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PIERCING THE CORPORATE VEIL: AN EMPIRICAL STUDY

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I
INTRODUCTION

Piercing the corporate veil is the most litigated issue in corporate law[1] and yet it remains among the least understood. As a general principle, corporations are recognized as legal entities separate from their shareholders, officers, and directors. Corporate obligations remain the liability of the entity and not of the shareholders, directors, or officers who own and/or act for the entity. "Piercing the corporate veil" refers to the judicially imposed exception to this principle by which courts disregard the separateness of the corporation and hold a shareholder responsible for the corporation's action as if it were the shareholder's own. The boundaries of this exception are usually stated in broad terms that offer little gnidance to judges or litigants in subsequent cases. In 1926, Benjamin Cardozo described this corner of the law as "enveloped in the mists of metaphor,"[2] and courts and commentators have been even less kind in

† Professor of Law, Washington University. Research support for this project was provided by a Treiman Fellowship of the Washington University School of Law. Arbi Ben Abdallah provided invaluable assistance in the statistical aspects of this project, and Deborah Rush provided research assistance. The paper benefited from the comments of Charles Adams, Ian Ayers, Doug Branson, James Cox, John Drobak, Theodore Eisenberg, Ed Greenberg, Frank Kennedy, Stephen Presser, Larry Ribstein, Roberta Romano, Tom Sullivan, and William Wang. The paper was presented at the first meeting of the American Law and Economics Association in May, 1991. I am responsible for any remaining deficiencies.

1 This project started with about 2000 cases found in Westlaw, using the search terms, "piercing the corporate veil" and "disregard! the corporate entity" and four Westlaw key numbers. A similar search of Lexis in July, 1990 also turned up about 2000 cases. By comparison, "corporate takeover" and "hostile takeover" (among the hottest corporate law topics in recent years) appear in fewer than 300 cases. A search for "fiduciary duty" and "corporate" or "director" turned up more than 4000 cases, but that topic includes a multitude of different issues.

2 Berkey v. Third Ave. Ry., 244 N.Y. 84, 155 N.E. 58 (1926) (opinion by Cardozo, J.), *reh'g denied*, 244 N.Y. 602, 155 N.E. 914 (1927). Justice Cardozo wrote:

> The whole problem of the relation between parent and subsidiary corporations is one that is still enveloped in the mists of metaphor. Metaphors in law are to be narrowly watched, for starting as devices to liberate thought, they end often by enslaving it. We say at times that the corporate entity will be ignored when the parent corporation operates a business through a subsidiary which is characterized as an 'alias' or a 'dummy'. All this is well enough if the picturesqueness of the epithets

subsequent years. Legal writers have described judicial decisions to pierce the veil as "irreconcilable and not entirely comprehensible,"[3] "defy[ing] any attempt at rational explanation,"[4] and occurring "freakishly."[5]

Much of the criticism, like Cardozo's comment, is directed more at the form and language of the decisions than at the results. A common refrain in the literature is an attack on the use of conclusory terms, such as "alter ego" and "instrumentality,"[6] that provide no insight into the nature of the factors considered. Commentators lament that the same facts appear in cases providing relief and cases denying relief[7] in an unpatterned mingling of relevant with neutral facts that has stymied constructive analysis.[8] The law is presented as offering completely antithetical doctrines[9] which courts are at liberty to utilize or ignore, depending upon the results desired.[10]

Despite this barrage of negative reviews, many believe that beneath this layer of unhelpful language courts are getting it right. An early scholar in this area, Elvin Latty, observed that, "in spite of conflicting and misleading dicta the judicial hunch usually carries through to a correct decision."[11] Adolf Berle wrote, "[t]he various reasons, fictions, argnments and important considerations are many, diverse, and frequently inconsistent; but the scheme of these various

> does not lead us to forget that the essential term to be defined is the act of operation. Dominion may be so complete, interference so obtrusive, that by general rules of agency the parent will be a principal and the subsidiary an agent. Where control is less than this, we are remitted to the tests of honesty and justice.

Id. at 94-95, 155 N.E. at 61.

3 PHILLIP I. BLUMBERG, THE LAW OF CORPORATE GROUPS: PROCEDURAL PROBLEMS IN THE LAW OF PARENT AND SUBSIDIARY CORPORATIONS 8 (1983).

4 Jonathan M. Landers, *A Unified Approach to Parent, Subsidiary & Affiliate Questions in Bankruptcy*, 42 U. CHI. L. REV. 589, 620 (1975).

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

6 Robert W. Hamilton, *The Corporate Entity*, 49 TEX. L. REV. 979, 979 (1971); *see* Elvin R. Latty, *The Corporate Entity as a Solvent of Legal Problems*, 34 MICH. L. REV. 597, 621-30 (1936); Note, *Judicial Supervision of the One-Man Corporation*, 45 HARV. L. REV. 1084, 1089 (1932).

7 *See* Comment, *Disregarding the Corporate Entity: Contract Claims*, 28 OHIO ST. L.J. 441, 450 (1967) (authored by David C. Cummings) ("[T]he factors of an instrumentality are more or less present in all cases where relief against a shareholder . . . is sought."); *see also* FREDERICK J. POWELL, PARENT AND SUBSIDIARY CORPORATIONS 9 (1931); Easterbrook & Fischel, *supra* note 5, at 109; William P. Hackney & Tracey G. Benson, *Shareholder Liability for Inadequate Capital*, 43 U. PITT. L. REV. 837, 843 (1982).

8 John F. Dobbyn, *A Practical Approach to Consistency in Veil-Piercing Cases*, 19 U. KAN. L. REV. 185, 188 (1971).

9 E.R. Latty, *A Conceptualistic Tangle and The One-Or-Two-Man Corporation*, 34 N.C.L. REV. 471, 472 (1956).

10 Note, *supra* note 6, at 1086.

11 Latty, *supra* note 6, at 630.

exceptions is none the less consistent and logical enough."[12] More recent scholarship has echoed these conclusions,[13] with some notable dissent arguing that current law is inadequate to deal with the concerns of tort victims[14] or the problems of corporate groups.[15]

Much of the legal scholarship in this area reflects scholars' efforts to reveal the decisional structure beneath the verbal shabbiness of the law's facade. This search has produced checklists of varying lengths[16] as well as more general theories of factors that should produce different results. For example, commentators have suggested that contract cases should be treated differently from tort cases,[17] or predicted that corporations with individuals as shareholders will be treated differently in a piercing context than corporations with other corporations as their shareholders.[18]

This empirical study evaluates these claims about piercing the veil cases by analyzing the nature of the corporations, the plaintiffs, the courts, and the reasons given by the courts for piercing or not piercing the corporate veil. The results suggest that the factors affecting the judicial outcome are not necessarily as suggested by previous commentary. For example, courts pierce less often in tort than in contract contexts, and a piercing decision is not less but more likely when the shareholder behind the veil is an individual rather than another corporation. Other results confirm prior predictions. For example, the likelihood of piercing increases as the number of shareholders decreases. Factors frequently cited by commentators, such as misrepresentation and undercapitalization, do make a difference, but this difference is more pronounced in contract settings than in tort or statutory settings.

The results of analyzing the entire data set demonstrate that the

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12 Adolf A. Berle, *The Theory of Enterprise Entity*, 47 COLUM. L. REV. 343, 345 (1947).

13 *See, e.g.*, Easterbrook & Fischel, *supra* note 5 (economic analysis—in particular the theory of the firm and the economics of insurance—explains the legal treatment of limited liability).

14 Note, *Should Shareholders Be Personally Liable for the Torts of Their Corporations?*, 76 YALE L.J. 1190 (1967) (authored by Arden Doss, Jr.) (limited liability thwarts the objective of modern tort law).

15 Phillip I. Blumberg, *The Corporate Entity in an Era of Multinational Corporations*, 15 DEL. J. CORP. L. 283, 328 (1990) ("the much criticized, irreconcilable, and unpredictable nature of such decisions should leave no doubt as to the fundamental inadequacy of traditional entity law to deal with the problems presented by the new corporate world").

16 *See, e.g.*, Cathy S. Krendl & James R. Krendl, *Piercing the Corporate Veil: Focusing the Inquiry*, 55 DEN. L.J. 1, 52-55 (1978) (a 31 point checklist); F. POWELL, *supra* note 7, at 9 (listing 11 factors for application of instrumentality rule).

17 *See, e.g.*, Easterbrook & Fischel, *supra* note 5, at 112; Hamilton, *supra* note 6, at 984.

18 Easterbrook & Fischel, *supra* note 5, at 111; Landers, *supra* note 4, at 619 (historical background indicates that limited liability was never intended to protect a parent corporation against liability for the debts of its subsidiary).

question of piercing the veil is contextual. Most significantly, piercing occurs only in close corporations or within corporate groups; it does not occur in public corporations. When piercing does occur, the courts' reasoning varies with the context, and decisions reflect the differing impact of various statutory policies affecting limited liability. The traditional reasons for piercing work best in bargain or contractual settings and less well in torts or statutory cases. Part II of this Article provides an overview of the law of piercing the corporate veil. Part III describes the methodology used in this project. Part IV describes the empirical results of the project, particularly as they affect various theories put forward in this area. The final part offers some conclusions as to piercing-the-veil law that can be drawn from the empirical results.

II
THE LAW OF PIERCING THE CORPORATE VEIL

A fundamental principle of corporate law is that shareholders in a corporation are not liable for the obligations of the enterprise beyond the capital that they contribute in exchange for their shares.[19] A corollary of this principle is that the corporation is an entity separate from its shareholders, directors, or officers.[20] Such limited liability was not always the rule in American law,[21] but it has been accepted in most American jurisdictions since the mid-nineteenth century.[22]

Limited liability permits parties to allocate the risk of an enterprise to a more efficient risk-bearer in particular circumstances. The possibility that the failure of a business would allow its creditors to reach all of an investor's nonbusiness assets might deter a risk-averse investor from investing, even though that possibility is small and the investment has a positive net present value. Limited liability encourages these investments.[23] Creditors of a limited liability enterprise bear more risk than do creditors of an identically funded enterprise where the creditors can pursue the nonenterprise assets of the investors. Creditors who choose to deal with a limited liability enterprise accept this risk and can raise their prices to reflect this

19 *See* MODEL BUSINESS CORP. ACT § 6.22(b) (1985).

20 The separate entity principle has many other implications not discussed here, such as the entity's ability to transfer property, to sue, and to be sued.

21 Phillip I. Blumberg, *Limited Liability and Corporate Groups*, 11 J. CORP. L. 573, 587-91 (1986) (describing early American law providing for shareholder liability).

22 *Id.* at 591-95 (limited liability was the rule by the middle of the nineteenth century with several exceptions that continued into the twentieth century).

23 Easterbrook & Fischel, *supra* note 5, at 97 (limited liability increases funding availability for projects that have positive net values, but carry too much risk in terms of potential to wipe out all of the investor's capital).

difference in risk or can seek security.[24] This shift in potential liability from shareholders to creditors produces gains for society if the creditors are more efficient in evaluating or bearing particular risks.[25] However, even if creditors are sometimes better risk-bearers, limited liability also shifts risks in other situations to claimants who had no choice in dealing with the enterprise (for example, tort victims or small uninformed creditors). To this extent, limited liability shifts some costs of doing business away from the corporation to other parts of society.[26]

Limited liability encourages development of public markets for stocks and thus helps make possible the liquidity and diversification benefits that investors receive from those markets.[27] Without limited liability, the risk each investor would face in investing in an enterprise would turn in part on the wealth of other investors.[28] Such a system would have search costs and other costs which would likely lead investors to make a few larger investments where risk-assessment information was accessible, and perhaps entail a reduced level of economic activity across the entire economy.[29]

The separateness of the corporate entity, most often used to protect those behind the veil from additional liability, also serves to

[24] Roger E. Meiners, James S. Mofsky, & Robert D. Tollison, *Piercing the Veil of Limited Liability*, 4 DEL. J. CORP. L. 351, 361 (1979) ("when an individual contracts to limit his liability or has it limited by law, market conditions force him to pay a price for limited liability").

[25] Richard A. Posner, *The Rights of Creditors of Affiliated Corporations*, 43 U. CHI. L. REV. 499, 501-02 (1976) (creditors might be superior risk bearers because they are less risk averse or have superior information). *But see* Easterbrook & Fischel, *supra* note 5, at 91 (presumption that creditors are more risk averse is implausible; superior information can explain some, but not all, of limited liability). One example of a creditor who may be a more efficient risk evaluator is a seller of a business who extends credit to finance the sale. A seller taking back a note for a purchase price might be better able to evaluate whether the business can produce sufficient income to pay off the note than the purchaser would.

[26] Blumberg, *supra* note 21, at 616-19 (limited liability fundamentally unfair to tort victims and other involuntary creditors and has undesirable consequences for labor claimants with severe informational disabilities and lack of ability to diversify and to absorb loss).

[27] Henry G. Manne, *Our Two Corporation Systems: Law and Economics*, 53 VA. L. REV. 259, 262 (1967) (publicly held corporations with many small shareholders could not exist without limited liability).

[28] Paul Halpern, Michael Trebilcock & Stuart Turnbull, *An Economic Analysis of Limited Liability in Corporation Law*, 30 U. TORONTO L.J. 117, 130-31 (1980); Susan E. Woodward, *Limited Liability in the Theory of the Firm*, 141 J. INSTITUTIONAL & THEORETICAL ECON. (ZEITSCHRIFT FÜR DIE GESAMTE STAATSWISSENSCHAFT) 601, 604-05 (1985). Proportional liability has been suggested as a response to these market concerns. *See* HENRY HANSMANN & REINIER KRAAKMAN, THE UNEASY CASE FOR LIMITING SHAREHOLDER LIABILITY FOR CORPORATE TORTS (1990).

[29] *Cf.* STEPHEN PRESSER, PIERCING THE CORPORATE VEIL 1-12 (1991) (arguing for a "democratic" justification for limited liability designed to encourage individual investment by those of moderate means as opposed to firms owned only by the wealthy).

insure the shareholder's entitlement to certain benefits that would not be available if the line between the corporation and its shareholders were disregarded. For example, shareholder-employees of a corporation may qualify for social security[30] or unemployment benefits[31] that would be reduced or unavailable if the corporation were disregarded. A separate entity may also be used to divide those parts of an enterprise which are subject to specific government regulation, such as insurance, banking, securities, or communications, from other parts of the enterprise that do not fall within the regulated area. The unregulated part of the business is free of the costs of regulation that it might not avoid were the enterprise considered as a whole.[32]

These purposes support the general rule that the separateness of a corporation from its shareholders will normally be respected. Yet this principle is not absolute, and courts regularly disregard the entity when its separateness is used for illegitimate purposes. A federal court at the turn of the century summarized the reasons to overcome separateness as "when the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime."[33] Professor Ballantine was even more general: "it comes down to a question of good faith and honesty in the use of corporate privilege for legitimate ends."[34]

Resolution of a piercing question is almost always left to a judge's determination of corporate illegitimacy. Almost all state corporations statutes simply ignore the whole idea of piercing the corporate veil. The Model Business Corporation Act provides that shareholders are not personally liable for the acts or debts of the corporation unless the articles of incorporation provide otherwise or the shareholder becomes personally liable "by reason of his own

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30 *See* Markarian v. Califano, 473 F. Supp. 671 (W.D.N.Y. 1979) (Social Security Administration could not pierce the veil of a close corporation to decrease a claimant's eligibility for benefits on the grounds that earnings were to be considered as coming from a sole proprietorship).

31 *See* Roccograndi Unemployment Compensation Case, 197 Pa. Super. 372, 178 A.2d 786 (1962) (holding sbareholder/employees to be self-employed and ineligible for benefits where claimants had sufficient control to lay themselves off) (reported at 178 A.2d 786 (1962) as Roccograndi v. Unemployment Compensation Bd. of Review).

32 *See* Johnson & Higgins v. Comm'r of Ins., 321 So. 2d 281, 281-85 (Miss. 1975) (statute requiring disclosure of the shareholders of any company applying for an insurance license did not require disclosure of shareholders of such a company's parent). *But see* General Tel. Co. v. United States, 449 F.2d 846, 855 (5th Cir. 1971) (regulations that restrict activities of telephone common carriers apply to noncarrier subsidiaries of carrier parents).

33 United States v. Milwaukee Refrigerator Transit Co., 142 F. 247, 255 (C.C.E.D. Wis. 1905).

34 Henry W. Ballantine, *Separate Entity of Parent and Subsidiary Corporations*, 14 CALIF. L. REV. 12, 19 (1925).

acts or conduct."[35] That last phrase is not further defined, nor is there any hint as to how much, if any, of the common-law doctrine of piercing the corporate veil is to be covered by this phrase. As the official comment to section 6.22 states, the section "sets forth the basic rule of nonliability of shareholders for corporate acts or debts that underlies modern corporation law."[36] Delaware's statute permits a corporation to include in its certificate a provision imposing personal liability, but otherwise the stockholders are not "personally liable for the payment of the corporation's debts except as they may be liable by reason of their own conduct or acts."[37]

A recent exception to this legislative silence is a 1989 Texas statute that limits a shareholder's liability for fraud arising from a corporation's contractual obligations "unless the obligee demonstrates that the [shareholder] caused the corporation to be used [for] actual fraud . . . , primarily for the direct personal benefit of the [shareholder]."[38] Another provision purports to block shareholder liability for a corporation's contractual obligations based on absence of corporate formalities.[39] That statute appears to be a response to a Texas case that pierced the corporate veil on very broad grounds,[40] and it seeks to toughen case law at least in contractual contexts. But the statute's focus on fraud and informalities addresses neither noncontractual contexts nor the many other reasons courts give for piercing the veil in a contractual context, such as undercapitalization and commingling of funds. The Texas statute still leaves courts as the primary law-makers for piercing the veil.

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35 Model Business Corp. Act § 6.22(b) (1985).

36 *See id.* § 6.22 official comment. Section 7.32(f), a 1990 proposed amendment to the Model Act, would provide some legislative guidance on piercing the veil where shareholders of close corporations enter agreements to eliminate or restrict the power of the board or otherwise provide for less formal corporate governance. Action pursuant to such an agreement

> shall not be a ground for imposing personal liability on any shareholder for the acts or debts of the corporation even if the agreement or its performance treats the corporation as if it were a partnership or results in failure to observe corporate formalities otherwise applicable to the matters governed by the agreement.

Changes in the Revised Model Business Corporation Act—Amendments Pertaining to Closely Held Corporations, 46 Bus. Law. 297, 301 (1990). Similar laws already exist in several states. *See* Cal. Corp. Code § 300(e) (West Supp. 1991); Tex. Bus. Corp. Ann. art. 12.37(f) (Vernon Supp. 1991); Wis. Stat. Ann. § 180.995(20) (West Supp. 1990). No effect of the statutes on judicial opinions is yet observable.

37 Del. Code Ann. tit. 8, § 162(b)(6) (1983).

38 Tex. Bus. Corp. Act Ann. art. 2.21A(2) (Vernon Supp. 1991).

39 *Id.* art. 2.21A(3).

40 Castleberry v. Branscum, 721 S.W.2d 270, 273 (Tex. 1986) (to pierce a corporate veil, a plaintiff need only prove constructive fraud, which 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").

The growth in federal legislation since the 1930s has changed the judicial role somewhat. Some statutes, like the federal securities laws, explicitly cover controlling shareholders and may explicitly mention subsidiaries or affiliates.[41] Other statutes use more generic terms such as "employer," "owner," or "operator," leaving definition of the scope of the terms to subsequent development.[42] Courts must determine if the specific statutory policy mandates less respect for the corporate form than would arise from the usual application of corporate law alone.

The continuing reliance on case instead of statutory law, and a parallel judicial reliance on case-by-case resolution in lieu of far-reaching standards, reflects the nature of the conduct being regulated. As with insider trading[43] and much of the law of directors' fiduciary duties,[44] additional specification may not be possible without inviting greater abuse, as investors and their lawyers plan transactions to avoid specific terms of the law.[45] For example, state corporations statutes limit the dividends that may be paid to shareholders,[46] but this bright-line rule has not removed the need for "piercing" as an alternative constraint to regulate shareholders who leave their corporation with few assets. Courts and legislators have chosen to rely on after-the-fact adjudication based on general principles in lieu of more specific standards.

This uncertainty in legal standard does not, however, reduce the business participant's desire to predict ultimate judicial outcomes. Toward that end, this project seeks to provide some empirical data on the factors used by courts in deciding whether to pierce the corporate veil.

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41 *See, e.g.*, 15 U.S.C. § 78t (1988) (liability of control persons). *See generally* PHILLIP I. BLUMBERG, THE LAW OF CORPORATE GROUPS: PROBLEMS OF PARENT AND SUBSIDIARY CORPORATIONS UNDER STATUTORY LAW OF GENERAL APPLICATION § 1.01 (1989), categorizing "specific" statutes and "general" statutes and describing how some statutes have been transformed from general statutes to specific statutes.

42 *See* PHILLIP I. BLUMBERG, *supra* note 41, § 1.01 nn. 6 & 7.

43 Congress has not defined insider trading, leaving the law to evolve on a case-by-case basis.

44 Although, there has been some movement to codify directors' fiduciary duty in the last 20 years. *See* MODEL BUSINESS CORP. ACT. § 8.30 (1985) (fiduciary duty remains judge-made law).

45 *See* I. MAURICE WORMSER, DISREGARD OF THE CORPORATE FICTION AND ALLIED CORPORATION PROBLEMS 37-38 (1927) (suggesting that an effort at codification is "not only impossible but preposterous").

46 *See, e.g.*, MODEL BUSINESS CORP. ACT § 6.40 (1985).

III
The Methodology of this Project

A. The Data Set

This project includes all Westlaw cases through 1985 concerning the issue of piercing the corporate veil.[47] Those cases that did not address corporate law were eliminated from the initial set of 2000, leaving a pool of about 1600 cases for which both factual and analytical data were collected.[48] The factual data compiled from each case included: whether or not the court pierced the veil; year; court; which jurisdiction's law was being applied; the number of shareholders in the corporation that was the object of piercing; whether a person or an entity was behind the corporate veil; the person or entity seeking the piercing; the substance of the claim (contract, tort, criminal law, or a specific statute); and whether or not the claim involved procedure.[49]

In addition to this factual data, the reasons courts gave to explain their decision to either pierce or not pierce the corporate veil were collected. These were less objective than the inquiries made above and reflected a judgment by the court to cite the presence or absence of certain factors. The data-gathering form included a universe of eighty-five reasons gleaned from previous research in the area and a sampling of the cases in the data set. These reasons were grouped into several major categories: undercapitalization;[50] failure to follow corporate formalities;[51] overlap of corporate records, functions or personnel;[52] misrepresentation;[53] shareholder domina-

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47 The search included the terms "piercing the corporate veil" and "disregard of corporate entity," and the appropriate Westlaw key numbers. For the precise search term, see *supra* note 1. The earliest date of the cases varied depending on the breadth of the various Westlaw libraries; there were almost no cases prior to 1930, and only a handful each year until the mid-1950s. *See infra* Table 2.

48 The data was collated from the cases by Rebecca Arnold, John Butrus, Cynthia Day, Paula Decker, Michael Mermal, Paul Rachlin, and Sherry Rozell, all now graduates of the Washington University School of Law.

49 The factual data gathered also included subordination as an alternative to the piercing/no piercing outcome. Eight subordination cases were found but because of the small number, they are not included in this analysis.

50 "Undercapitalization" was subdivided into those cases in which undercapitalization was present at the beginning of the corporation's life and those cases in which the corporation became undercapitalized later.

51 "Informalities" was subdivided into matters relating to meetings, records, or other informalities.

52 The "overlap" category separately tabulated overlap in meetings, directors, business activity, owners, management, bank accounts, hiring and firing decisions, books, contracts, insurance policies, advertising, corporate acts, officers, assets, records, tax returns, stationery, personalities, employees, tariffs, retirement plans and organizational charts. If a court listed two or more of these categories, each item was recorded.

53 This category included both misrepresentation as to the corporation's assets and financial condition, and misrepresentation as to the party responsible for payment.

tion;[54] intertwining and lack of substantive separation;[55] use of the conclusory terms "alter ego"[56] and "instrumentality";[57] the general ground of fairness;[58] assumption of risk;[59] refusal to let a corporation pierce itself;[60] and statutory policy.[61] Courts frequently give more than one reason for their decisions; multiple reasons were recorded where listed by the court.

B. Methodology Questions

This study provides data beyond that previously assembled on

Courts sometimes use "fraud" language to describe these claims, but in most cases the misrepresentation is less than that required to recover under common-law fraud (or some codification of that rule of law). Indeed, if the plaintiff had a good fraud case, she would prohably have pleaded it. *See* Krendl & Krendl, *supra* note 16, at 31 ("fraud [is] difficult to prove, and the quantum of evidence available in most corporate veil cases is considerably smaller than would be required to carry the burden on a fraud claim").

54 "Shareholder domination" includes such conduct as the shareholder paying corporate expenses or continuing losses, paying salaries of corporate employees or guaranteeing corporate deht, owning all of the stock of the corporation, treating the corporation as a department, or the corporation engaging in no independent action.

55 This category is closely related to shareholder domination. It provided a place to separately identify commingling of funds or siphoning of corporate funds, the shareholder treating corporate assets as its own, and other intertwining activities. A separate category was used to identify cases for which the court described the relationship between corporation and shareholder as an agency relationship.

56 A court's perception that a corporation is merely the "alter ego" of its shareholders is a common reason given for piercing the veil. It is frequently attacked by commentators for its conclusory nature. *See, e.g.*, Latty, *supra* note 6, at 625; Note, *supra* note 6, at 1086.

57 Whether a corporation is nothing more than an "instrumentality" of its shareholders has long been used as a test for piercing the veil, *see* F. POWELL, *supra* note 7, at 8-9, hut it too has received much abuse from commentators. *See, e.g.*, Easterbrook & Fischel, *supra* note 5, at 109; Hackney & Benson, *supra* note 7, at 843 (instrumentality of too uncertain meaning to express any legal test).

58 Several commentators have said that the question comes down to fairness. *See, e.g.*, *supra* text accompanying note 34. Courts, too, are sometimes satisfied with the reason. Courts include a general reference to equity, fairness, or justice as a reason for piercing in 135 cases in the data set.

59 The "assumption of risk" category was designed to capture those cases in which courts addressed specifically whether participants contracted with a corporation and thereby assumed the risk that the corporate assets would be insufficient to pay the debts.

60 Self-piercing cases use terminology similar to piercing cases, but the chances of a court allowing such piercing are much less. In self-piercing, the corporation asks the court to pierce the veil to entitle the enterprise to a benefit that would not be available if the corporation were considered separate from its shareholders.

61 "Statutory policy" could be derived from statutes, treaties, or foreign law. The "judicial reasoning" part of the form did not separately identify statutory policy, but the factual part of the survey form, asking for the context in which the case arose, identified the following types of statutes: tax, workers' compensation, unemployment compensation, social security, Medicare, antidiscrimination, garnishment, usury, antitrust, patent, maritime, securities, public utilities, corporate, condemnation, real property, foreign subsidiaries, labor, estates, divorce, ERISA, environmental, bankruptcy, and liquor regulation. Constitutional issues and general government regulation were also identified.

the question of piercing the corporate veil.[62] As with any empirical study, it is worthwhile to keep in mind what the study can and cannot do. These results are based on reported cases that may not be a representative sample: of all piercing the veil cases actually decided (since many opinions are not reported); of all piercing the veil cases actually filed (since most cases are settled); or of the total number of transactions in which a "piercing" question comes up (since many questions are resolved without litigation).[63] These limitations make it inappropriate to draw conclusions as to the number of corporations in which the question of piercing the corporate veil arises. As Richard Posner has written, one reading only veil piercing cases would assume that the purpose of the corporate affiliation is to mislead creditors.[64]

The literature on selection bias (including the work by Priest and Klein[65] and Priest alone[66]) suggests that disputes selected for litigation will constitute neither a random nor representative sample of the set of all disputes. Any relative comparison of various factors, such as the one done here, can be affected to the extent that litigants understand the prior learning on a legal issue and use that knowledge to decide which cases to file, to continue on appeal, or to settle.[67] While that type of selection might be occurring in this set of reported opinions, other factors suggest that the bias is not so great as to prevent meaningful uses of differences in the results. First, as the previous section discusses, the law in this area has not crystallized.[68] Case results are very fact specific, and the fact patterns that cause a court to pierce or not to pierce are not clearly understood. The area of uncertainty is broad enough that litigants have continued to bring a large number of cases. Second, the lack of any significant change over time in the percentage of cases in which courts

62 In an additional article in progress, I use this data and a logit analysis, a form of statistical regression analysis, to test the relationship between a dependent variable, here the court's decision to pierce the veil, and independent variables here the various factors recorded in the data set. Not surprisingly, the "conclusory" indicators of alter ego and instrumentality are the factors most closely associated with a piercing result. The explanation of that model and the results are left for another day.

63 A search of Lexis, as opposed to Westlaw, cases would produce a somewhat different universe, but probably not affect the results.

64 Posner, *supra* note 25, at 524.

65 George L. Priest & Benjamin Klein, *The Selection of Disputes for Litigation*, 13 J. LEGAL STUD. 1, 4 (1984) (developing a model that suggests "disputes selected for litigation (as opposed to settlement) will constitute neither a random nor a representative sample of the set of all disputes").

66 George L. Priest, *Selective Characteristics of Litigation*, 9 J. LEGAL STUD. 399 (1980); George L. Priest, Measuring Legal Change (1987) (Yale Law School working paper, Program in Civil Liability).

67 For example, defendants who thought that undercapitalization leads to veil piercing would be more inclined to settle those cases before trial.

68 *See, e.g.*, sources cited *supra* notes 3-18.

pierce the veil, or any significant difference between results in state and federal court cases or between results in trial, appellate, and supreme court cases, suggests that the sample has stayed within the same broad range.[69] Finally, to the extent that these results are used to evaluate theories in prior commentary, this study uses a data set broader than the sample of reported cases that form the basis for the comments previously put forward.

IV
EMPIRICAL RESULTS

A. The Frequency Distributions

1. *General Observations*

Some initial observations can be made based on review of the entire data set. Piercing of the corporate veil is limited to close corporations and corporate groups (parent/subsidiary or sibling corporations).[70] In the entire data set, piercing did not occur in a publicly held corporation.[71] This universal respect for the separateness of the corporate entity in publicly held corporations reflects the different role that limited liability plays in larger corporations. All corporations can use the corporate form to allocate risk.[72] Limited liability performs the additional function in larger corporations of facilitating the transferability of shares and making possible organ-

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69 The results are given in Tables 2, 3, and 4. Except in Table 4, the data is not broken down between trial and appellate courts. It is possible that there is an "affirmed" effect, a tendency of appellate courts to affirm the decisions of lower courts, which the data as presented here does not reveal. For a more general discussion of this possibility, see Theodore Eisenberg & Stewart J. Schwab, *What Shapes Perceptions of the Federal Court System?*, 56 U. CHI. L. REV. 501, 517-19 (1989).

70 As set out in Table 7, *infra*, the data set included 777 close corporation cases, 637 parent/subsidiary or sibling cases, and nine cases involving public corporations. Two or more corporations controlled by the same person or entity are "sibling corporations."

71 In the nine public corporations cases included in the data set the court's decision was not to pierce. Professor Blumberg lists Anderson v. Abbott, 321 U.S. 349, *reh'g denied*, 321 U.S. 804 (1944), as a possible exception to the generalization that courts do not pierce the veils of publicly held corporations. Blumberg, *supra* note 15, at 289 n.11; *cf.* Fors v. Farrell, 271 Mich. 358, 260 N.W. 886 (1935) (similar result under a comparable Michigan statute). The *Abbott* Court held that shareholders of a bank holding company, who apparently numbered several thousand, were subject to the double liability imposed by federal statute on bank shareholders, even though the bank holding company was the sole actual shareholder of the bank subject to the statute. The Court sought to prevent evasion of the double assessment provisions of the Banking Act. This case can be distinguished from many piercing cases because of the specific provisions of the Banking Act which impose double liability on all shareholders. *Abbott* does not necessarily support imposing liability on public shareholders in the absence of a statute. Banking law no longer imposes double liability, so it is appropriate to characterize this case as sui generis. Even so, Justice Douglas's broad language continues to be cited as justification for piercing the veils of close corporations and parent/subsidiary companies.

72 *See supra* text accompanying notes 24-26.

ized securities markets with the increased liquidity and diversification benefits that these markets make possible.[73] The absence of these market-related benefits for close corporations[74] explains, in part, why courts are more willing to pierce the veil of close corporations, but a piercing result still requires a combination of other factors. The total absence of piercing in public corporations permits a stronger positive statement for those corporations: the market-related benefits of limited liability are sufficient to prevail over all possible claims of those who have claims against the public corporation and cannot collect from its assets.

A subsidiary corporation has sometimes been termed a special variation of a one shareholder corporation, a view that would make piercing entirely a close corporation doctrine. However, the data illustrate that piercing cases in which the corporation's shareholders are individuals differ in several ways from the cases in which the shareholder is another corporation, so that there is value in describing piercing for close corporations separately from piercing within corporate groups.[75]

Courts pierced the veil in about 40% of reported cases.

TABLE ONE

Category	All cases	Pierce	No Pierce	% Piercing
#	1583	636	947	40.18

The remainder of this article examines factors which lead to piercing percentages different from the overall percentage shown in Table 1. Before evaluating these factors consider first the factors that do not appear to have any significant effect on the results:

— There is no trend over time. Courts do not appear to be moving toward permitting piercing in more and more situations.[76]

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73 *See* Woodward, *supra* note 28, at 603 ("[l]imited liability [in publicly traded firms] can be motivated solely by transaction and information costs" without the consideration of risk aversion); *see also* Halpern, Trebilcock & Turnbull, *supra* note 28, at 130-31 (a capital market would exist for unlimited liability firms among wealthy investors, but there will not be a single price for all shares of a particular company).

74 *See* Easterbrook & Fischel, *supra* note 5, at 109-10 (the authors note that close corporations do not reap the other benefits of limited liability: facilitating efficient riskbearing, facilitating monitoring by capital markets, less need for facilitating the takeover market or diversification, and greater moral hazard problems).

75 For example, about two-thirds of the tort cases involve corporate shareholder defendants. The piercing rate for those cases is lower than for cases in the data set. *See infra* text accompanying notes 171-72.

76 *Contra* David H. Barber, *Piercing the Corporate Veil*, 17 WILLAMETTE L. REV. 371, 404 (1981) (courts moving slowly toward permitting piercing in more and more situations).

While there are variations from year to year, the percentage of cases in which courts pierce the veil has stayed relatively constant over the last several decades.[77]

TABLE TWO

Category	Total number of cases	Pierce	No Pierce	% Piercing
Pre-1960	130	53	77	40.77
1960s	399	164	235	41.10
1970s	572	233	339	40.73
1980s	484	187	297	38.64

— State courts pierce the veil in about the same percentage of cases as federal courts.[78]

TABLE THREE

Category	Total number of cases	Pierce	No Pierce	% Piercing
State Courts	938	369	569	39.34
Federal Courts	647	268	379	41.42

— Trial, appellate, and supreme courts pierce in a similar percentage of cases.[79]

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[77] Table 2 shows results from each of the last three decades. The differences between decades in Table 2 are not statistically significant. The statistical significance refers to the degree of confidence we have in rejecting a particular null hypothesis. In this paper the null hypothesis is usually some variation of the hypothesis that there is no difference between piercing percentages from different groups of cases (*e.g.*, those in different time periods or those involving corporations with different numbers of shareholders).

The significance level is the probability that a result as extreme as the one observed could have occurred by chance. If the observed significance level is small enough, usually 0.05, the null hypothesis is rejected.

A Z test is used to measure the difference. A Z value greater than 1.96 indicates that a result is significant at the 0.05 level. That is, in 95 times out of 100, the difference as set forth in the data would not have occurred by chance. That threshold is used in this paper for results described as statistically significant.

[78] The difference is not statistically significant. These findings contradict earlier suggestions that federal courts are more willing to pierce the corporate veil. *See* Note, *Piercing the Corporate Veil: The Alter Ego Doctrine Under Federal Common Law*, 95 HARV. L. REV. 853, 870 (1982); *see also* Note, *Piercing the Corporate Veil in Federal Courts: Is Circumvention of a Statute Enough?*, 13 PAC. L.J. 1245, 1255 (1982) (authored by Patricia J. Hartman) (federal courts require a lesser burden of proof to disregard the corporate entity).

[79] The differences are not statistically significant.

TABLE FOUR

Category	Total number of cases	Pierce	No Pierce	% Piercing
Trial Courts	401	161	240	40.15
Intermediate App.	860	338	522	39.30
Supreme Courts	316	133	183	42.09

— The identity of the plaintiff as either an individual or a corporation leads to no differences in results.[80]

TABLE FIVE

Category	Total number of cases	Pierce	No Pierce	% Piercing
Individual Plaintiff	695	262	433	37.70
Corporate Plaintiff	652	240	412	36.81

— Creditors and noncreditors have similar success rates in cases they bring as plaintiffs.[81]

2. *Differences by State*

The percentage of cases in which courts pierce the veil varies depending on which state's law is being applied. Among the eight states with the most piercing decisions, the percentage of cases in which courts pierced ranged from 31% in Pennsylvania and 35% in New York to 45% in California.[82] Given the small number of cases in each jurisdiction, the differences between the states are not statistically significant. Therefore, it is not possible to say with certainty

80 Government plaintiffs were not classified as either individual or corporate and had a piercing success rate of about 58%. *See infra* Table 8.

81 *See infra* Table 8. "Creditors" was used here to include those persons who had a bargain-type relationship with the corporation prior to the event that gave rise to the piercing claim. The differences in Table 8 between government as plaintiff and creditors as plaintiff and between corporations as plaintiff and creditors as plaintiff are statistically significant.

82 *See infra* Table 6. The results from the states with the largest numbers of piercing cases are as follows:

States	Cases	Percentage Pierced
New York	212	34.91
Texas	106	34.91
California	89	44.94
Illinois	78	42.31
Louisiana	67	35.82
Pennsylvania	65	30.77
Georgia	47	38.30
Florida	46	41.30

TABLE SIX

Category	Total number of cases	Pierce	No Pierce	% Piercing
AK	10	3	7	30.00
AL	17	11	6	64.71
AR	23	9	14	39.13
AZ	17	7	10	41.18
CA	89	40	49	44.94
CO	13	7	6	53.85
CT	11	7	4	63.64
DC	10	6	4	60.00
DE	11	0	11	0.00
Federal	302	119	183	39.40
FL	46	19	27	41.30
GA	47	18	29	38.30
HA	4	1	3	25.00
IA	12	7	5	58.33
ID	9	6	3	66.67
IL	78	33	45	42.31
IN	16	11	5	68.75
KS	19	15	4	78.95
KY	15	4	11	26.67
LA	67	24	43	35.82
MA	15	6	9	40.00
MD	15	6	9	40.00
ME	8	2	6	25.00
MI	22	6	16	27.27
MN	13	5	8	38.46
MO	30	12	18	40.00
MS	14	5	9	35.71
MT	8	4	4	50.00
NC	21	9	12	42.86
ND	4	3	1	75.00
NE	12	7	5	58.33
NH	5	0	5	0.00
NJ	20	9	11	45.00
NM	13	2	11	15.38
NV	12	5	7	41.67
NY	212	74	138	34.91
OH	14	8	6	57.14
OK	15	6	9	40.00
OR	16	9	7	56.25
PA	65	20	45	30.77
PR	3	0	3	0.00
RI	6	2	4	33.33
SC	8	3	5	37.50
SD	8	5	3	62.50
TN	18	7	11	38.89
TX	106	37	69	34.91
UT	7	3	4	42.86
VA	16	4	12	25.00
VT	0	0	0	0
WA	27	12	15	44.44
WI	16	8	8	50.00
WV	7	3	4	42.86
WY	8	5	3	62.50

that these results are due to different views of the law.[83]

The higher percentage of piercing in California cases may reflect that state's relative lateness in embracing the doctrine of limited liability. Until 1931, shareholders in California corporations remained liable for at least some of a creditor's claim against the corporation.[84] Each shareholder was liable for the proportion of each creditor's claim that corresponded to the shareholder's proportional ownership in the stock of the corporation.[85] This liability expired three years after the date on which corporate liability was incurred and was subject to other limitations.[86] It is uncertain how often this liability was asserted, but the statute probably contributed to a perception that public policy in California favored piercing the corporate veil.

New York, as this country's leading commercial center, has produced the most piercing cases. As a group, the New York decisions seem somewhat more restrictive on piercing than cases from the rest of the country.[87] Delaware, clearly the most dominant state in corporate law, has produced very few piercing cases.[88] This result is consistent with viewing piercing as a close corporation issue,[89] since Delaware's traditional focus has been on large corporations where there is a separation of function between managers and shareholders.[90] Using Delaware law, courts did not pierce in any of the

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83 Again, "statistical significance" refers to the degree of confidence we have in rejecting a null hypothesis that the difference in the results could not have occurred by chance. *See supra* note 77. The *Z* test value for the difference between California and New York, for example, was 1.66.

84 Under the California constitution and implementing statutes between 1849 and 1931, shareholders had a pro rata liability for all corporate obligations incurred while they were shareholders. *See* 2 HAROLD MARSH, JR., MARSH'S CALIFORNIA CORPORATION LAW § 15.13 (2d ed. 1986).

85 CAL. CONST. art. IV, § 36 (1849) (repealed 1879); *id.* art. XII, § 3 (1879) (repealed 1930). An 1850 statute specified that each shareholder was liable only for the proportion of a claim that corresponded to the shareholder's proportional ownership of the corporation. Act of Apr. 22, 1850, ch. 128, § 32, 1850 Cal. Stat. 347, 350, *amended by* Act of Apr. 27, 1863, ch. 518, § 1, 1863 Cal. Stat. 766, *repealed by* Act of June 12, 1931, ch. 862, § 1, 1931 Cal. Stat. 1762. A 1929 statute authorized limited liability if "Limited" or "Ltd." was included in the corporate name. Act of May 23, 1929, ch. 418, § 1, 1929 Cal. Stat. 740. The constitutional provision providing for shareholder liability was repealed in 1930, and the implementing statute was repealed in 1931. Act of June 12, 1931, ch. 862, § 1, 1931 Cal. Stat. 1762.

86 2 H. MARSH, *supra* note 84, § 15.13 at 330.

87 New York cases made up 13.39% of the data set. The percentage of cases in which the courts pierced (34.91%) is less than the 40.1% for all cases, but this difference is not statistically significant. *See supra* note 77.

88 In the data set, there were 11 cases decided on the basis of Delaware law.

89 *See supra* text accompanying notes 70-74.

90 More than half of all corporations listed on the New York Stock Exchange are incorporated in Delaware, but Delaware cases make up less than 0.7% of the data set. The lack of Delaware cases illustrates the focus on close corporations evident in the piercing cases, and suggests that even for corporate groups, the issue occurs less fre-

eleven reported cases. This fact may reflect the larger size of Delaware corporations or a general leaning toward protecting corporations in that jurisdiction.[91]

Knowledge of differences between states is useful only when parties to the litigation can predict and choose which state law will be applied. Potential defendants, who almost always are corporate insiders, can choose the state of incorporation.[92] Those who have chosen a restrictive piercing jurisdiction would argue that a court should apply the "internal affairs" rule and apply the laws of the state of incorporation to the piercing decision.[93] The internal affairs rule is a choice of law principle under which the laws of the state of incorporation govern arrangements between shareholders and managers.[94] A few states, including New York and California, have asserted by statute their right to apply their own law to corporations incorporated in other states.[95] These statutes do not specifically list piercing, which is a common-law doctrine in all states, but it seems likely that a state which aggressively applied its corporations statute would apply its common law in the same way.

Piercing the veil cases may not be governed by the internal affairs rule even if that rule is applied to foreigu corporations. The dispute in a piercing case is not between shareholders and managers, the traditional province of the internal affairs rule, but between the corporation's insiders and persons or entities who contracted with the enterprise or who are connected to the enter-

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quently in the largest American corporations. Of the few Delaware cases, most relate to parent/subsidiary contexts. *See, e.g.*, Pauley Petroleum, Inc. v. Continental Oil Co., 43 Del. Ch. 366, 231 A.2d 450 (1967), *aff'd*, 43 Del. Ch. 516, 239 A.2d 629 (1968); Buechner v. Farbenfabriken Bayer Aktiengesellschaft, 38 Del. Ch. 490, 154 A.2d 684 (1959).

91 The only other jurisdictions with a lower piercing percentage were New Hampshire (no piercing in five cases) and Puerto Rico (no piercing in three cases). There were no Vermont cases.

92 The jurisdiction of incorporation is chosen in the first instance by the incorporator and can be changed thereafter by the directors and the shareholders. Creditors have no direct influence on this choice.

93 The internal affairs rule refers to legal rules governing relations among shareholders, officers, and directors, which are the major topics of state corporations codes. *See* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 309 (1969).

94 *See, e.g.*, MODEL BUSINESS CORP. ACT § 15.05(c) (1984) ("This Act does not authorize this state to regulate the organization or internal affairs of a foreign corporation authorized to transact business in this state.").

95 *See, e.g.*, CAL. CORP. CODE § 2115 (West 1991) (requiring corporations with certain minimum contacts to comply with several California provisions protecting shareholders: cumulative voting, inspection, and dissenters' rights); N.Y. BUS. CORP. LAW § 1317 (McKinney 1991). The constitutionality of these statutes has not been resolved. *Compare* Wilson v. Louisiana-Pacific Resources Inc., 138 Cal. App. 3d 216, 187 Cal. Rptr. 852 (1982) (upholding imposition of a California cumulative voting provision on a Utah corporation doing business in California) *with* Arden-Mayfair, Inc. v. Louart Corp., 385 A.2d 3 (Del. Ch. 1978) (holding the California statute inapplicable under generally recognized choice of law principles).

prise by tort or other laws.[96] The *Restatement (Second) of the Conflict of Laws* suggests that the rule favoring the law of the state of incorporation extends to questions of liability to creditors.[97] Yet states other than the state of incorporation have sometimes asserted the right to apply their own statutes in order to protect their citizens who are tort victims or creditors of out of state corporations.[98] Such a connection with potential plaintiffs may give a non-incorporating state a link to the transaction sufficient enough so that it can assert the applicability of its laws. This can create uncertainty if multiple states seek to apply differing rules of limited liability to the same corporation. However, given the small number of piercing cases decided in many jurisdictions and the similar results in many states, this degree of uncertainty does not seem large.[99]

Knowledge of the differences between state approaches will probably be of greater use to prospective plaintiffs, who, given a choice, would rather file in a state whose results are more inclined to piercing. Even if a forum state agrees to apply the law of the more restrictive state of incorporation, the piercing law in all jurisdictions leaves considerable room for judicial discretion; a plaintiff may prefer this discretion to be exercised by a judge from a more friendly "piercing" culture.

3. *Differences Based on the Number and Identity of the Shareholders*

The number of shareholders makes a difference in the propensity of courts to pierce the veil of corporations. Among close corporations, those with only one shareholder were pierced in almost

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96 A Texas statute, enacted in 1989 after the *Castleberry* case, discussed *supra* note 40, states that the laws of the jurisdiction of incorporation of a foreign corporation shall govern internal affairs and "the liability, if any, of shareholders of the foreign corporation for the debts, liabilities and obligations of the foreign corporation for which they are not otherwise liable by statute or agreement." TEX. BUS. CORP. ACT ANN. art. 8.02 (Vernon 1991).

97 RESTATEMENT (SECOND) OF THE CONFLICT OF LAWS § 307 (1969) ("The local law of the state of incorporation will be applied to determine the existence and extent of a shareholder's liability to the corporation for assessments or contributions and to its creditors for corporate debts."). The comment to section 307 refers to exceptions for actions deemed "penal or . . . contrary to a strong local public policy." *Id.* comment e at 329; *see also* TEX. BUS. CORP. ACT ANN. art. 8.02 (Vernon 1991) (discussed *supra* note 96).

98 *See* Joncas v. Krueger, 61 Wis. 2d 529, 535, 213 N.W.2d 1, 4 (1973) (Wisconsin statute imposing personal liability on corporate shareholders for unpaid wages due to corporation's employees is applicable to foreign corporations. "We see no valid distinction . . . why Wisconsin employees working in Wisconsin should be classified for benefits depending upon where their employer is incorporated."). *But see* Armstrong v. Dyer, 268 N.Y. 671, 198 N.E. 551 (1935) (under similar New York statute, shareholders of a foreign corporation are not liable).

99 *See, e.g.*, Japan Petroleum Co. (Nigeria) v. Ashland Oil, Inc., 456 F. Supp. 831, 840 n.17 (D. Del. 1978) (most standards are essentially the same despite slight variations).

50% of the cases; for two or three shareholder corporations, the percentage dropped to just over 46%, and for close corporations with more than three shareholders, the percentage dropped to about 35%. The differences between the one, two or three person corporations, and the other close corporations are statistically significant.[100]

TABLE SEVEN

Identity of Shareholders	Total number of cases	Pierce	No Pierce	% Piercing
Individuals: — One	276	137	139	49.64
— Two or Three	238	110	128	46.22
Close but — More than Three	263	92	171	34.98
— Public Shareholders	9	0	9	0.00
Total Individuals	786	339	447	43.13
Corporate: — Parent	386	142	244	36.79
— Subsidiary	68	19	49	27.94
— Sibling	183	76	107	41.53
Total Corporate	637	237	400	37.21

Since the 1897 decision of the House of Lords upholding the limited liability of what was essentially a one person corporation,[101] courts and commentators have vigorously debated the propriety of limited liability for these enterprises.[102] Lord Herschell in that case asked, "[h]ow does it concern the creditor whether the capital . . . is owned by seven persons . . . or . . . almost entirely owned . . . by one

100 The *Z* test value for single shareholders versus close corporations with more than three shareholders is 3.44. The *Z* test value for two or three person corporations versus larger close corporations is 2.50.

101 Salomon v. A. Salomon & Co., 1897 App. Cas. 22 (1896) (shares held in the name of a leather merchant, his wife, and five children; after the company became insolvent, the House of Lords rejected the creditor's claim that the corporation was a sham).

102 *See, e.g.*, Bernard F. Cataldo, *Limited Liability with One-Man Companies and Subsidiary Corporations*, 18 LAW & CONTEMP. PROBS. 473, 475 (1953); Warner Fuller, *The Incorporated Individual: A Study of the One-Man Company*, 51 HARV. L. REV. 1373, 1405 (1938); Note, *supra* note 6, at 1089 (peculiar opportunity for manipulation and superior knowledge of sole shareholder make it desirable that a sole shareholder claiming limited liability affirmatively show that corporation is adequately financed).

person?"[103] The results show that the number of shareholders seems to matter to judges. However, it is not, as some have suggested, virtually impossible for one person corporations to retain limited liability in any circumstance.[104] Even though many of the factors used by courts to justify piercing the veil are inescapable in one person corporations,[105] these corporations still retain limited liability in half of the reported cases.

The role that an individual plays within a corporation also has an effect on the outcome. Defendants who served only as shareholders were less likely to be successful targets of piercing suits than shareholders who also served as directors or officers.[106] Further, in the few cases that characterized potential defendants as passive shareholders rather than active in the business as directors, officers, or otherwise, the courts almost always found no liability.[107]

4. *Differences Based on Whether the Defendant is an Individual or a Corporation*

When potential defendants against whom liability is sought are grouped as either individuals or corporations, courts pierce the veil to get at individual defendants more often than they pierce to reach corporations.[108] This result is contrary to what some commentators have suggested.[109] However, if the one or the two or three person corporations are excluded from this count, the courts pierce more often to reach shareholders who are corporations.[110]

Among potential corporate shareholders, courts are more in-

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103 *Salomon*, 1897 App. Cas. at 44-45.

104 *See, e.g.*, Note, *Corporations—Shareholder Liability—Louisiana Adopts a Balancing Test for Piercing the Corporate Veil*, 58 TUL. L. REV. 1089, 1100 (1984) (authored by Patricia A. Carteaux) (language in early cases seems to render retention of limited liability in a one man corporation nearly impossible).

105 For example, many of the overlap factors are inevitable in a one person corporation.

106 When the targets of piercing were described as shareholders, courts pierced in 41.51% of the cases (203 of 489). When the targets of piercing were described as both shareholders and officers or directors, the percentage of piercing cases moved to 46.36% (140 of 302).

107 Courts refused to pierce in five of the six cases in the data set that were directed at passive shareholders.

108 When potential targets of piercing were individuals, courts pierced in 43.13% of the cases (339 of 786). Piercing was the outcome in 37.21% of cases where the target was another corporation (237 of 637). *See supra* Table 7.

109 Easterbrook & Fischel, *supra* note 5, at 110-11; Krendl & Krendl, *supra* note 16, at 42 (parent-subsidiary relationship will be more closely scrutinized and may be more readily susceptible to veil-piercing than corporations with individual shareholders). *But see* Note, *Inadequately Capitalized Subsidiaries*, 19 U. CHI. L. REV. 872 n.1 (1952) (in the case of corporations with inadequate capitalization, "liability appears to be more frequently limited when the stockholder is not a corporate entity").

110 See *supra* Table 7 for the data on one shareholder and two or three shareholder corporations. The percentage for remaining close corporations, 34.98% (92 of 263

clined to pierce when the potential liability is directed at sibling corporations, and less inclined to pierce when a plaintiff seeks to look through a parent to get to a subsidiary.[111]

5. *Differences Based on the Identity of the Plaintiff*

Although the identity of the potential defendant as either an individual or a corporation did contribute to differences in result,[112] the identity of the plaintiff as either an individual or a corporation did not have an impact.[113] The most successful plaintiffs were governmental entities, and the least successful were the corporations themselves and shareholder seeking piercing of their own corporation.

TABLE EIGHT

Category	Total number of cases	Pierce	No Pierce	% Piercing
Creditor Plaintiff	612	259	353	42.32
Noncreditor Plaintiff	514	207	307	40.27
Government Plaintiff	218	126	92	57.80
Corporate (self) Plaintiff	164	22	142	13.41
Shareholder Plaintiff	59	15	44	25.42

The differences between the government or corporate plaintiffs and the creditor plaintiffs are statistically significant.[114] The government's success often comes in the context of a statutory policy, as opposed to a contract or tort context.

The corporation itself seldom is successful in arguing self-pierc-

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cases), is less than the 37.21% piercing result where the shareholders are corporations. This difference is not statistically significant.

111 *See supra* Table 7. When the piercing was directed through a parent to get at a subsidiary, courts pierced in only 19 of 68 cases (27.94%). In the more common case where litigants sought to reach through the subsidiary to get to the parent, the courts pierced in 142 of 386 cases (36.79%), still a lower rate than in the sibling situation (41.53%).

112 See the results described in Table 7 *supra*.

113 See the results described in Table 5 *supra*.

114 The Z test value for the government as plaintiff compared to creditors as plaintiff is 4.12. The Z test value for the corporation as plaintiff as compared to creditors as plaintiffs is 6.83. For an explanation of Z values, see *supra* note 77.

ing. Courts tell participants that they chose the form of the enterprise and that they are stuck with it in bad times as well as in good.[115] Yet the willingness of courts to pierce the veil in one out of every eight of these cases shows the contextual nature of the corporate form. The form is preserved in some situations but not others, and judicial decisions are required to determine the appropriate contexts for preservation.

6. *Differences Based on the Substantive Context in Which the Claim Arose*

When the cases are broken down based upon whether they arose in a contract situation or a tort situation, the results show that courts pierce more often in the contract context than in tort context. This difference is statistically significant.[116]

TABLE NINE

Context	Total Cases	Pierce	No Pierce	% Piercing
Contract	779	327	452	41.98
Tort	226	70	156	30.97
Criminal	15	10	5	66.67
Statute	552	224	328	40.58

When the question is asked a slightly different way—did the transaction that was the subject of the piercing result from voluntary contact or involuntary contact?—the results are similar to those obtained in contract and tort cases, respectively.[117]

These results, more than any other in the project, go against the conventional wisdom.[118] Many commentators have noted that

115 *See* Note, *Reverse Piercing the Corporate Veil: Should Corporation Owners Have It Both Ways*, 30 WM. & MARY L. REV. 667, 668 (1989) (authored by Michael J. Gaertner).

116 The Z test value is 2.98. A contract situation was defined to include piercing cases arising out of bargain situations in which the plaintiff entered into an individual transaction with the corporation.

117 For voluntary contact, courts pierced in 479 of 1142 cases (41.94%). For cases with no voluntary contact, courts pierced in 133 of 379 cases (35.09%). These results include more cases than the contract and tort categories in Table 9 because the voluntary/involuntary categories picked up cases that arose out of various statutory contexts. Some of these cases arose from voluntary transactions between the parties (*e.g.*, a bankruptcy setting in which a creditor is seeking to pierce the veil) and some arose from situations in which the parties had no voluntary contact (*e.g.*, criminal law or other regulatory law).

118 They also are counter to Alexander Frey's early study on individual liability for defective incorporation. That study found greater liability for individuals in situations where the plaintiff had not dealt with the entity as a corporation than those cases in

tort claimants have a better claim to piercing the veil because they did not choose to deal with the corporate enterprise that ultimately was unable to pay its obligation.[119] In contrast, a contract claimant voluntarily dealt with the corporate entity, had a greater opportunity to evaluate the credit risks, and could have chosen not to deal with the corporation. According to this reasoning, courts should pierce more readily in tort settings.[120] The next part of this Article examines several factors in an attempt to explain the variance of these results from conventional expectations. As the next part illustrates, a large segment of the contract cases, but not the tort cases, arise in situations where the court is concerned with possible misrepresentation, and courts pierce the veil in almost all cases in which they find misrepresentation.[121] But even if misrepresentation cases are deleted from the contract and tort cases, courts still pierce more often in contract than in tort.

7. *Differences Based on Procedure*

Jurisdiction and other procedural cases raise different issues than the more ordinary contract and tort questions in veil piercing jurisprudence. For example, in *Cannon Manufacturing Co. v. Cudahy Packing Co.*,[122] a North Carolina plaintiff sued a parent corporation in North Carolina on the basis of the North Carolina activity of a

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which the dealings were on a corporate basis. Alexander Hamilton Frey, *Legal Analysis and the "De Facto" Doctrine*, 100 U. PA. L. REV. 1153, 1174 (1952).

119 *See, e.g.*, Krendl & Krendl, *supra* note 16, at 34; Landers, *supra* note 4, at 623 (creditors better able to protect themselves). This distinction between contract and tort creditors is not recent. *See* William O. Douglas & Carrol M. Shanks, *Insulation from Liability Through Subsidiary Corporations*, 39 YALE L.J. 193, 210-11 (1929) (noticing difference between contract and tort settings).

120 Easterbrook & Fischel, *supra* note 5, at 112 (rationale for greater willingness to pierce in torts than contracts follows directly from the economics of moral hazard; where corporations don't have to pay for the risk, they are more likely to engage in activities where social costs exceed social benefit).

Other commentators have noted that results did not seem to fit with theory. *See* Barber, *supra* note 76, at 381 (one might expect different treatment for contract and tort but most courts mechanically apply the same test to both situations); G. 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 (1988) (despite extensive scholarship on this point, most courts have failed to distinguish between tort and contract); Hamilton, *supra* note 6, at 984-85, (astonishing to find that this fundamental distinction is only dimly perceived by many courts).

121 Misrepresentation in this context refers to conduct that usually is something less than would be required to recover under the common-law action of deceit. *See supra* note 53. For purposes of this study, misrepresentations that occurred in a bargain relationship were included in the contract category, since the primary purpose of the contract/tort division was to distinguish those transactions in which the parties had a preexisting relationship from those in which they did not.

122 267 U.S. 333 (1925). Professor Blumberg suggests: "The star of Cannon is unmistakably on the wane." P. BLUMBERG, *supra* note 3, at 47.

wholly-owned subsidiary. The United States Supreme Court concluded that the subsidiary was a separate and distinct corporate entity and that jurisdiction over the parent was lacking. In contrast, later courts have been more willing to find jurisdiction; for example, the California Supreme Court found jurisdiction in *Empire Steel Corp. v. Superior Court*,[123] holding that a parent was doing business in California by reason of its interrelationship with its subsidiary.

An early article by Professors Douglas and Shanks noted the different context of the jurisdiction cases and dismissed them from further discussion.[124] More recently, Professor Blumberg has emphasized the different concerns in procedural cases: fairness and convenience to the parties, federalism concerns, and an entity's reasonable expectations of being called into court in a forum where it derives income from its affiliates' business.[125] In the procedural area, Blumberg sees enterprise law and a focus on corporate groups as replacing the entity concept and the concern for limited liability.[126] Other commentators and courts have suggested that a more lenient standard applies in deciding whether to pierce the veil in order to establish jurisdiction, than in deciding whether the links are sufficient to make the shareholders liable for corporate debts.[127] The results in this study do not reflect a greater inclination to pierce when the question is procedural, although there is a higher percentage of piercing in venue cases.

TABLE TEN

Procedure	Total Cases	Pierce	No Pierce	% Piercing
Jurisdiction	141	52	89	36.88
Venue	12	7	5	58.33

8. *Differences Based on Statutory Claims*

Piercing the corporate veil is no longer limited to the common-law contexts of contract and tort. Reflecting the increasing regulatory bent of our society, courts have been asked to disregard the veil

123 56 Cal. 2d 823, 366 P.2d 502, 17 Cal. Rptr. 150 (1961).

124 Douglas & Shanks, *supra* note 119, at 204.

125 P. BLUMBERG, *supra* note 3, at 461.

126 *Id.*

127 *See* Comprehensive Sports Planning, Inc. v. Pleasant Valley Country Club, 73 Misc. 2d 477, 341 N.Y.S.2d 914 (N.Y. Civ. Ct. 1973) (standard for piercing varies with purpose, and standard for establishing jurisdiction is less strict than standard for finding shareholder liability); *cf.* Charles I. Wellborn, *Subsidiary Corporations in New York: When is Mere Ownership Enough to Establish Jurisdiction Over the Parent*, 22 BUFFALO L. REV. 681, 685-87 (1973) (limited liability and limited amenability are coexistent).

in a variety of statutory contexts. These cases clearly show the contextual nature of the piercing the veil question; courts look to the specific context more than any inherent corporate characteristic to determine if the separateness of the corporate form should be respected. Of the 552 cases that raised the piercing question in a statutory context, courts disregarded the separate entity about 40% of the time,[128] the same rate as in the overall study. However, there are large disparities depending on the various statutes. For example, in cases involving tax law, courts pierced the veil in only 31% of the cases.[129] The federal income tax, like most federal and state tax codes, presumes that the corporation is a taxable entity separate from its shareholders, creating the possibility of double taxation on the income from the enterprise. The corporation is first taxed on its income, and a separate tax is also levied on dividends paid to shareholders by the corporation from the corporation's already taxed income.[130] Courts are apparently less inclined to look behind the separate entity in tax contexts.

Workers' compensation is another area where courts are less inclined to pierce, doing so in less than 13% of the cases.[131] These cases often involve the issue of whether an injured worker can bring a civil action against a parent or other company related to the worker's employer, in spite of workers' compensation statutes that impose liability without fault as the employee's sole remedy against the employer. Defendant parent corporations often seek to pierce the veil to block a plaintiff's separate suit for recovery against the parent and leave the plaintiff covered only by workers' compensation from the subsidiary.[132] Courts' disinclination to pierce the veil usually permits these claims to continue, apparently putting concern for recovery over any corporate law concerns.[133]

At the other end of the spectrum, courts are more inclined to pierce in environmental cases[134] and other areas where there is a

128 Courts pierced in 224 of 552 cases (40.58%). The different statutory categories are listed *infra* note 135.

129 When the dispute was based on tax law (federal, state, income, estate, etc.), courts pierced in 41 of 133 cases (30.83%). *See infra* note 135.

130 Of course, there are ways to avoid double taxation, such as electing subchapter S status or zeroing out corporate income.

131 Courts pierced in only 5 of 39 cases (12.82%) involving workers' compensation. *See infra* note 135.

132 In effect, corporate defendants claim a form of self-piercing, asking the trier of fact to consider the corporation and its shareholder as one employer, which blocks the civil claim against both. *See* PHILIP I. BLUMBERG, THE LAW OF CORPORATE GROUPS SUBSTANTIVE LAW 327-38 (1987).

133 The failure to pierce is probably encouraged by the general judicial reluctance to let corporations argue self-piercing. *See, e.g.*, Boggs v. Blue Diamond Coal, 590 F.2d 655 (6th Cir.), *cert. denied* 444 U.S. 836 (1979).

134 This conclusion is muted because there are only a few cases in the data set (six).

strong regulatory purpose,[135] including a specific effort to reach related companies or individuals who control companies.

The importance of statutory policy is reflected in less use of such traditional piercing factors as undercapitalization, informalities, and misrepresentation in statutory cases as compared to contract cases. Undercapitalization is present in more than 18% of contract cases in which the courts pierced the veil but is only present in 8% of the statutory cases.[136] Similarly, the rate at which informalities and misrepresentation appear in contract cases is nearly double the rate at which these factors appear in statutory cases.[137]

Some environmental laws make corporate participants personally liable for actions they take or fail to take on behalf of the corporation. *See, e.g.*, Comprehensive Environmental Response Compensation and Liability Act of 1980 (CERCLA), 42 U.S.C. §§ 9601-9675 (1988), which imposes liability on owners or operators of certain polluting facilities. In light of this statutory policy, it is not surprising to see a higher piercing percentage in environmental cases.

135 The results for cases broken down by statutory context are:

Context	Piercing/No-Piercing	%
ERISA	2/0	100.00
Environment	5/1	83.33
Fraud	9/2	81.82
Patent	14/5	73.68
Discrimination	5/2	71.43
Antitrust	10/6	62.50
Securities	4/3	57.14
Estate	8/6	57.14
Medicare	4/3	57.14
Public Utilities	6/5	54.55
Labor	16/14	53.33
Govt. Regulation	21/19	52.50
Liquor	3/3	50.00
Bankruptcy	16/18	47.06
Divorce	12/14	46.15
Usury	8/10	44.44
Unemployment	9/13	40.91
Maritime	4/6	40.00
Garnishment	2/4	33.33
Tax	41/92	30.83
Other	6/15	28.57
Corporate	7/18	28.00
Social Security	1/3	25.00
Real Property	3/12	20.00
Foreign Subsidiary	1/4	20.00
Condemnation	2/10	16.67
Workers Comp.	5/34	12.82
FELA	0/4	0
Constitution	0/2	0

136 Undercapitalization was present in 61 of the 327 contract cases in which the court pierced the veil (18.65%). Courts cited undercapitalization in only 18 of the 224 statutory cases in which they pierced (8.04%).

137 Informalities were cited in 67 of 327 contract cases in which the court pierced (20.49%) as compared to 25 of 224 statutory cases (11.16%). Misrepresentation was cited in 98 of the 327 contract cases (29.97%) and 39 of the 224 statutory cases (17.41%).

B. Reasons Given by the Courts

The seeming indeterminacy of veil-piercing law reflects not just the conclusory language frequently used by the courts but also the broad range of reasons proffered when the courts attempt to explain their conclusions. As one commentator has noted, the same reasons seem to appear in cases which pierce the veil and those decisions which do not.[138] The next section presents the empirical results of the reasons given by the courts, focusing both on the relative frequency with which these reasons appear in piercing cases and the percentage of times that the appearance of these reasons coincides with a piercing result. Subsequent sections analyze in more detail two substantive areas often discussed in connection with piercing: undercapitalization and informalities.

TABLE ELEVEN

Category	Number of Cases in which factor mentioned	Number of Piercing Results	Number of No-Piercing Results	Percentage Pierced
Instrumentality	75	73	2	97.33
Alter Ego	181	173	8	95.58
Misrepresentation	169	159	10	94.08
Agency	52	48	4	92.31
Dummy	78	70	8	89.74
Lack of Substantive Separation	141	120	21	85.11
Intertwining	63	54	9	85.71
Undercapitalization	120	88	32	73.33
Informalities	151	101	50	66.89
Domination & Control	551	314	237	56.99
Overlap:				
Officers	174	87	87	50.00
Directors	152	66	86	43.42
Owners	101	49	52	48.51
Office	68	40	28	58.82
Business Activity	43	35	8	81.40
Employees	52	36	16	69.23
Managment	43	28	15	65.12
Other	169	118	51	69.82
Total Overlap	812	459	343	56.53

138 Comment, *Disregarding the Corporate Entity: Contract Claims*, 28 OHIO ST. L.J. 441, 441 (1967).

1. *The Frequency Distribution*

The factors most often associated with an affirmative result in a piercing case were not necessarily those that appeared the most often. The group of factors most associated with successful piercing (with the empirical results given in parentheses) included several of the traditional conclusory factors: "instrumentality" (97.33%), "alter ego" (95.58%), and "dummy" (89.74%). Also in this most successful category were cases involving misrepresentation, present in 169 cases and leading to a piercing result 159 times (94%). If a court found intertwining or lack of substantive separation, it pierced the veil more than 85% of the time.

Factors leading less often to a piercing result were undercapitalization (73%) and failure to follow corporate formalities (67%).[139] Still further down the success ladder were judicial citations to domination and control (57%) and overlap of various sorts between the corporation and the shareholder (57%). Within this group, courts placed different importance on various kinds of overlap. Where common business activities were cited, the courts pierced 81% of the time; for common employees, 69% of the time; and for common management, 65% of the time. Other commonalities were less often associated with piercing. Courts pierced only 59% of the time when they listed common offices and only half of the time for common officers. Even less important were common directors (courts pierced only 43% of the time when this factor was mentioned) and common owners (49%). These results suggest that courts are looking beyond the formal overlap of shareholders, directors, and officers to see if businesses show other signs of intertwining between the corporation and the shareholder.

The survey form, used to collect information for each case in the data set, also listed factors whose absence was mentioned by the court.[140] Courts refused to pierce the veil in at least 92% of the cases in which a factor's absence was noted, and sometimes up to 100% of those cases. Misrepresentation emerges as the factor whose absence was most often noted by the courts.[141] Courts cited the absence of misrepresentation in 391 cases, almost one-quarter of the cases, and more than twice the number of cases in which the

139 These categories are indirectly characterized *supra* notes 50 and 51.

140 Since the piercing tests used by courts tend to include many factors, courts often mention factors that lead to piercing which are not present in a particular case. The factors tabulated are the same ones listed *infra* note 141.

141 The total number of cases in which the absence of a particular factor was noted by the court and the outcome of those cases are:

presence of misrepresentation is mentioned.[142] The absence of overlap of management and other corporate relations is mentioned more than 300 times, as compared to more than 800 cases in which the presence of such an overlap is mentioned.[143]

2. *Undercapitalization*

Undercapitalization is a factor frequently cited by commentators as part of a normative standard in piercing cases. Ballantine said in the 1940s, "[i]t is coming to be recognized as the policy of the law that shareholders should in good faith put at the risk of the business unincumbered capital reasonably adequate for its prospective liabilities."[144] Other commentators have gone so far as to conclude that undercapitalization is present in every piercing case[145] or that every undercapitalization case should lead to piercing.[146] Several commentators see undercapitalization as particularly important in tort cases as compared to contract cases,[147] or as interacting with other factors such as misrepresentation to enhance the likelihood of piercing.[148] The results of undercapitalization cases are surprising

Absent Factor Mentioned	Pierce/No Pierce	Percentage Not Pierced
Misrepresentation	30/361	92.33
Overlap (all factors)	24/285	92.23
Alter Ego	1/165	99.40
Domination & Control	2/124	98.41
Lack of Substantive Separation	1/99	99.00
Informalities	4/71	94.67
Misuse of Corporate Purpose	4/67	94.37
Dummy	0/64	100
Instrumentality	0/59	100
Agency	1/53	98.15
Undercapitalization	3/48	94.12

142 Misrepresentation was noted as present in 169 cases. When courts mentioned the absence of misrepresentation in 391 cases, they went on to pierce in only 30. When courts observed the presence of misrepresentation, they went on to pierce just over 94% of the time (159 of 169 cases). *See supra* Table 11.

143 Courts mentioned the absence of overlap between corporation and shareholders in 309 cases and pierced in 24. Courts observed the presence of overlap in 822 cases, and pierced in 469 (57.06%). *See supra* Table 11.

144 HENRY WINTHROP BALLANTINE, BALLANTINE ON CORPORATIONS 303 (rev. ed. 1946).

145 Berle, *supra* note 12, at 349 n.15 ("In all cases insufficient capitalization is persuasive evidence that the enterprise was not separate").

146 Rutheford B. Campbell, *Limited Liability For Corporate Shareholders: Myth Or Matter-Of-Fact*, 63 KY. L.J. 23, 53 (1975).

147 Berle, *supra* note 12, at 352-53; Hamilton, *supra* note 6, at 988; Note, *Inadequate Capitalization As A Basis For Shareholder Liability: The California Approach And A Recommendation*, 45 S. CAL. L. REV. 823, 836 (1972) (authored by Robert E. Dye).

148 Hackney & Benson, *supra* note 7, at 865 ("[A]ny element of misrepresentation, express or implied, coupled with undercapitalization, will warrant imposition of . . . liability").

in light of this commentary; these expectations are not reflected in the results. Of 327 contract cases in which courts pierced the veil, undercapitalization is present only in sixty-one (about 19%); of seventy tort cases in which courts pierced the veil, undercapitalization is present in only nine (just under 13%). A piercing result was somewhat more likely in the tort cases in which undercapitalization was present (75%) than in contract cases (70%), but the small number of tort cases in which undercapitalization is mentioned decreases the impact of this difference.[149] In both contexts, courts refused to pierce in 25 to 30% of the cases even when undercapitalization was present, belying any automatic predictive value for that factor.

Undercapitalization was mentioned in only 8% of the statutory cases, which is somewhat less than the percentage for tort cases, and less than half of the contract case percentage. The court pierced in 82%[150] of these statutory cases, more than for either torts or contract cases.[151]

The presence of undercapitalization was noted in about the same percentage of successful piercing cases involving close corporations, parent-subsidiary corporations, and sibling corporations (between 10% and 12%).[152] Its presence was noted in a larger percentage of sole shareholder cases (14.5%) and in a much larger number of cases involving two or three shareholders. Undercapitalization appeared in over 24% of two- or three-shareholder cases in which the courts pierced the veil.[153] Yet, overall, undercapitalization appears in a small minority of the cases.[154]

Undercapitalization and fraud in the same setting do not explain a large number of cases. Of 636 cases in which courts pierced the veil, either undercapitalization or misrepresentation was present

149 Undercapitalization was present in 12 torts cases; in nine, courts pierced the veil (75.00%). Undercapitalization was present in 87 contracts cases; in 61, courts pierced the veil (70.11%). The difference is not statistically significant.

150 Piercing occurred in 18 of 22 cases.

151 See the results described *supra* text accompanying note 149.

152 *See infra* note 154.

153 *See id.*

154 When piercing the veil, courts cited undercapitalization as follows:

Number of Shareholders	Number of Cases When Court Pierced	Number of Piercing Cases Citing Undercap	Percentage of Piercing Cases that Cited Undercap
One	137	20	14.60
Two or Three	110	27	24.55
Close	92	11	11.96
Parent/Sub	162	18	11.11
Sibling	76	8	10.53

in 222 (about 35%), but both were listed as present in only 25. Misrepresentation was present in slightly over 28% of the undercapitalization cases in which the court pierced (twenty-five of eighty-eight). Undercapitalization was present in just under 16% of the misrepresentation cases in which the court pierced (25 of 159). These results indicate that misrepresentation has some predictive value in undercapitalization cases, but still more than 70% of the successful undercapitalization cases do not mention misrepresentation.

As cited in the last section, undercapitalization is not among the factors most frequently cited by the courts in piercing the veil,[155] nor is it among the factors associated with the greatest likelihood of piercing.[156] The relative infrequency with which courts cite undercapitalization in tort-related piercing cases suggests it is an issue that appeals to commentators for reasons other than its predictive significance.

3. *Informalities*

Judicial reliance on a corporation's failure to follow corporate formalities as a basis for piercing the veil has been criticized as theoretically unsound.[157] Other commentators note that courts nearly always cite disregard of formalities, and that failure to maintain formalities substantially increases the probability of piercing.[158] Again the results do not provide confirmation for the commentary. Of 151 cases in which courts cited a corporation's failure to follow corporate formalities, courts pierced the veil in 101 (just under 67%). That percentage of piercing is a little less than the percentage for undercapitalization, and is well below the results in several other categories where the success rate for piercing was in the 85% to 95% range.[159]

Informalities are cited in 20% of the contract cases in which courts pierced, as compared to about 11% of the tort and statutory cases in which courts pierced.[160] That difference between contract

155 *See supra* Table 11.

156 *Id.*

157 *E.g.*, Krendl & Krendl, *supra* note 16, at 28 n.98 (noting that most states do not penalize a corporation for non-compliance with procedural formalities, and further noting that while a failure to follow formalities may indicate that the corporation is an instrumentality and may be misleading, the misrepresentation issue adequately addresses these concerns).

158 Barber, *supra* note 76, at 377; Campbell, *supra* note 146, at 45; Epperson & Canny, *supra* note 120, at 641.

159 See results described *supra* Table 11.

160 See the results described *supra* note 137. Informalities were present in 8 of the 70 (11.43%) tort cases in which courts pierced the veil.

and tort is similar to the results for undercapitalization.[161] However, unlike undercapitalization, the outcome varied among the three categories of cases. The courts pierced in 61% of the contract cases with informalities (as compared to 70% for undercapitalization); 53% of the tort cases with informalities (compared to 75% for tort cases with undercapitalization); and 40% of the statutory cases with informalities (compared to 82% for statutory cases with undercapitalization).[162] Thus, the factor of corporate informalities is more important for contract cases than for other cases, both in the number of times it is used and its likelihood of coinciding with a piercing result. There is some connection between informalities and misrepresentation;[163] of 101 cases in which the court pierced and cited informalities, twenty-four also mentioned misrepresentation.

4. *Contract versus Tort*

Most commentators separate contracts from tort, arguing that a tort context presents an entirely separate problem from contract in piercing the corporate veil, and suggesting that courts should be much more willing to disregard the corporate entity and reach the shareholders when a tort has been committed.[164] Commentators cite a moral hazard problem: insiders in a limited liability corporation can transfer costs of accidents to those who deal with the corporation.[165] Surprisingly, in light of these theories, the results of the cases show a smaller percentage of tort cases than contract cases in which the court pierced the veil.[166]

The relative absence of tort cases in piercing jurisprudence (only 226 as compared to almost 800 contract cases) suggests that piercing law is rooted in concerns of inequitable bargains. The results seem to confirm Robert Clark's point that the most recurring problems in the piercing area are fraudulent transfers and similar

161 See the results described *supra* note 136. Undercapitalization was present in 9 of the 70 tort cases in which the court pierced (12.86%).

162 Of 109 contract cases where informalities were present, the courts pierced in 67 (61.47%). Of 15 tort cases with informalities, the courts pierced in 8 (53.33%). Of 62 statutory cases involving informalities, the courts pierced in 25 (40.32%). The comparable results for undercapitalization are found *supra* text accompanying notes 149 and 151.

163 *See* Krendl & Krendl, *supra* note 16, at 31-34.

164 *See supra* text accompanying notes 118-20.

165 Easterbrook & Fischel, *supra* note 5, at 112.

166 *See supra* Table 9. Some commentators have noted the lower percentages for piercing in the tort context. *See* Epperson & Canny, *supra* note 120, at 633 (despite extensive scholarship that tort plaintiffs should be preferred, the consistent outcome in Maryland and the District of Columbia has been to prefer the contract plaintiff more than the tort plaintiff).

contract-related claims.[167] However, even if we eliminate the misrepresentation cases from the contracts group, the piercing results still remain higher in contract cases.[168] Courts pierced in about 34% of the nonmisrepresentation contract cases as opposed to 27% of the nonmisrepresentation tort cases.[169] Undercapitalization, which many commentators believe should cut more strongly in favor of piercing the veil in tort,[170] can explain only a small portion of the tort cases. Courts pierced in nine of the twelve (75%) tort cases in which undercapitalization was cited as compared to sixty-one of eighty-seven contract cases (slightly more than 70%) in which undercapitalization was mentioned by the court. The impact of this small difference is reduced by the fact that the undercapitalization factor is less often cited in tort than in contract cases. Overall, tort settings seem to involve different concerns than contracts cases.

The lower percentage of piercing in tort cases is interesting because more than two-thirds of the tort cases involve corporate defendants (either a sibling, parent, or subsidiary).[171] This combination of a corporate deep pocket and a nonvoluntary claimant suggests that the plaintiff would have a greater chance of success.[172] Yet courts pierce the veil in less than one quarter of the parent-subsidiary cases where the plaintiff alleged a tort claim. There may be some selection bias in this area or the parties may have different stakes in the outcome.[173] The change in product-liability law and tort law generally in recent decades may have led plaintiffs to bring suits that go beyond prior law.[174] Additionally, the large number of

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167 Robert Charles Clark, *The Duties of the Corporate Debtor to Its Creditors*, 90 HARV. L. REV. 505, 542 n.98 (1977).

168 Misrepresentation can be treated as a tort. Although, in the piercing area, the misrepresentation referred to by courts does not rise to the level required for the traditional tort of deceit. *See supra* note 121. In this study, the contract category included transactions arising from a bargain setting; not surprisingly, almost all misrepresentation cases occurred in this setting.

169 In the contracts area, courts pierced in 327 of 779 cases (41.98%). *See supra* Table 9. Misrepresentation was cited by the court in 107 of those cases (98 in which the court pierced and 9 in which the court did not pierce). If those misrepresentation cases are subtracted from the contract group, the court pierced in 229 of 672 cases (34.08%), a percentage still higher than that of the tort results when misrepresentation cases are omitted (58 of 213) (27.23%).

170 See authorities cited *supra* note 147.

171 For tort cases, 149 of 205 (72.68%) involved corporations as targeted shareholders and 56 involved individuals (27.32%). The corporate/individual identity was not determined in the remaining 21 tort cases. In the overall set, excluding cases in which the corporate status of the defendant was not determined, 45% of the cases were directed at corporate defendants and 55% were targeted at individuals.

172 See authorities cited *supra* notes 119 and 120.

173 *See* Priest & Klein, *supra* note 65, at 40.

174 *Cf.* James A. Henderson & Theodore Eisenberg, *The Quiet Revolution in Products Liability: An Empirical Study of Legal Change*, 37 UCLA L. REV. 479, 483-85 (1990) (noting that the fall of the citadel of privity in the 1960s was followed by the fall of other barriers

corporate defendants may mean that they have more to lose than plaintiffs have to gain, pushing the results in the direction of less piercing. Undercapitalization and informalities are seldom mentioned in these cases.

V
Conclusion

Piercing the corporate veil raises the issue of whether the risks of an enterprise can be shifted to parties outside the corporation. The usual corporate law rule of limited liability means that when a corporation is introduced into a transaction, some of the risk in the transaction passes to outside parties. If the corporation's assets are insufficient to pay its debts, creditors, not shareholders, are left exposed.

This rule is not mandatory. Parties are free to change it by providing for individual liability of shareholders. Even if the parties have not changed this rule, a court might accomplish the same result by piercing the corporate veil. Courts essentially treat the rule of limited liability as a presumption that can be rebutted by sufficient facts. The hundreds of cases in which courts have pierced the corporate veil tell us that this presumption can be rebutted. Yet the various factors and lists in cases and commentary create more confusion than clarity as to when disregard of the corporate entity is appropriate. The empirical analysis described in this article removes some of the mist and metaphor by illustrating when the presumption of limited liability holds and when it does not.

First, piercing the corporate veil is a doctrine exclusively directed at close corporations and corporate groups. The total absence of piercing in publicly held corporations indicates the presence of factors in the public corporation setting that make the presumption of limited liability unassailable. It is not that risk cannot be shifted to nonconsenting outsiders by the use of the corporate form, for surely this occurs in public corporations. Nor is the law unwilling to permit passive investors to suffer because of the actions of their managers who act in the name of the entity. The value of shareholders' investments in public corporations declines when civil or criminal liability is assessed against the enterprise because of the acts of officers and other employees. The willingness to sometimes hold shareholders of close corporations liable, but never shareholders of public corporations, suggests that limited liability's

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to recovery such as the patent danger rule and the bystander rule as courts extended the boundaries of products liability, and concluding that plaintiffs challenging traditional barriers "met with enough success to create the reasonable expectation that it was just a matter of time before those citadels fell in turn.").

positive role in facilitating the public market for shares is strong enough to overcome any justification for piercing.

Second, the data suggests that for close corporations, piercing the corporate veil is strongly rooted in the bargain setting. Because the market-related reasons for limited liability are absent in close corporations and corporate groups, the most important justification for limited liability is permitting parties in a consensual relationship to use the corporate form to allocate the risks of the transaction and the enterprise. Thus the presumption of limited liability is strongest when the outside party adversely affected by the corporation's limited assets was aware of the corporation's separate existence at the time of the transaction. Conversely, courts will disregard limited liability for the same reasons that other bargains are not respected by courts. For example, misrepresentation is one of the most frequent factors listed by courts when they pierce the veil.

The principle of limited liability covers more than explicit bargains; it is more than a default rule that simply saves the parties the costs of writing the rule to shift some risk away from shareholders. In addition, it permits the corporate insiders to choose the risk allocation rule without consulting other parties who might be affected. The law respects this choice unless compelling reasons are shown to vary from it. This provides the insiders a degree of certainty in planning, even while it shifts risks to those who did not explicitly contemplate those risks.

The reasons which courts find compelling to rebut the presumption of limited liability often relate to the activity of insiders. Mere ownership of stock (or overlap of ownership in corporate groups) is not sufficient, nor is overlap of shareholders and directors (or common directors within a corporate group). More pejorative conduct is required. Undercapitalization, if found by the court, usually leads to loss of limited liability. Failure to follow corporate formalities also leads to piercing, but more powerful factors are demonstrations of lack of substantive separation of the corporation and its shareholders, and intertwining in the activities of the corporation and its shareholders.

As the fact patterns move completely away from prior consensual interaction between the parties, the presumption of limited liability loses even more of its strength. Limited liability cannot serve a market purpose for corporations whose shares are not publicly traded. It does not appear to serve the purpose of transferring risk to a more efficient risk-bearer; few tort victims would choose the risks involuntarily thrust upon them by a corporation unable to pay for harm caused by its operation. In this setting, respect for the shareholder's limited liability provides predictability to shareholders in planning their business affairs with whatever encouragement for investing that predictability might offer. The refusal of courts to pierce in tort settings demonstrates that this "planning" reason can be strong enough to influence the piercing result, even when market or risk-shifting justifications do not apply or cut against respect for the entity.

The reasons that lead courts to drop the presumption in the bargain setting—for example, misrepresentation, undercapitalization, and failure to follow corporate formalities—also lead to piercing in tort settings, but they are present in many fewer instances. The apparently anomalous results of this study, that courts pierce less often in torts even though the reasons for limited liability appear less strong, probably reflects the "presumption" structure of piercing-the-veil law. To pierce the veil in the bargain setting, something must affirmatively displace the presumption of limited liability. The focus has been on factors (such as misrepresentation or undercapitalization) which show that insiders have abused the privilege of limited liability. Those factors developed in a bargain setting show up less frequently when there has been no prior transaction between the parties. Thus, when courts look for reasons to disregard the presumption, few of the "old reliables" appear. Yet the justification for limited liability is also weak and the traditional piercing doctrine does not easily accommodate this change. The law's use of a presumption of limited liability pushes courts to look for affirmative reasons to disregard the presumption. Courts are left ill-equipped to deal with a typical tort situation within a corporate group when the reasons for limited liability have shrunk to nothing more than the insiders' value of certainty, and yet no affirmative reasons for piercing are present.

What is significant about the tort cases, therefore, is their relative infrequency. Not surprisingly, other doctrines, such as successor liability in products-liability law, have grown to fill some of the gaps. Thus the silence of the tort numbers may be as significant as any factors that are present.

Piercing-the-veil cases arising in statutory contexts also illustrate the weakening of the presumption of limited liability as the situation moves away from a bargain context. As in the tort context, limited liability serves no public market function, nor does it facilitate efficient allocation of risks between parties. Again, the primary issue becomes the value of letting insiders set the allocation of risk by forming corporations and of giving them the planning certainty that would come from not disregarding the corporate entity. As was true with tort, the more common bargain reasons for piercing—misrepresentation, undercapitalization, and absence of corporate formalities—do not occur in these statutory contexts as often as in the bargain cases.

Yet, unlike the tort situation, the default rule of corporate law has not been left undisturbed in its respect for the corporate entity and recognition of the choice made by insiders. Rather, the legislature, either explicitly or implicitly, has provided additional guidance on the allocation of risks or benefits available under various statutes. Sometimes the statute provides an explicit broadening of liability as, for example, with the securities laws that regulate certain persons and also those who control, are controlled by, or are controlled in common with the regulated entity. In other areas, the purpose of the law may be implicit or may be developed by administrative interpretation. For example, under the labor laws, the question of whether a corporate form should be disregarded turns not on undercapitalization or other common piercing factors, but on whether there was a common labor policy among the related companies such that a failure to pierce would frustrate the specific purpose of the federal labor laws.[175] Other statutes, like the tax laws, reaffirm the presumption of limited liability embodied in corporate law, and so piercing would be expected to occur less frequently.

Thus, this empirical study permits us to see the contextual nature of the piercing-the-corporate-veil question and the structure by which it operates. Limited liability is a presumptive rule of law that facilitates the development of public markets for securities, permits the allocation of risk or benefits between parties, and supports the certainty of planning by those who have organized the corporation. Where there are public markets or where all parties to the transaction participated in the allocation of risk, the law declines to disregard the presumption. In other situations, where the greatest effect of limited liability seems to be only to further the certainty of corporate insiders' planning, the presumption holds unless the insiders have engaged in conduct that makes continuing respect of the bargain unfair.

In addressing tort situations, courts should recognize that the common-law presumption of limited liability was developed to address the allocation of risk in bargain, not tort situations, and that the usual reasons for disregarding the corporate entity do not occur in tort settings. Courts start with the presumption of limited liability, and when none of the usual "suspects" can be found, that presumption continues. If this presumption is going to change, it likely will take legislation or will occur by use of noncorporate legal doctrines.

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[175] This law is summarized in P. BLUMBERG, *supra* note 41, at 396-99.

Indeed, the key element for courts to recognize in statutory cases is that the legislature has changed the corporate law presumption of limited liability. The focus should not be on the traditional factors for piercing the veil in a bargain setting, but on the extent to which a specific statutory scheme either permits or limits a corporate insider's ability to allocate liability or gain a benefit by forming a corporation. Piercing the corporate veil will remain a judicially applied doctrine, but the varying strength of the presumption of limited liability in different contexts should produce a more understandable body of law that has a greater connection to the normative reasons for limited liability.