must prove a higher degree of culpability than tort cases because the contract plaintiff “has sufficient information to make an informed choice . . . before entering the transaction”).

150. Hamilton, *supra* 30, 984–985. Courts generally discuss this issue in the context of tort creditors as not consenting to dealings with the corporation. See, e.g., *United States v. Jon-T Chems., Inc.*, 768 F.2d 686 (5th Cir. 1985). Although it is true that certain torts would be considered consensual (for example, breach of fiduciary duty, see *Cascade Energy & Metals Corp. v. Banks*, 896 F.2d 1557, 1577 (10th Cir. 1990)), tort plaintiffs are otherwise rarely consensual creditors and cannot be taken to have assumed the risk of a corporation's insolvency. David Cummins, Comment, *Disregarding the Corporate Entity: Contract Claims*, 28 OHIO ST. L.J. 441, 459 (1967). Similarly, some contract creditors would be considered nonconsensual because of significantly unequal bargaining power and the inability to obtain the above-mentioned protections. See FLETCHER ET AL., *supra* note 13, § 41.85 (“when parties contracting with a corporation are not commercially experienced enough to anticipate the problems that might result from dealing with an inadequately capitalized corporation, the tort/contract distinction may not always be held against them”); Easterbrook & Fischel, *supra* note 4, at 110 (“Piercing the veil—especially in favor of trade creditors and tort creditors who cannot negotiate with the firm—reduces the extent to which third parties bear these costs.”). Additionally, employment discrimination judgment creditors, although based on a consensual, employment relationship, would more accurately be deemed involuntary creditors due to the imbalance in bargaining power between employer and employee and the fact that employees (particularly unsophisticated ones) cannot always be expected to understand the nature of his or her employment agreement. See Morris, *supra* note 89, at 294 (noting an exception to limited liability for consensual creditors exists where the creditor should not be expected to understand the nature of the agreement); see generally Sandra F. Sperino, *Let's Pretend Discrimination is a Tort*, 75 OHIO ST. L.J. 1107 (2014) (discussing how courts characterize employment discrimination statutes as torts). For the sake of simplicity, I assume all tort creditors are involuntary and all contract creditors are voluntary.

151. See Nicholas Allen, *Reverse Piercing of the Corporate Veil: A Straightforward Path to Justice*, 85 ST. JOHN'S L. REV. 1147, 1150 (2012) (explaining that a traditional piercing of the corporate veil requires a showing that “the owners exercised complete domination of the corporation in respect to the transaction attacked”).

152. See Marcantel, *supra* note 36, at 200.

153. See Mark Koba, *Initial Public Offering*, CNBC EXPLAINS (Apr. 20, 2012), <https://www.cnbc.com/id/47099278>. This argument only holds true for such entities that are required to indicate initial capital stock. *Id.* But see, Mark J. Loewenstein, *Fiduciary Duties and Unincorporated Business Entities: In Defense of the “Manifestly Unreasonable” Standard*, 41 TULSA L. REV. 411, 437 (2005–2006) (“The historical importance of fiduciary duties in partnerships does not mean, of course that fiduciary duties must be mandatory in contemporary unincorporated business entities.”). Some limited liability entities, such as limited liability companies (which do

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creditor that chooses to do business with an underfinanced company is knowingly assuming the risk that the company might not have assets to pay its financial obligations.<sup>154</sup> Tort creditors, on the other hand, do not choose whether or not to deal with the corporation.<sup>155</sup> An undercapitalized corporation is able to externalize the costs of risky corporate behavior by passing such costs on to the tort creditor without their consent.<sup>156</sup>

One commentator contrasted the economic considerations for involuntary tort creditors from those of voluntary contract creditors as follows:

*Involuntary, or tort, creditors are in a quite different situation. The pedestrian hit by a taxi cab or the victim of a toxic waste spill has not agreed to assume the risk of corporate insolvency and shareholders' limited liability. He has not received ex ante compensation for doing so or had the opportunity to bargain for contractual safeguards. The owners of a limited liability entity therefore are in a position to shift some of the social costs of their business activity onto members of the public who have not agreed to bear those costs. As long as an activity holds some promise of increasing shareholder wealth, limited liability encourages shareholders (or their representatives) to undertake it without regard for the magnitude of possible social costs, which may be far greater than the benefits to the owners themselves. In this respect, limited liability for tort claims creates a moral hazard problem and results in inefficient resource allocation decisions.*<sup>157</sup>

The strength of a tort creditor's policy justifications is partially offset by the benefits of retaining limited liability when a closely held corporation faces tort liability that its owners did not reasonably foresee.<sup>158</sup> This occurs in the context of damages that exceed the insurance coverage that a reasonably prudent business

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not have stock), are not required to do so. Mark J. Loewenstein, *Fiduciary Duties and Unincorporated Business Entities: In Defense of the "Manifestly Unreasonable" Standard*, 41 TULSA L. REV. 411, 437 (2005-2006) ("The historical importance of fiduciary duties in partnerships does not mean, of course that fiduciary duties must be mandatory in contemporary unincorporated business entities.").

154. See, e.g., *Laya v. Erin Homes, Inc.*, 352 S.E.2d 93, 100 (W.V. 1986) (noting that when, under the circumstances, a party has the opportunity to conduct an investigation into the credit of the corporation prior to entering into such contract, such party will be deemed to have assumed the risk of any gross undercapitalization).

155. Fenton, *supra* note 148, at 10 (describing a tort creditor as an "involuntary creditor").

156. See Franklin A. Gevurtz, *Piercing Piercing: An Attempt to Lift the Veil of Confusion Surrounding the Doctrine of Piercing the Corporate Veil*, 76 OR. L. REV. 853, 887 (1997).

157. Millon, *supra* note 1, at 1316-1317.

158. See Gevurtz, *supra* note 156, at 887.

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would obtain under the circumstances.<sup>159</sup> Shareholders cannot be deemed “at fault” in causing the tort creditor’s loss when insolvency results from events that a reasonable shareholder could not anticipate or the occurrence of which was reasonably deemed to be a remote possibility.<sup>160</sup> Limited liability would be acceptable in such situations as the benefits to society of retaining such limited liability would outweigh the cost to the tort victim for the unforeseeable claim.<sup>161</sup>

Our current veil piercing jurisprudence, therefore, represents an acknowledgment that altering the extent of limited liability so as to reduce its social costs is appropriate under certain circumstances, but wholesale elimination of the doctrine is not appropriate.<sup>162</sup> The very act of holding investors and other related parties liable helps to shift these social costs away from creditors.<sup>163</sup> Only within the last few decades have a substantial number of courts acknowledged the need to further alter the extent of shareholder liability to tort creditors.<sup>164</sup>

### IV. VEIL-PIERCING TESTS IN THE TORT CONTEXT

Courts that have referenced the contract-tort dichotomy have almost unanimously agreed that judicial veil piercing is more flexible for tort, as opposed to ordinary contract creditors.<sup>165</sup> Naturally, this begs the question as to *how* courts are providing

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159. See Millon, *supra* note 1, at 1308 (“[L]imited liability would protect shareholders from the kinds of losses that should be their primary concern, namely business insolvency due to causes that could not reasonably have been anticipated or prevented: contractual obligations that are unpayable because of developments that were unforeseen when they were undertaken and tort claims that exceed an insurance policy’s reasonably chosen cover limit.”).

160. See *Id.* at 1341–42.

161. See Robert J. Rhee, *Bonding Limited Liability*, 51 WM. & MARY L. REV. 1417, 1421 (2009-2010) (no reasonable society would allow limited liability to stand if “the firm’s activity would impose a net social cost”).

162. Millon, *supra* note 1, at 1357–58.

163. *Id.* at 1374.

164. See Hamilton, *supra* note 30, at 985 (different public policy issues of torts and contract claims “is only dimly perceived by many courts, which indiscriminately cite and purport to apply tort precedents in contract cases and vice versa”).

165. See, e.g., *Jablonsky v. Klemm*, 377 N.W.2d 560, 565 (N.D. 1985) (citing *United States v. Jon-T Chems., Inc.*, 768 F.2d 686, 692–93 (5th Cir. 1985)); *Edwards Co., Inc. v. Monogram Indus., Inc.*, 730 F.2d 977, 980–984 (5th Cir. 1984); *Cascade Energy & Metals Corp. v. Banks*, 896 F.2d 1557, 1577 (10th Cir. 1990); *Tower Investors, LLC v. 111 E. Chestnut Consultants, Inc.*, 864 N.E.2d 927, 941 (2007); *Theberge v. Darbro, Inc.*, 684 A.2d 1298, 1301 (Me. 1996); *Riggins v. Dixie Shoring Co.*, 592 So. 2d 1282, 1285 (La. 1992); *Southern Elec. Supply Co. v. Raleigh City Nat’l Bank*, 320 S.E.2d 515, 522 n.13 (W.V. 1984); *Northbound Grp., Inc. v. Norvax, Inc.*, 795 F.3d 647, 652 (7th Cir. 2015); *D’Elia v. Rice Dev., Inc.*, 147 P.3d 515, 522 (Utah Ct. App. 2006); *Perpetual Real Estate Servs., Inc. v. Michaelson Proprs., Inc.*, 974 F.2d 545, 550 (4th Cir. 1992); *Penn Nat’l Gaming, Inc. v. Ratliff*, 954 So. 2d 427, 431–32 (Miss. 2007); *OMV Assocs., L.P. v. Clearway Acquisition, Inc.*, 976 N.E.2d 185, 192 (Mass. App. Ct. 2012); *Secon Serv. Sys. v. St. Joseph Bank & Trust Co.*, 855 F.2d 406, 415–16 (7th Cir. 1988). *But see* *Rice v. Oriental Fireworks Co.*, 707 P.2d 1250, 1255 n.3 (Or. Ct. App. 1985); *Fina Oil & Chem. Co. v. Pester Mktg. Co.*, No. 95-1367-JTM, 1997 WL 225900 (D. Kan. Apr. 25, 1997) (denying defendants’ argument for a stricter veil piercing standard in contract cases, noting “there is no Kansas authority

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such flexibility. Under certain circumstances, courts have applied a different veil-piercing standard, such as a plaintiff's attempt to assert personal jurisdiction over a parent and subsidiary.<sup>166</sup> Under such circumstances, some courts impose an even higher standard than traditional veil piercing doctrine.<sup>167</sup> However, in regards to the contract-tort dichotomy, courts generally apply the *same* test to both types of creditors but reach different results.<sup>168</sup> The equitable, totality-of-the-circumstances test is applied more leniently in tort cases because of the different policy implications.<sup>169</sup>

*A. Same Test Applied More Leniently*

Many, if not most, courts that have referenced the tort-contract dichotomy have simply stated that a tort creditor can more easily pierce the veil, without creating a separate rule for tort creditors.<sup>170</sup> In many of these cases, we are left with little direction as to how the same rule is applied to tort creditors as opposed to contract creditors.<sup>171</sup> When viewed in light of established equitable principles and the totality of the circumstances, however, courts have alluded to the ways in which veil piercing is more flexible for tort creditors.<sup>172</sup> As one court noted, even though the legal precepts governing veil piercing in contract and tort claims are substantially the

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for this rule, and it has been rejected by the Kansas Court of Appeals”) (citing *Kvassay v. Murray*, 808 P.2d 896, 906 (Kan. App. 1991)); *Hammock v. Calo*, No. CA95-03-022, 1995 WL 631653 (Ohio Ct. App. Oct. 30, 1995) (refusing to “follow the example of other jurisdictions” in imposing “a less stringent standard for piercing the corporate veil in tort actions”); 1 FLETCHER ET AL., *supra* note 13, § 41.85.

166. See, e.g., John Swain & Edwin Aguilar, *Piercing the Veil to Assert Personal Jurisdiction over Corporate Affiliates: An Empirical Study of the Cannon Doctrine*, 84 B.U.L. REV. 445, 454–456 (2004).

167. See *id.*

168. Barber, *supra* note 104, at 381; Halabi, *supra* note 24, at 1014 (2015).

169. Jane C. Schlicht, Comment, *Piercing the Nonprofit Corporate Veil*, 66 MARQ. L. REV. 134, 141 (1982) (explaining that courts defend the totality-of-the-circumstances-test because of its “equitable nature”).

170. See, e.g., *Secon Serv. Sys. v. St. Joseph Bank & Trust Co.*, 855 F.2d 406, 414 (7th Cir. 1988) (noting that it is “a lot harder” to pierce the veil in contract disputes than for tort judgments and that “Indiana courts consider the same sorts of factors in both tort and contract cases”); Meredith Dearborn, Comment, *Enterprise Liability: Reviewing and Revitalizing Liability for Corporate Groups*, 97 CAL. L. REV. 195, 197 n. 16 (2009) (“[P]iercing the corporate veil does not doctrinally differentiate between tort and contract creditors.”); Halabi, *supra* note 24, at 1033 (“Many jurisdictions do not specify particular differences in their three-part tests but allow generally for heightened review in contract cases.”).

171. See *supra* note 170 and accompanying text.

172. Schlicht, *supra* note 169, at 141 (explain that courts defend totality of the circumstances tests because “its equitable nature demands that it be flexible”).

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same, the *attitude* toward veil piercing is more flexible in tort.<sup>173</sup> In fact, tort claims influence a court's leniency in assessing both veil piercing prongs.<sup>174</sup>

*1. Tort Claims Effect on Formalities Prong*

The formalities prong requires a showing of such unity of interest and ownership that the separate personalities of the corporation, LLC or other separate entity and of the individual owners no longer exist.<sup>175</sup> Courts make such determinations by a totality of the circumstances test, relying heavily on the existence of certain factors.<sup>176</sup> The judge is at liberty to weigh the importance of each factor, in relation to the facts and circumstances of the case, to determine whether the prong has been satisfied.<sup>177</sup> Upon requesting its veil piercing remedy in the context of a tort claim against the shareholder or related entity, courts have reweighted the various factors in favor of a finding of unity of interest and ownership.<sup>178</sup>

*a. Axtmann v. Chillemi*

The North Dakota Supreme Court provided such flexibility to the formalities prong factors in *Axtmann v. Chillemi*.<sup>179</sup> In this case, the plaintiffs sued a real estate agent and real estate broker for fraud and obtained a judgment against both.<sup>180</sup> The real estate brokerage dissolved immediately prior to the judgment.<sup>181</sup> The plaintiffs brought a subsequent action against the sole shareholder of the brokerage, an officer of the brokerage and a related, successor company, alleging fraudulent transfer to the related company and requesting that the corporate veil of the brokerage be pierced to reach all the new defendants.<sup>182</sup>

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173. See, e.g., *Penn Nat'l Gaming, Inc. v. Ratliff*, 954 So. 2d 427, 431–32 (Miss. 2007) (“While we have never articulated whether a different standard applies to tort claims, precedent from other jurisdictions suggests that the same basic standard should apply.”); *Miles v. Am. Tel. & Tel. Co.*, 703 F.2d 193, 195 (5th Cir. 1983); *Dearborn*, *supra* note 170, at 197 n. 16 (“[P]iercing the corporate veil does not doctrinally differentiate between tort and contract creditors.”); *Barber*, *supra* note 104, at 381 (one might expect different treatment for contract and tort but most courts mechanically apply the same test to both situations).

174. See *Oh*, *supra* note 24, at 87 (noting that it widely accepted that “veil-piercing is more compelling in [t]ort than [c]ontract” cases).

175. See *supra* Part II.B.

176. See *supra* Part II.B.

177. *Schlict*, *supra* note 169, at 142 (explaining that courts balance a number of factors to determine if the two-prong test has been satisfied).

178. *Id.* at 143 (arguing that courts will only pierce a corporate veil when, among other factors, “a unity of interest and ownership between the corporation and its shareholders” has terminated”).

179. See generally *Axtmann v. Chillemi*, 740 N.W.2d 838 (N.D. 2007).

180. *Id.* at 842.

181. *Id.*

182. *Id.* at 842–43.

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The Court applied a series of eight factors—North Dakota’s version of the formalities prong factors—that were used to assess each defendant’s relationship to the operation of the corporation to determine whether each individual defendant was the alter ego of the corporation.<sup>183</sup> These factors included insufficient capitalization, failure to observe corporate formalities, nonpayment of dividends, insolvency at the time of the transaction in question, siphoning of funds by the dominant shareholder, nonfunctioning of other officers and directors, absence of corporate records, and the existence of the corporation as a mere facade for individual dealings.<sup>184</sup> Additionally, the Court required an element of injustice, inequity, or fundamental unfairness in order to pierce the veil—North Dakota’s fairness prong.<sup>185</sup>

Before assessing the eight factors, the Court “recognized that the attitude toward piercing the corporate veil is more flexible in tort than in contract, because the creditor has an element of choice inherent in a voluntary contractual relationship whereas the ordinary tort case forces the debtor-creditor relationship upon the creditor by the occurrence of an unexpected tort.”<sup>186</sup> The Court first ruled that the trial court was not clearly erroneous in finding requisite evidence for three of the eight factors: that the broker was undercapitalized, insolvent, and a pass-through corporation with no substantial assets.<sup>187</sup>

In upholding the trial court’s overall finding to pierce the corporate veil of the broker, the Court specifically noted that its veil-piercing analysis was *informed by the underlying tort judgment*.<sup>188</sup> The Court identified lack of capitalization as a factor that was “particularly significant” to its formalities prong analysis in tort cases.<sup>189</sup> The fact that the corporate broker was marginally financed also played a role in the court’s fairness analysis as it involved an “added policy consideration” of whether shareholders may transfer such risk of loss to the public.<sup>190</sup>

*Axtmann* demonstrates how tort claims affect a court’s veil piercing analysis when the test for contract and tort claimants is the same.<sup>191</sup> North Dakota uses the same

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183. *Id.* at 843 (citing *Jablonsky v. Klemm*, 377 N.W.2d 560, 563 (N.D. 1985)) (quoting *Victoria Elevator Co. v. Meridian Grain Co., Inc.*, 283 N.W.2d 509, 512 (Minn. 1979)) (compiling a list of factors to determine whether the defendant was the alter ego of the corporation)).

184. *Id.* at 843 (citing *Jablonsky v. Klemm*, 377 N.W.2d 560, 563 (N.D. 1985))(quoting *Victoria Elevator Co. v. Meridian Grain Co., Inc.*, 283 N.W.2d 509, 512 (Minn. 1979)).

185. *Axtmann v. Chillemi*, 740 N.W.2d 838, 843 (N.D. 2007) (citing *Jablonsky v. Klemm*, 377 N.W.2d 560, 563–64 (N.D. 1985)).

186. *Id.*

187. *Id.* at 847.

188. *Id.*

189. *Id.*

190. *Id.*

191. *See Halabi*, *supra* note 24, at 1014 (finding that while tort and contract based claims are examined with the same test, “tort based veil-piercing claims succeeded at a higher rate than contract claims”).



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veil piercing test in contract cases as it does in tort cases.<sup>192</sup> However, in tort cases, the court was allowed more flexibility in re-weighting factors in favor of veil piercing.<sup>193</sup> A finding of undercapitalization also triggered an “added policy consideration,” in the context of a tort creditor, that influenced the fairness requirement.<sup>194</sup> Perhaps if the claim had been one of contract and the undercapitalization factor had not been weighted so heavily, the outcome would have been different.<sup>195</sup>

*b. Secon Service System, Inc. v. St. Joseph Bank & Trust Co.*

The effect of a tort claim on the formalities prong factors is also evident in contract cases<sup>196</sup> where the court makes specific reference to the contract-tort dichotomy.<sup>197</sup> *Secon Service System, Inc. v. St. Joseph Bank & Trust Co.* involved a contract dispute between Secon Service System, Inc. and a trucking company, in which Secon Service sought to pierce the veil of the trucking company to reach the assets of St. Joseph Bank & Trust Co.—a creditor of the trucking company.<sup>198</sup>

The United States Court of Appeals for the Seventh Circuit first acknowledged the confusion surrounding veil piercing jurisprudence but noted that one of the points that stood out was the fact that “it is a lot harder to hold investors liable in contract disputes than for tort judgments.”<sup>199</sup> The Court continued by noting that contract creditors voluntarily transact with the other party and are afforded an opportunity to negotiate terms reflecting enhanced risk of doing business with a limited liability

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192. See, e.g., *Monster Heavy Haulers, LLC v. Goliath Energy Servs., LLC*, 883 N.W.2d 917, 927 (N.D. 2016).

193. See *Southern Elec. Supply Co. v. Raleigh City Nat'l Bank*, 320 S.E.2d 515, 523 (W.V. 1984) (listing a number of factors to be considered when determining whether to pierce the corporate veil in a tort case).

194. *Axtmann*, 740 N.W. at 843–44 (citing *Jablonsky v. Klemm*, 377 N.W.2d 560, 565 (N.D. 1985)) (finding that [i]n tort cases, particular significance is placed on whether a corporation is undercapitalized, which involves an added public policy consideration”).

195. *Id.* at 844 (finding that five of the eight factors dictated against piercing).

196. The overwhelming majority of veil-piercing cases are contract-based. See Thompson, *An Empirical Study*, *supra* note 19, 1058 t.9; Oh, *supra* note 24, at 124 (“As in Thompson’s study, veil-piercing claims arise in Contract more than in any other substantive claim.”). However, many of these cases reference the contract-tort distinction in justifying a stricter standard for contract claimants. See, e.g., *Northbound Grp., Inc. v. Norvax, Inc.*, 795 F.3d 647, 652–53 (7th Cir. 2015) (quoting *Secon Serv. Sys., Inc. v. St. Joseph Bank & Trust Co.*, 855 F.2d 406, 413 (7th Cir. 1988); *Perpetual Real Estate Servs., Inc. v. Michaelson Props., Inc.*, 974 F.2d 545, 550 (4th Cir. 1992). Such cases are thus helpful in determining the way in which a court would apply veil piercing law more leniently to tort creditors.

197. *Secon Serv. Sys., Inc.*, 855 F.2d at 413.

198. *Id.* at 407–409.

199. *Id.* at 413 (citing PHILLIP I. BLUMBERG, *THE LAW OF CORPORATE GROUPS: TORT, CONTRACT, AND OTHER COMMON LAW PROBLEMS IN THE SUBSTANTIVE LAW OF PARENT AND SUBSIDIARY CORPORATIONS* §26.02 (1987)).

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entity.<sup>200</sup> Contrarily, tort creditors do not have a chance to obtain compensation after the fact for exposure to increased risk.<sup>201</sup>

In reviewing whether to pierce the veil, the Court balanced a long list of factors, all of which were important but non dispositive.<sup>202</sup> These factors helped the court determine whether the plaintiff was an “innocent third party” that needed protection from the corporation.<sup>203</sup> The Court also required a showing of fraud or injustice.<sup>204</sup> The plaintiff argued that he had conclusively established that the bank controlled the trucking company and was therefore entitled to pierce the veil.<sup>205</sup> The Court rejected the plaintiff’s argument, stating that even if the bank controlled the trucking company, such control “is only one of the elements required.”<sup>206</sup> In *contract* cases, the Court continued, Indiana courts always had required more than control to pierce the corporate veil for the benefit of *contract* creditors.<sup>207</sup> Unless the corporation engaged in some practice that might have misled its contract creditors into thinking they were dealing with another entity, there simply was no need to “protect” them.<sup>208</sup>

In noting that the contract creditor needed to satisfy more than just the control factor, the Court qualified the requirement by limiting it to *contract creditors*.<sup>209</sup> The constant comparison to tort creditors evidenced its willingness to provide significant leniency to tort creditors in satisfying the balancing of the factors.<sup>210</sup> “*Unlike tort claimants*, [the contract creditor plaintiff] chose to deal with the corporation.”<sup>211</sup> Furthermore, in an effort to make the point even more clear, the Court affirmed that contract creditors are required to provide “additional evidence” because of the “possibility” that they might have been unable to determine with whom they were dealing.<sup>212</sup> Additional evidence as compared to whom? There is no doubt the court

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200. *Id.* at 413–14.

201. *Id.* at 414.

202. *Id.*

203. *Secon Serv. Sys., Inc. v. St. Joseph Bank & Trust Co.*, 855 F.2d 406, 414 (7th Cir. 1988).

204. *Id.* (quoting *Extra Energy Coal Co. v. Diamond Energy and Res., Inc.*, 467 N.E.2d 439, 441–42 (Ind. Ct. App. 1984)).

205. *Id.* at 409.

206. *Id.* at 415.

207. *Id.*

208. *Id.* at 415–416.

209. *Secon Serv. Sys., Inc. v. St. Joseph Bank & Trust Co.*, 855 F.2d 406, 416 (7th Cir. 1988) (emphasis added); *see, e.g.*, *Extra Energy Coal Co. v. Diamond Energy and Res., Inc.*, 467 N.E.2d at 441 (separate corporate identity upheld in the absence of evidence that the contract creditor “was in any way deceived as to with whom it was dealing”); *Hinds v. McNair*, 129 N.E.2d 553, 559 (Ind. 1955) (purchase of real estate from corporation with distinct name does not give rise to investor liability); *Brunswick Corp. v. Waxman*, 599 F.2d 34 (2d Cir. 1979); *United States v. Jon-T Chems., Inc.*, 768 F.2d 686 (5th Cir. 1985).

210. *Secon Serv. Sys., Inc.*, 855 F.2d at 413.

211. *Id.* at 416 (emphasis added).

212. *Id.*

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was alluding to the fact that because tort creditors do not know with whom they are dealing (indeed, they often do not intend to “deal” with the corporation at all), and would therefore “need protection” from the corporation as innocent third parties, then they may simply be required to establish control, along with some kind of injustice, in order to pierce the veil.<sup>213</sup>

*c. True Motivation Behind Formalities Prong*

With so much focus on courts’ varied set of factors making up the formalities prong, it is no wonder such confusion exists with respect to veil piercing jurisprudence.<sup>214</sup> But what is the real motivation behind the law’s emphasis on these factors? Are courts truly worried about the separate personality of a corporation? After all, with most states allowing for the creation of single member LLCs<sup>215</sup> and single shareholder corporations,<sup>216</sup> there is no doubt that decisions of the business owner will also be the decisions of the business entity. And legislatures have therefore acknowledged that such management structures are permissible.<sup>217</sup>

Instead of the metaphysical separation between shareholder and corporation, courts are more concerned with the casual manner in which the relationship was managed, and how such management increases the likelihood that the corporation would impose inefficient harms on third parties.<sup>218</sup> The emphasis on the separate personality of the corporation is a rhetorical device that courts employ to justify discouraging socially-harmful management of the corporation.<sup>219</sup> In no other case is the protection of third parties from inefficient harms more pronounced than in the case of the tort creditor.<sup>220</sup> Consequently, courts *should* be more lenient in finding evidence of lack of separation in such cases.<sup>221</sup>

*2. Tort Claims Effect on Fairness Prong*

The fact that a creditor is pursuing a tort claim as the foundation of its veil-piercing remedy may have the most marked impact in the fairness prong.<sup>222</sup> This prong is

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213. *Id.*

214. *See* Gevurtz, *supra* note 156, at 854–58.

215. *See, e.g.*, REVISED UNIF. LTD. LIAB. CO. ACT §401(A) (NAT’L CONFERENCE OF COMM’RS ON UNIF. STATE LAWS 2006).

216. *Id.* § 401.

217. *Id.*

218. *See* Macey & Mitts, *supra* note 23, at 129–30.

219. *Id.* at 130.

220. *See supra* Part III.

221. *See generally* Northbound Grp., Inv. v. Norvax, Inc., 795 F.3d 647 (7th Cir. 2015) (holding that Illinois doctrine of direct participant liability did not authorize the imposition of liability for breach of contract).

222. *See, e.g.*, Marcantel, *supra* note 36, at 199 (arguing that the contract-tort distinction “makes sense, if nowhere else, when discussing the injustice element of the piercing doctrine”).

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central to the equitable nature of the remedy, focusing on facts and circumstances demonstrating some wrongdoing, fraud, illegality, injustice, or inequitable result that will occur if the defendant entity's veil is not pierced.<sup>223</sup> The facts and circumstances to prove the fairness prong are, however, often vastly different for tort and contract creditors.<sup>224</sup>

a. *Northbound Group, Inc. v. Norvax, Inc.*

*Northbound Group, Inc. v. Norvax, Inc.* is an example of the influence the tort-contract distinction has on the second, fairness prong.<sup>225</sup> In *Northbound Group, Inc.*, the plaintiff sued several defendants on contract-based claims arising from the sale of its business to the defendants.<sup>226</sup> The defendants included the parent company of the wholly-owned defendant with which the plaintiff had contracted in the sale of its business and the plaintiff sought to pierce the veil of the subsidiary defendant.<sup>227</sup>

The Seventh Circuit first assessed the instrumentalities (formalities) prong and determined that the parent company was the mere instrumentality of its subsidiary.<sup>228</sup> However, the plaintiff offered no evidence that respecting the separate corporate existence of the subsidiary would sanction a fraud or promote injustice, which was the second prong of the Illinois veil piercing law.<sup>229</sup> The court reasoned that this second prong "is especially difficult for a party to make in a breach of contract action where 'courts should apply even more stringent standards to determine when to pierce the corporate veil than they would in tort cases.'"<sup>230</sup> The court then described the policy justification for allowing such leniency for tort creditors: the inability to obtain compensation for increased risk, as opposed to a contract creditor's voluntary arrangement with the corporation and opportunity to negotiate terms reflecting enhanced risk, such as requiring guarantees.<sup>231</sup> The plaintiff's argument of fraud or injustice was found to be meritless and the court refused to pierce the veil.<sup>232</sup>

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223. See *supra* Part II.B.

224. See *Edwards Co., Inc. v. Monogram Indus.*, 730 F.2d 977, 980–84 (5th Cir. 1984) (discussing distinction between tort and contract cases for corporate veil purposes).

225. See *Northbound Grp., Inc. v. Norvax, Inc.*, 795 F.3d 647 (7th Cir. 2015).

226. *Id.* at 649.

227. *Id.* at 650–51.

228. *Id.* at 652.

229. *Id.*

230. *Id.* (quoting *Tower Inv'rs, LLC v. 111 East Chestnut Consultants*, 864 N.E.2d 927, 941 (Ill. App. Ct. 2007)).

231. *Northbound Grp., Inc. v. Norvax, Inc.*, 795 F.3d 647, 652–53 (quoting *Secon Serv. Sys., Inc. v. St. Joseph Bank & Tr. Co.*, 855 F.2d 406, 413–114 (7th Cir. 1988)).

232. *Id.* at 653.

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The *Northbound Group, Inc.* court specifically noted the leniency with which it adjudicates the second prong of the veil piercing test with respect to tort creditors.<sup>233</sup> By using a somewhat vague and undefined term like “injustice,”<sup>234</sup> the court could assess the totality of the circumstances when considering the strong tort creditor’s policy argument in determining that an injustice had occurred for such a creditor.<sup>235</sup>

*b. Perpetual Real Estate Services, Inc. v. Michaelson Properties, Inc.*

The Fourth Circuit’s analysis of the fairness prong is also illustrative.<sup>236</sup> In *Perpetual Real Estate Services, Inc. v. Michaelson Properties, Inc.*, the Court discussed Virginia’s veil piercing law by first reviewing the formalities prong factors.<sup>237</sup> Proof of these factors, alone, was not enough to pierce the veil, however.<sup>238</sup> Virginia law also required a showing that the corporation was used to disguise a wrong, obscure fraud or conceal crime—a fairness prong.<sup>239</sup>

The contract creditor plaintiff argued that the fairness prong could be satisfied by a showing of “fundamental unfairness” – likely as a means of “disguising a wrong.”<sup>240</sup> The Court ruled that the plaintiff had failed to prove that the defendant disguised a wrong, obscured fraud, or concealed a crime.<sup>241</sup> In so ruling, the Court held the contract creditor to a “more stringent standard” because it voluntarily and knowingly entered into the agreement and was expected to “suffer the consequences of the limited liability” that are part of the corporate organization, which “is not the situation in tort cases.”<sup>242</sup> The more stringent standard for contract creditors referenced by the court included a showing of misrepresentation.<sup>243</sup>

The court’s reasoning for the more stringent standard centered on the contracting parties’ ability to allocate the risk of the transaction themselves.<sup>244</sup> And the term “more stringent standard” was specifically used in comparison to tort cases, where

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233. See *id.* at 652–53.

234. See Macey & Mitts, *supra* note 23, at 106–08 (discussing vague terms such as promoting fraud, injustice or illegalities as justifications for piercing the veil).

235. *Northbound Grp., Inc.*, 795 F.3d at 652.

236. See *Perpetual Real Estate v. Michaelson Prop. Inc.*, 974 F.2d 545 (4th Cir. 1992).

237. *Id.* at 548–49.

238. *Id.* at 549.

239. *Id.* at 548 (quoting *Cheatle v. Rudd’s Swimming Pool Supply Co.*, 360 S.E.2d 828, 831 (Va. 1987)).

240. *Id.* at 549 (quoting *DeWitt Truck Brokers, Inc. v. W. Ray Flemming Fruit Co.*, 540 F.2d 681, 683 (4th Cir. 1976)).

241. *Id.*

242. *Perpetual Real Estate v. Michaelson Prop. Inc.*, 974 F.2d 545, 550 (4th Cir. 1992). (quoting 1 WILLIAM M. FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS. § 41.85 (1990)).

243. *Id.* (quoting *United States v. Jon-T Chems., Inc.*, 768 F.2d 686, 693 (5th Cir. 1985)).

244. *Id.* (“Absent some evidence of misrepresentation, courts should not rewrite contracts or disturb the allocation of risk the parties have themselves established.”).

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the plaintiff does not “voluntarily and knowingly” enter into an agreement with the corporate defendant.<sup>245</sup> Furthermore, in rejecting the plaintiff’s argument for a more lenient showing of “fundamental unfairness,” the court concluded by stating that “fairness is for the parties to the contract to evaluate, not the courts.”<sup>246</sup> One can infer how the court would therefore treat tort creditors by its focus on whether the parties transacted with each other voluntarily, were able to allocate risk among themselves, and could evaluate the fairness of the transaction.<sup>247</sup> In the situation where the parties are unable to evaluate fairness, the court left open the possibility for tort creditors to satisfy the fairness prong by the more lenient showing of fundamental unfairness.<sup>248</sup>

*B. A Legislative Response*

In an effort to circumvent broad veil piercing common law, the Texas legislature has gone further than any other state in statutorily protecting shareholders from veil-piercing.<sup>249</sup> And although it memorialized the higher standard in statute, the specific wording of the statute evidences a clear intention by the legislature to protect involuntary tort creditors.<sup>250</sup>

Texas veil piercing law has changed significantly over the past few decades.<sup>251</sup> Notwithstanding the changes, the Texas legislature and courts have continued differentiating claims based on tort and those based on contract.<sup>252</sup> Texas courts once exclusively followed the alter ego theory of veil piercing liability, under which shareholders could be held liable “when there exists such unity between the corporation and individual that the corporation ceases to be separate and when holding only the corporation liable would promote [fraud or] injustice.”<sup>253</sup> A totality of the circumstances test was used to review the shareholder’s dealings with the

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245. *Id.* (quoting 1 WILLIAM M. FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 41.85, at 712 (1990)).

246. *Id.* at 551.

247. *Id.*

248. *Perpetual Real Estate v. Michaelson Prop. Inc.*, 974 F.2d 545, 551 (4th Cir. 1992).

249. See Allen Sparkman, *Will Your Veil be Pierced? How Strong is Your Entity’s Liab. Shield?—Piercing the Veil, Alter Ego, Ego, and Other Bases for Holding an Owner Liable for Debts of an Entity*, 12 HASTINGS BUS. L.J. 349, 424 (2016).

250. *Id.* at 425.

251. See generally Elizabeth S. Miller, *Are There Limits on Limited Liability? Owner Liability Protection and Piercing the Veil of Texas Business Entities*, 43 TEX. J. BUS. L. 405 (2009).

252. *Id.*

253. *Mancorp, Inc. v. Culpepper*, 802 S.W.2d 226, 228 (Tex. 1990) (citing *Castleberry v. Barnscum*, 721 S.W.2d 270, 272 (Tex. 1986), *superseded by statute*, TEX. BUS. CORP. ACT. ANN. art. 2.21 (West 2010) (expired), *as recognized in SSP Partners v. Gladstrong Invs. (USA) Corp.*, 275 S.W.3d 444, 455 (Tex. 2008)).

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corporation in determining whether there was an alter ego relationship.<sup>254</sup> For evidence of such a relationship, Texas courts relied on several relevant, nonexclusive (formalities) factors.<sup>255</sup> Courts also looked at whether the claims sounded in tort or contract, allowing tort claimants more leniency in satisfying the fairness prong without a showing of fraud.<sup>256</sup>

Texas veil piercing law was broadened with the introduction of the “sham to perpetrate a fraud” theory in *Castleberry v. Branscum* in 1986.<sup>257</sup> In *Castleberry*, the Texas Supreme Court pierced the corporate veil on the basis that “the separate corporate existence would bring about an inequitable result.”<sup>258</sup> Both contract creditors and tort creditors needed only to prove constructive fraud instead of actual fraud.<sup>259</sup> The *Castleberry* court advanced a “flexible fact-specific approach focusing on equity,” relying on “common sense and justice.”<sup>260</sup>

The Texas legislature responded by amending the Texas Business Corporation Act<sup>261</sup> (which subsequently carried forward into the Business Organizations Code) such that a shareholder could not be held liable for corporate debts with respect to “any contractual obligation of the corporation or any matter relating to or arising from the obligation on the basis that the [shareholder] was the alter ego of the corporation or on the basis of actual or constructive fraud, a sham to perpetrate a fraud, or other similar theory.”<sup>262</sup> Instead, such contract creditors (and creditors with claims relating to or arising from contracts) were required to show that the shareholder “caused the corporation to be used for the purpose of perpetrating and did perpetrate an actual fraud.”<sup>263</sup> The legislature also eliminated a shareholder’s liability for failure to follow certain corporate formalities.<sup>264</sup>

Although Texas Bar committee commentary characterizes the “constructive fraud,” *Castleberry* standard of veil piercing as “questionable” for contractually-

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254. *Id.* at 228 (“An alter ego relationship may be shown from the total dealings of the corporation and the individual.”); Miller, *supra* note 251, at 1; *see generally* Gentry v. Credit Plan Corp. of Houston, 528 S.W.2d 571, 573 (Tex. 1975).

255. *See, e.g., Mancorp*, 802 S.W.2d at 228.

256. *See Gentry*, 528 S.W.2d 573.

257. *See generally* *Castleberry v. Branscum*, 721 S.W.2d 270 (Tex. 1986) *superseded by statute*, TEX. BUS. CORP. ACT, ANN. art. 2.21 (West 2010) (expired), *as recognized in* SSP Partners v. Gladstrong Invs. (USA) Corp., 275 S.W.3d 444, 455 (Tex. 2008)).

258. *Id.* at 272–73.

259. *Id.* at 273.

260. *Id.*

261. Texas Business Corporation Act of 1956, TEX. BUS. CORP. ACT ANN. arts. 1.01 *et seq.*, *repealed by* Texas Business Organizations Code of 2003, TEX. BUS. ORGS. CODE ANN. § 1 *et seq.*

262. TEX. BUS. ORGS. CODE ANN. § 21.223(a)(2) (West 2017); *see also* Miller, *supra* note 251, at 3.

263. *Id.* § 21.223(b).

264. *Id.* § 21.223(a)(3).

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based tort claims,<sup>265</sup> claims based on tort that are unconnected to contract were not included.<sup>266</sup> The Texas legislature clearly went out of its way to limit the strict fraud requirement to contract creditors and creditors with claims “relating to or arising from” contracts.<sup>267</sup> It is therefore likely that the broad *Castleberry* standard still applies to tort creditors.<sup>268</sup>

*C. Should Courts Apply a Separate Test for Tort Creditors?*

In an effort to ensure that tort victims are protected from the adverse consequences of limited liability, some commentators have proposed a completely separate veil-piercing test – one that focuses on a controlling shareholder or manager’s duty to adequately capitalize the corporation.<sup>269</sup> According to this theory, the basis of liability would be determined according to established principles of tort policy.<sup>270</sup> Tort policy would thus focus on the party better able to bear the loss, deter the formation of “shell” corporations, and ask whether the shareholder is better suited to determine the extent of risk and insure against it.<sup>271</sup>

The tort policy analysis would also resolve the issue of the extent of a defendant’s damages. Because the measure of damages should follow the breach of duty, the defendant’s liability would be capped at the lesser of the amount of the plaintiff’s injury or the level of capital deemed adequate or reasonable.<sup>272</sup> Business owners are therefore protected from extra-ordinary liability from corporate torts.<sup>273</sup>

Although the tort-duty solution does simplify the veil-piercing analysis for tort victims considerably, and admittedly has many other beneficial effects, such a drastic change in one hundred years of veil piercing jurisprudence could only be justified if such jurisprudence was not adequately protecting these victims from the adverse consequences of limited liability.<sup>274</sup> Indeed, these same commentators discuss the negative consequences of limited liability on tort victims, claiming that we have all “then moved on as though there is nothing to do about this unfortunate wrinkle in the

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265. See Miller, *supra* note 251, at 3–4 (citing TEX. BUS. CORP. ACT ART. 2.21, Comment of Bar Committee–1996).

266. TEX. BUS. ORGS. CODE ANN. § 21.223 (West 2017).

267. *Id.* § 21.223(a)(2).

268. See, e.g., TEX. BUS. ORGS. CODE ANN. § 21.223 (West 2017). The Author has found no tort cases, unrelated to contract, that confirm this. However, the purposeful wording of the statute makes this fairly certain. See *id.*

269. See Michael, *supra* note 110, at 50.

270. See *id.*

271. *Id.*

272. *Id.*

273. See generally *id.*

274. See generally *id.*



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economic perfection of the law” as if the law had yet to provide a viable solution.<sup>275</sup> Such arguments fly in the face of the clearly established trend by courts over the last few decades to acknowledge the policy justifications for tort-creditor leniency and to provide such leniency in assessing both the formalities and fairness prongs of the existing veil-piercing law.<sup>276</sup>

## V. EQUITABLE PRINCIPLES AND POLICY CONSIDERATIONS GOVERN

Notwithstanding the wide spectrum of specific veil-piercing “tests” across the country, commentators agree, interestingly enough, that judges generally reach the correct results in the cases they decide.<sup>277</sup> But how can such different veil piercing tests come to the same correct conclusions? Surely if one jurisdiction emphasized certain formalities factors, while a different jurisdiction focused on other factors, the results would differ. Yet courts are somehow arriving at the “correct” decisions.<sup>278</sup>

Courts’ accuracy with respect to veil piercing decisions is no more apparent than in the context of tort claims where courts seem to find their way to the most equitable, fair decision, even though they often appear unconcerned by the vagueness of the doctrines they are formulating.<sup>279</sup> The unifying piece in each tort case is not any one of the formalities factors, but the policy concerns, which, more often than not, find themselves sprinkled in the court’s reasoning.<sup>280</sup> As commentators have noted, the court’s balancing of the underlying policies, not abstract factors determining corporate separateness, tend to be the best predictor of results.<sup>281</sup>

Indeed, in the tort context, judicial decisions tend to corroborate this idea that equitable policy governs the courts’ end result.<sup>282</sup> In *Axtmann*, the North Dakota Supreme Court was concerned about the tort creditor’s lack of choice in voluntarily interacting with the corporation, as well as the risk of loss being transferred to the public.<sup>283</sup> For the *Secon Service System, Inc.* court, the focus was also on the voluntary nature of the plaintiff’s association with the corporation and the plaintiff’s ability to negotiate terms reflecting enhanced risks.<sup>284</sup> The Seventh Circuit in *Northbound Group, Inc.* was concerned about the plaintiff’s inability to obtain compensation for increased risk and the opportunity to negotiate terms reflecting

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275. Michael, *supra* note 110, at 49 (quoting David W. Leebron, *Limited Liability, Tort Victims, and Creditors*, 91 COLUM. L. REV. 1565, 1601 (1991)).

276. *See generally id.*

277. *See supra* Part III.

278. *See generally* Macey & Mitts, *supra* note 23.

279. *Id.* at 104.

280. *See generally* Morris, *supra* note 89.

281. *See, e.g., id.* at 275.

282. *See generally supra* Part IV.A.

283. *See supra* Part IV.A.1.a.

284. *See supra* Part IV.A.1.b.

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such increased risk.<sup>285</sup> Finally, the Fourth Circuit in *Perpetual Real Estate Services, Inc.* similarly made its decision based upon the voluntary nature of the plaintiff's interaction with the corporation.<sup>286</sup>

The impact of these policy considerations cannot be underestimated. On paper, the judge may focus most of her time explaining whether the formalities factors have been satisfied, resulting in somewhat incoherent justifications for piercing the veil.<sup>287</sup> The truth, however, is that the judge's main policy considerations (which might not necessarily be explicit in the opinion) direct the judge in deciding whether the given factors have been satisfied in a certain case, or as one commentator described, are a metaphorical means of stating the result itself.<sup>288</sup> This makes sense, especially considering the equitable nature of the remedy and the fact that the decisions of equity judges typically have a "reasoned regularity."<sup>289</sup>

The tort creditor may have the strongest claim to the remedy, which is centered on equity and fairness. Tort creditors are supported by powerful arguments of non-consent, lack of information, lack of choice, unequal bargaining power and the involuntary transfer of costs resulting from risky corporate behavior.<sup>290</sup> These arguments make up the primary policy justification for piercing the veil in the tort context: tort victims should not be required to bear the costs of risky corporate behavior when they neither chose to deal with the corporation nor had the opportunity to protect themselves from the risk of corporate insolvency.<sup>291</sup>

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285. See *supra* Part IV.A.2.a.

286. See *supra* Part IV.A.2.b.

287. Macey & Mitts, *supra* note 23, at 103.

288. Morris, *supra* note 89, at 288.

289. Kennedy, *supra* note 42, at 614 (quoting KARL LLEWELLYN, *THE COMMON-LAW TRADITION: DECIDING APPEALS* 216 (1960)).

290. See *generally id.*

291. This policy justification applies to involuntary tort creditors and is the strongest justification out of the involuntary creditors. See *generally id.* However, other involuntary creditors, such as trade creditors and employees, have policy justifications more persuasive than the otherwise contract creditor. *Id.* These other involuntary creditors should not be required to bear the costs of risky corporate behavior when they neither had the ability to obtain requisite information about the corporation's solvency, nor had the ability to protect themselves from such risk by obtaining guarantees, security interests or adequate compensation before dealing with the corporation. *Id.*