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# PIERCING THE CORPORATE VEIL IN LOUISIANA ABSENT FRAUD OR DECEIT

## INTRODUCTION

Recently, Louisiana courts have stated that a corporation's status as a separate entity may be disregarded, in exceptional circumstances, absent any fraud or deceit practiced by the corporate shareholders.<sup>1</sup> These statements have been expressed mostly by way of dictum and have rarely been applied in the jurisprudence. The purpose of this paper is to examine the notion of piercing the corporate veil where the shareholders have not practiced fraud or deceit. The analysis begins with a study of the tests that Louisiana courts require to be met before veil piercing under these circumstances is allowed. The sources of these tests are also discussed. Next, the paper examines the courts' application of these tests. Finally, the paper discusses the weaknesses of these tests.

The courts' allowance of veil piercing suggests that corporations must maintain certain standards in conducting their affairs or risk losing the attribute of shareholders' limited liability. These standards should promote fair dealing between corporate creditors and the corporation. By setting standards which promote fair dealing, the courts fulfill an important objective of public policy. The courts encourage corporate debtors to act in a manner conducive to the payment of corporate debts. When courts set such standards, they enhance the probability that corporations will have funds available to pay creditors.

One major weakness in the courts' present tests for veil piercing absent fraud or deceit is that the tests are not always compatible with the corporation's duties of fair dealing with its creditors. Consequently, the tests do not seem to enhance the probability of a corporation's creditors recovering on their claims. The tests do, however, erode the legislatively established policy of limited liability without a corresponding benefit to society. This paper attempts to analyze such situations, their adverse effects upon corporations, and their lack of benefit to creditors.

Another problem is that the tests are so vague and broad, enabling application to most "one-man" corporations. Also, the tests offer very little guidance to corporate planners. It is very difficult to advise owners

of a small corporation how to conduct their affairs without being susceptible to veil piercing.

### *Piercing the Corporate Veil*

Generally, a corporation is regarded as an entity separate and distinct from its shareholders. Shareholders are not ordinarily responsible for obligations of the corporation.<sup>2</sup> The courts, however, occasionally will disregard the corporation's separateness or "pierce the corporate veil," when the corporate form has been used to "defeat public convenience, justify wrong, protect fraud, or defend crime."<sup>3</sup>

Veil piercing cases are generally of two broad categories. "Type One" is the category in which a third party seeks to hold shareholders individually liable for a corporate obligation.<sup>4</sup> This category consists of two distinct sub-categories distinguished by the type of creditor involved—contractual creditors and delictual creditors. When the creditor prevails in a Type One veil piercing case, the court renders the limited liability aspect of the corporate form ineffective to shield a shareholder from personal liability.

The "Type Two" category results where a shareholder utilizes a corporation to perform indirectly acts which the shareholder could not legally perform as an individual.<sup>5</sup> Whereas the end result of Type One

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2. La. R.S. 12:93B (1969). Although the statutory rule appears to absolutely preclude shareholder liability for corporate obligations, the Louisiana jurisprudence has not interpreted the statute in this manner. If the statutory rule were absolute, there could be no veil piercing.

3. *Glazer v. Commission on Ethics*, 431 So. 2d 752, 757 (La. 1983). For other discussions of Louisiana veil piercing cases, see Note, *Corporations—Shareholders Liability—Louisiana Adopts a Balancing Test for Piercing the Corporate Veil*, 58 Tul. L. Rev. 1089 (1984).

4. *Smith v. Cotton's Fleet Serv., Inc.*, 500 So. 2d 759 (La. 1987); *LeBlanc v. Opt. Inc.*, 421 So. 2d 984 (La. App. 3d Cir. 1982), writ denied, 427 So. 2d 438 (La. 1983); *Coury v. Coury Moss, Inc.*, 510 So. 2d 1316 (La. App. 3d Cir. 1987); *Hall v. North East Ins. Co.*, 507 So. 2d 255 (La. App. 3d Cir. 1987).

5. See, e.g., *Glazer v. Commission on Ethics*, 431 So. 2d 752 (La. 1983). In this case, Glazer, a member of the State Mineral Board, utilized his wholly owned corporation to sell steel to the State of Louisiana. Louisiana conflict of interest law specifically prohibited Glazer from selling steel to the state in his individual capacity.

The court disregarded the corporate entity and treated the corporate sales as if they were transacted by Glazer personally. The court held that the privilege of separate corporate identity may not be asserted when doing so does not promote the public policies supporting a separate entity and when doing so overrides other significant public interests. *Id.* at 754.

See also *Robertson v. Louisiana Pub. Serv. Comm'n*, 349 So. 2d 1262 (La. 1977) (attempt to circumvent common carrier requirements); *American Courier Corp. v. Louisiana Pub. Serv. Comm'n*, 256 La. 464, 236 So. 2d 802 (1970) (attempt to circumvent common carrier requirements); *In re Sea Shell, Inc.*, 509 So. 2d 90 (La. App. 1st Cir. 1987) (attempt to circumvent conflict of interest for public officials requirements).

piercing is to hold shareholders individually liable for the obligations of the corporation, the end result of Type Two piercing is to prevent a shareholder's use of a corporate intermediary to circumvent legal or regulatory restrictions on his own behavior.<sup>6</sup>

This paper focuses upon Type One cases. Type One cases involve a struggle between two important policy concerns—equitable considerations in favor of compensating the obligee of a corporate obligation versus the legislatively established policy of affording corporate shareholders limited liability.<sup>7</sup> The merits of a corporation's limited liability status have received judicial recognition. For example, in *Glazer v. Commission on Ethics*<sup>8</sup> the court stated, "The purpose of the insulation and limited liability of shareholders is to promote commerce and industrial growth by encouraging them to make capital contributions to corporations without subjecting all of their personal wealth to the risks of business."<sup>9</sup> Since the legislature has recognized the importance of limited liability in the promotion of commerce, the Louisiana courts have held that disregard of the corporate entity is appropriate only in very exceptional circumstances.<sup>10</sup>

#### VEIL PIERCING ABSENT FRAUD OR DECEIT

##### *Tests for Veil Piercing Absent Fraud or Deceit*

*Kingsman Enterprises, Inc. v. Bakerfield Electric Company*<sup>11</sup> is the seminal case for the proposition that veil piercing may occur absent any fraud or deceit practiced by shareholders.<sup>12</sup> The *Kingsman* court artic-

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6. See supra note 5.

7. La. Civ. Code arts. 435, 437.

8. 431 So. 2d 752 (La. 1983). For a discussion of *Glazer* see supra note 5.

9. Id. at 757.

10. *Johnson v. Kinchen*, 160 So. 2d 296 (La. App. 1st Cir. 1964).

11. 339 So. 2d 1280 (La. App. 1st Cir. 1976).

12. This language is also cited in *Coury v. Coury Moss, Inc.*, 510 So. 2d 1316 (La. App. 3d Cir. 1987); *G.I.'s Club, Inc. v. American Legion Post #374*, 504 So. 2d 967 (La. App. 1st Cir. 1987); *Sutton's Steel & Supply, Inc. v. Van Stavern*, 496 So. 2d 1360 (La. App. 3d Cir.), writ denied, 498 So. 2d 757 (1986); *West Bldg. Materials, Inc. v. Daley*, 476 So. 2d 554 (La. App. 3d Cir. 1985); *Harris v. Best of American, Inc.*, 466 So. 2d 1309 (La. App. 1st Cir.), writ denied, 470 So. 2d 121 (1985); *Holley v. Palermo*, 461 So. 2d 539 (La. App. 3d Cir. 1984); *Cahn Elec. Appliance Co. v. Harper*, 430 So. 2d 143 (La. App. 2d Cir. 1983); *American Bank v. Smith Aviation, Inc.*, 433 So. 2d 750 (La. App. 3d Cir. 1983); *LeBlanc v. Opt. Inc.*, 421 So. 2d 984 (La. App. 3d Cir. 1982), writ denied, 477 So. 2d 438 (1983); *Abraham v. Lake Forest, Inc.*, 377 So. 2d 465 (La. App. 4th Cir. 1979), writ denied, 380 So. 2d 99 (1980); *Donald M. Clement, Inc. v. Demon, Inc.*, 364 So. 2d 204 (La. App. 4th Cir. 1978); *Smith-Hearron v. Frazier*, 352 So. 2d 263 (La. App. 2d Cir. 1977), writ denied, 353 So. 2d 1337 (1978).

ulated the factors necessary to pierce the veil absent fraud or deceit even though the court ultimately found that these factors were not present.<sup>13</sup> First, the court stated that a basis for piercing the corporate veil in addition to the situation in which fraud or deceit is practiced is "the failure to conduct business on a corporate footing;"<sup>14</sup> a failing which results in a corporation becoming indistinguishable from its shareholders.<sup>15</sup>

Next, *Kingsman* cited the following passage from *Keller v. Haas*:<sup>16</sup>

It is well settled that where an individual forms a corporation of which he is the sole and only stockholder or owns such control of the stock that the act of the corporation is his own, then he may not use the screen of corporate entity to absolve himself of responsibility.<sup>17</sup>

The *Kingsman* opinion then listed circumstances which, absent fraud or deceit, might justify piercing the corporate veil. The list included: (1) commingling of corporate and shareholder funds, (2) failure to follow statutory formalities required for incorporation and for the transaction of corporate affairs, (3) undercapitalization, (4) failure to provide separate bank accounts and bookkeeping records, and (5) failure to hold regular shareholders or directors meetings.<sup>18</sup> The court also adopted a "totality of circumstances" test which required analyzing the existence of all of these factors together as a part of the total circumstances of each individual case.<sup>19</sup> Interestingly, these tests for "piercing" absent fraud or deceit are virtually identical to those tests used when fraud or deceit is present.<sup>20</sup> The difference seems to be one of degree. The court

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13. 339 So. 2d at 1282-83.

14. *Id.* at 1282.

15. As authority, the court cited *Gordon v. Baton Rouge Stores Co.*, 168 La. 248, 121 So. 759 (1929) and *Brown v. Benton Creosoting Co.*, 147 So. 2d 89 (La. App. 2d Cir. 1962). In *Gordon*, the corporate shareholder's claim against that corporation was rejected because the shareholder "treated the business of the corporation as his individual business." 168 La. at 249, 121 So. at 760. The facts indicated commingling of funds and complete control by the shareholder.

*Brown* held that the defendant, Benton Creosoting Co., was the alter ego of Kennedy Sawmills, Inc. The stock of Benton Creosoting was pledged to Kennedy Sawmills to secure a note made by Benton Creosoting, payable to Kennedy Sawmills. The court stressed the fact that Kennedy Sawmills completely controlled Benton Creosoting and that the shareholders of Benton Creosoting themselves considered that they had abandoned their interest to the company. The company was unable to service its debt to Kennedy Sawmills. 147 So. 2d at 93.

16. 202 La. 486, 12 So. 2d 238 (1943).

17. *Id.* at 488, 12 So. 2d at 240.

18. 339 So. 2d 1282 n.1.

19. *Id.* at 1283.

20. See *Abraham v. Lake Forest, Inc.*, 377 So. 2d 465, 468 (La. App. 4th Cir. 1979).

held that "[w]hen fraud or deceit is absent, other circumstances must be so strong as to clearly indicate that the corporation and shareholder operated as one."<sup>21</sup>

Although the Louisiana Supreme Court has not explicitly adopted the dictum in the *Kingsman* line of cases,<sup>22</sup> it has used similar language. In *Glazer v. Commission on Ethics*,<sup>23</sup> the Louisiana Supreme Court stated that

the strong social interest in encouraging capital investment would require that the separate identity be respected absent conduct on the part of the shareholders constituting waiver of the privilege of insulation, such as their own disregard of the corporate form, or their use of the corporate form to perpetrate fraud.<sup>24</sup>

This language appears to indicate that fraud is merely one of the grounds that might justify veil piercing and that the corporate entity could be disregarded even without fraud if the shareholders themselves disregarded its separate entity status.

The Louisiana Supreme Court cited two cases as authority for this position:<sup>25</sup> *Union Local 1476 of Amalgamated Meatcutters v. Union Citizens Club*<sup>26</sup> and *Smith-Hearron v. Frazier, Inc.*<sup>27</sup> These cases both refer to the *Kingsman* case.<sup>28</sup> *Union Local 1476* cited *Kingsman* for the proposition that the corporate veil may be pierced when shareholders fail to conduct a corporation on a separate footing.<sup>29</sup> *Smith-Hearron* cited the *Kingsman* language allowing veil piercing absent fraud or deceit.<sup>30</sup>

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21. *Kingsman*, 339 So. 2d at 1284 (emphasis added).

22. The Louisiana Supreme Court has not reviewed an opinion citing the *Kingsman* dictum. Justice Lemmon stated the following, however, in a concurrence to denying a writ of certiorari in *LeBlanc v. Opt. Inc.*, 427 So. 2d 438 (La. 1983):

Although the lower court's conclusion that the corporate veil should be pierced is extremely doubtful from the facts contained in the court of appeal opinion . . . relator admits that Opt. Inc. has substantial assets in excess of the amount awarded LeBlanc. Therefore, any inquiry into Friedberg's liability in this suspensive appeal would be purely academic.

*Id.* at 439.

23. 431 So. 2d 752 (La. 1983).

24. *Id.* at 757; see also *Smith v. Cotton's Fleet Serv., Inc.*, 500 So. 2d 759, 762 (La. 1987).

25. *Glazer*, 431 So. 2d at 757.

26. 408 So. 2d 371 (La. App. 1st Cir. 1981).

27. 352 So. 2d 263 (La. App. 2d Cir. 1977), writ denied, 353 So. 2d 1337 (1978).

28. *Union Local 1476*, 408 So. 2d at 373; *Smith-Hearron*, 352 So. 2d at 265.

29. 408 So. 2d at 373.

30. 352 So. 2d at 265. In addition, the *Smith-Hearron* case cited two other cases also relied upon in *Kingsman*: *Keller v. Haas*, 202 La. 486, 12 So. 2d 238 (1943) and *Brown v. Benton Creosoting Co.*, 147 So. 2d 89 (La. App. 2d Cir. 1962).

*Application of Veil Piercing Absent Fraud or Deceit*

Despite the frequency with which the "no fraud or deceit" language is recited in the jurisprudence, it is rarely applied. *Hebert v. Wiegand*<sup>31</sup> is one of the few examples in which a Louisiana court arguably has pierced the corporate veil despite an absence of fraud or deceit. The defendant corporation sold property it owned to the plaintiffs. The parties never recorded the sale. Notwithstanding this agreement, the corporation subsequently sold the property to another party. The defendant (shareholder and president) explained that he had entered into the subsequent sale because he was fearful that a creditor might seize the property while it was in his hands. Moreover, the defendant had stated that the subsequent buyer agreed to transfer the property to the plaintiff when the plaintiff paid the balance due on the sale.

The fourth circuit evidently agreed with the district court's finding that the defendant did not intend to defraud the plaintiff.<sup>32</sup> Nevertheless, the court allowed the corporate veil to be pierced.<sup>33</sup> In reaching its conclusion, the court cited the following facts: (1) the fact that defendant owned 98% of the corporation, (2) the lack of corporate records, board meetings, and shareholders meetings, (3) the lack of minutes except where necessary to approve an action by defendant, (4) the commingling of personal and corporate funds, and (5) the defendant's exercise of absolute control over corporate affairs.<sup>34</sup>

The court said that "[e]very act purportedly to have been done by or in the name of the corporation was entirely dictated and controlled by, and was in fact the act of, [the defendant] personally. Thus, he cannot find refuge behind the corporate shield to escape his personal liability . . . ."<sup>35</sup> The court cited numerous Louisiana cases in support of its holding.<sup>36</sup> Although this case was decided before *Kingsman*, the

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31. 207 So. 2d 882 (La. App. 4th Cir. 1968).

32. *Id.* at 886. The court stated: "We think Mr. Wiegand was fully aware of his (or his corporation's) obligation to [plaintiff] and that he probably entertained the hope that he could, when the time came, in some manner obtain a transfer of lot 160 to [plaintiff] or his assignee." *Id.* at 887.

33. *Id.* at 886. The court stated: "We are convinced, however, even absent any fraudulent intent, the judgment dismissing [plaintiff's] suit against Wiegand individually was in error."

34. *Id.* at 887.

35. *Id.*

36. The following cases were cited as authority: *Keller v. Haas*, 202 La. 486, 12 So. 2d 238 (1943); *Shreveport Sash & Door Co. v. Ray*, 159 So. 2d 434 (La. App. 2d Cir. 1963); *Brown v. Benton Creosoting Co.*, 147 So. 2d 89 (La. App. 2d Cir. 1962); *Jackson v. Kirschman*, 173 So. 562 (La. App. Or. 1937), *aff'd* on rehearing without discussion of this issue, 175 So. 105 (La. App. Or. 1937); *Lindstrom v. Sauer*, 166 So. 636 (La. App. Or. 1936); *Mayo v. Pioneer Bank & Trust Co.*, 274 F.2d 320 (5th Cir.), *cert. denied*, 362 U.S. 962, 80 S. Ct. 878 (1960).

fourth circuit relied on many of the same sources in arriving at its holding.<sup>37</sup>

Another case in which the court arguably<sup>38</sup> allowed veil piercing absent fraud or deceit is *LeBlanc v. Opt Inc.*<sup>39</sup> In this case, defendant corporation had employed LeBlanc for three years. The defendant's sole shareholder, Friedberg, had represented to LeBlanc that the corporation would give LeBlanc a commission on sales of corporate property. LeBlanc immediately began readying the property for commercial sale on behalf of the corporation. However, despite entering into an oral employment contract with the defendant corporation, LeBlanc had not secured a written contract. Three years later, Friedberg decided to discontinue the project and terminated LeBlanc's employment "without proper compensation for his services."<sup>40</sup>

The trial court awarded LeBlanc compensation, under *quantum meruit*, for his services to the defendant corporation. The trial court also allowed veil piercing in order to hold Friedberg individually liable for the obligation. The court cited the following factors in support of veil piercing: (1) commingling of funds, (2) no annual meeting of board of directors, (3) lack of minutes of shareholders meetings, and (4) Friedberg's domination of defendant corporation's affairs.<sup>41</sup>

The third circuit affirmed the trial court's decision, stating that "such representations and dealings, such as here, almost amount to an attempt to defraud. . . . [I]n order to prevent such an injustice, we find that the trial court properly disregarded the corporate veil and held Friedberg personally liable."<sup>42</sup> It is unclear how the court was affected by its finding that Friedberg's actions "almost amount to an attempt to defraud."<sup>43</sup>

*Hebert* and *LeBlanc* both involved contractual claims. There are other cases involving delictual claims in which the courts have pierced the corporate veil without a finding that shareholders perpetrated fraud or deceit upon third parties.<sup>44</sup> For example, the court made no specific finding that shareholders perpetrated fraud in *Giuffria v. Red River*

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37. Compare supra note 36 with supra note 15.

38. See infra note 43 and accompanying text.

39. 421 So. 2d 984 (La. App. 3d Cir. 1982), writ denied, 427 So. 2d 438 (1983).

40. *LeBlanc*, 421 So. 2d at 989.

41. *Id.* at 986-89.

42. *Id.* at 989.

43. *Id.*

44. *Giuffria v. Red River Barge Lines, Inc.*, 452 So. 2d 793 (La. App. 4th Cir.), writ denied, 458 So. 2d 118 (1984); *Ogaard v. Wiley*, 325 So. 2d 642 (La. App. 3d Cir. 1975).



*Barge Lines, Inc.*<sup>45</sup> In this case, a truck driven by Red River's employee collided with plaintiff's automobile. At trial, the jury awarded plaintiff damages for injuries arising out of the employee's negligence and found that the corporate veil should be pierced to allow the plaintiff to recover against Red River's parent corporation, Elevating Boats, Inc. Elevating Boats owned seventy-two percent of Red River. On appeal, the fourth circuit affirmed the judgment.<sup>46</sup>

The delictual cases, however, are easily explained. Whether or not the shareholders practiced fraud or deceit is generally irrelevant in tort cases.<sup>47</sup> In other words, shareholders have not defrauded tort victims or fraudulently induced them to transact business with the corporation. Fraud is a vice of consent.<sup>48</sup> Since the claims of many delictual creditors, such as accident victims, will not have arisen out of consensual dealings with the corporation, fraud will often be irrelevant in these cases.<sup>49</sup>

#### *Weaknesses of Courts' Tests for Veil Piercing Absent Fraud or Deceit*

The tests for veil piercing absent fraud or deceit, as articulated in *Kingsman* and its progeny, center around two basic themes: dominance by a single shareholder and indistinguishability between the corporation and its shareholders.<sup>50</sup> One major weakness of the current tests is that they are extremely vague and are applicable to almost any closely held corporation. Another weakness is that meeting or failing these tests has little causal relationship with a claimant's inability to collect his debt out of corporate assets. Furthermore, the tests do not distinguish between tort and contract creditors. The causal relationships and policy considerations are very different in tort and contract creditor situations. Finally,

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45. 452 So. 2d 793 (La. App. 4th Cir.), writ denied, 458 So. 2d 118 (1984).

46. The court cited a list of factors indicating that the parent corporation exercised complete control over the subsidiary, that the subsidiary failed to follow certain statutory formalities, and that the parent corporation had loaned over \$200,000 to the subsidiary. *Id.* at 795.

47. See Downs, *Piercing the Corporate Veil—Do Corporations Provide Limited Personal Liability?*, 53 U.M.K.C. L. Rev. 174, 181 (1985).

48. La. Civ. Code art. 1948.

49. There may, however, be some situations in which the above discussion is inapplicable. For example, a corporation may commit a tort which arises out of a contractual relationship between a corporation and tort victim. In such a situation, the victim has an opportunity to examine his debtor. The victim could, perhaps, make inquiries concerning the corporation's assets or insurance coverage which are available to meet tort claims. Such facts might dictate a showing of fraud or wrongdoing before allowing veil piercing, depending upon the nature of the transaction and the type of creditor involved.

50. *Kingsman Enters., Inc. v. Bakerfield Elec. Co.*, 339 So. 2d 1280, 1282 (La. App. 1st Cir. 1976).

the courts have never adequately addressed a very important causal factor in a corporation's inability to meet its obligations—undercapitalization.

*Complete Control Exercised by a Single Shareholder*

The *Kingsman* case relied upon several older cases in allowing veil piercing absent fraud or deceit.<sup>51</sup> Each cited case deals with a situation where one shareholder exercises complete control over the corporation. In these cases, the courts place great weight on the fact that the corporations are being used by one person to transact his personal business. Additionally, all of these cases either antedate the 1968 revision of the corporate statutes now in effect, or they rely upon cases decided before 1968.<sup>52</sup> Arguably, these cases are no longer applicable after the 1968 revisions of Louisiana Revised Statutes 12:21 and 12:82.

The 1968 revision of Louisiana Revised Statutes 12:21 reduced the number of required incorporators from three to one. Louisiana Revised Statutes 12:81 allowed a corporation with fewer than three shareholders to have fewer than three members on its board of directors. The adoption of the 1968 revisions reveals a legislative recognition and approval of situations in which one person utilizes a corporation to transact business. Thus, unlike the pre-1968 statutes, the current legislation clearly permits corporations owned and controlled by a single shareholder.<sup>53</sup> Furthermore, the courts have stated that one-man corporations are permissible.<sup>54</sup>

Courts are troubled by a sole shareholder's use of a corporation merely as his own personal instrumentality. This "mere instrumentality" notion is largely an issue of control.<sup>55</sup> The courts have set forth the

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51. *Keller v. Haas*, 202 La. 486, 12 So. 2d 238 (1943); *Gordon v. Baton Rouge Stores Co.*, 168 La. 248, 121 So. 759 (1929); *Brown v. Benton Creosoting Co.*, 147 So. 2d 89 (La. App. 2d Cir. 1962).

52. All of these cases were heard by the courts before 1968 except *Hebert v. Wiegand*, 207 So. 2d 882 (La. App. 4th Cir. 1968) and *Texas Indus., Inc. v. Dupuy and Dupuy Developers, Inc.*, 227 So. 2d 265 (La. App. 2d Cir. 1969). These two cases, however, rely upon cases decided before 1968 for authority.

53. The portions of the Louisiana Revised Statutes which provide that only one incorporator or director is necessary are also found in the Model Business Corporation Act [hereinafter M.B.C.A.]. The comments to section 6 of the M.B.C.A. read as follows: "Prior to 1969, the Model Act required a minimum of three directors. Section 36 now removes the minimum requirement. It was deemed wise to recognize in the statute the growing practice of one-man management in close corporations."

54. *Harris v. Best of America, Inc.*, 466 So. 2d 1309, 1316 (La. App. 1st Cir.), writ denied, 470 So. 2d 121 (1985); *Cahn Elec. Appliance Co. v. Harper*, 430 So. 2d 143, 144 (La. App. 2d Cir. 1983); *Abraham v. Lake Forest, Inc.*, 377 So. 2d 465, 468 (La. App. 4th Cir. 1979).

55. See H. Henn and J. Alexander, *Laws of Corporations* § 147 (3d ed. 1983).

"mere instrumentality" exception to corporate protection because they believe that the corporation is being controlled by a shareholder for personal use to such an extent that the identity of the corporation is inseparable from the identity of the shareholder. Thus, the shareholder is no longer entitled to separate corporate entity status to protect himself if corporate debts should exceed corporate assets.<sup>56</sup>

This test is troublesome because it is difficult to determine when a closely held corporation is not, in a legal sense, being managed as the "mere instrumentality" of its shareholders. The language of many of the veil piercing cases seems to condemn the use of corporations merely to conduct the personal business of their dominant shareholders.<sup>57</sup> But in the ordinary situation, this is precisely what happens when shareholders incorporate their businesses. In the shareholders' minds, the function of the corporation is to serve and benefit its owners. Thus, they will cause it to act accordingly. It certainly seems nonsensical to suggest that shareholders should occasionally cause their corporations to act contrary to their interests so that the company will not be seen as their "instrumentality."

Besides the breadth and vagueness of the instrumentality test, it also suffers from the lack of any policy justification. Courts rarely discuss the causal connection between the harm to a third party and the exercise of complete control of a corporation by a dominant shareholder. The complete control of the corporation by a dominant shareholder does not, in and of itself, render a corporation unable to meet its obligations to third parties. However, according to at least one author, what troubles the court about the "instrumentality" situation is that it indicates that fraud or deceit by the shareholders is likely to have occurred.<sup>58</sup> In fact, the first circuit, in examining the circumstances in which a shareholder may be held liable for corporate obligations, stated that "the failure of a shareholder to adequately separate the corporation's identity from his own because of various factors *may lead to fraud or deceit.*"<sup>59</sup> However,

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56. *Id.*

57. See, e.g., *Gordon v. Baton Rouge Stores, Co.*, 168 La. 248, 121 So. 759 (1929).

58. Clark, *The Duties of the Corporate Debtor to Its Creditors*, 90 Harv. L. Rev. 505 (1977). The author states:

[T]hese indicia [that the corporation is the mere instrumentality of a shareholder] do at least *suggest* that fraudulent transfers may have taken place, or that creditors justifiably relied on the creditworthiness of the dominant stockholder or an affiliated corporation, and when sufficiently suffused with intimations and evidence of some actual self-dealing, may create the appearance of a justification for going beyond the limits imposed by doctrine which would require atomistic analysis and a precise remedy.

*Id.* at 553.

59. *Kingsman Enters., Inc. v. Bakerfield Elec. Co.*, 339 So. 2d 1280, 1283 (La. App. 1st Cir. 1976) (emphasis added).

if that is so, then it is the failure to maintain good books and records that should be examined, and not the simple exercise of control. The instrumentality metaphor only obscures the true issues.<sup>60</sup>

### *Inability to Distinguish Between Corporation and Shareholders*

*Kingsman* held that the corporate entity may be disregarded when the corporation is indistinguishable from its shareholders.<sup>61</sup> The courts, however, have never specifically outlined what renders a corporation and its shareholders indistinguishable. In fact, a thoughtful analysis of this proposition leads to the conclusion that it is an absurdity where the shareholder is an individual. The notion of an individual being indistinguishable from the corporation he owns is perplexing at best. Presumably, the courts are describing a situation in which the corporate patrimony and shareholder patrimony are not distinguishable.

The cases cited as authority for veil piercing when a corporation is indistinguishable from its shareholders again refer to a single shareholder's complete control over a corporation.<sup>62</sup> In none of the cited cases is it literally impossible to distinguish between the corporation and its shareholders. Even in *Benton v. Benton Creosoting Co.*,<sup>63</sup> where the same officers and directors managed the two corporations involved, the facts do not truly show that one corporation could not be distinguished from the other.<sup>64</sup>

While it is conceivable that a true inability to determine where the corporation "ends" and the shareholder "begins" might actually arise, it seems highly unlikely that this could happen without some deception practiced by shareholders. Nevertheless, the courts seem more concerned with shareholders' compliance with formal rules than with protecting creditors against deception. Thus, without connecting the formal rules to any particular purposes or functions, the courts seem to be saying, "If you don't act like a corporation, then you will not be treated as one."<sup>65</sup>

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60. A situation where the "mere instrumentality" theory may be useful is where a corporation is created to do what the shareholder could not lawfully do. A primary example of this type of piercing is found in *Glazer v. Commission on Ethics*, 431 So. 2d 752 (La. 1983), discussed supra in note 5. In this type of case, veil piercing takes place due to the shareholder's conduct of business within a corporate entity which he could not lawfully conduct personally. Thus, the shareholder's exercise of control over the corporation is directly relevant. Moreover, control by the shareholder causes a violation of the public policy interests served by lawmakers' rendering the shareholders' conduct unlawful.

61. See supra note 14 and accompanying text.

62. *Id.*

63. 147 So. 2d 89 (La. App. 2d Cir. 1962).

64. See supra note 14.

65. See *Downs*, supra note 47, at 177.

On the other hand, the courts may believe shareholders who allow a corporation to become indistinguishable from themselves are committing a wrong which is itself a type of fraud. The effect of this is to create a less exacting standard for the proof of fraud. One writer suggests that courts do not require a precise showing of fraud in these cases because this showing would be extremely difficult and very costly for plaintiffs.<sup>66</sup> While the wisdom of any particular standard of proof might be debatable, at least this is the type of policy-oriented rationale that could provide the guidance needed in this area of the law.

There is some support for this theory in the cases. When discussing indistinguishability, courts frequently refer to commingling of corporate and shareholder funds.<sup>67</sup> This was a factor considered in *Kingsman*.<sup>68</sup> The courts may say that commingling of shareholder and corporate funds is evidence of the shareholder's "lack of regard" for the separate entity status, but commingling suggests more than mere disrespect. It contributes directly to the plaintiff's inability to collect his claim from the corporation and, as a result, may justify veil piercing.

A shareholder's payment of personal expenses out of corporate funds is also discussed in some cases. This feature is closely related to commingling of assets. While objectionable to some, it may not be a particularly useful test for veil piercing if actual commingling does not occur. Although the payment of personal expenses from corporate funds might render a corporation insolvent, the shareholder may simply circumvent this problem by declaring dividends and paying his expenses with those dividends.

Indeed, the payment of personal expenses could easily be deemed a constructive dividend by the courts if the payments are not related to services that the shareholder performs for the corporation.<sup>69</sup> Moreover, if the courts can classify such payments as dividends, Louisiana Revised Statutes 12:63 offers a remedy to corporate creditors. This statute provides that a dividend may not be paid which will render the corporation insolvent. Furthermore, Louisiana Revised Statutes 12:93 provides that

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66. See Clark, *supra* note 58, at 543.

67. *Coury v. Coury Moss, Inc.*, 510 So. 2d 1316, 1318 (La. App. 3d Cir. 1987); *G.I.'s Club, Inc. v. American Legion Post #374*, 504 So. 2d 967, 968 (La. App. 1st Cir. 1987); *G.R.W. Eng'rs, Inc. v. Elam*, 504 So. 2d 117, 120 (La. App. 2d Cir. 1987); *Sutton's Steel & Supply, Inc. v. Van Stavern*, 496 So. 2d 1360, 1364 (La. App. 3d Cir. 1986); *West Bldg. Materials, Inc. v. Daley*, 476 So. 2d 554, 557 (La. App. 3d Cir. 1985).

68. *Kingsman Enters., Inc. v. Bakerfield Elec. Co.*, 339 So. 2d 1280, 1282 (La. App. 1st Cir. 1976).

69. See, e.g., *Paramount-Richards Theatres v. Commissioner*, 143 F.2d 602 (5th Cir. 1946), where the court classified as dividends for tax purposes payments made by a corporation even though the formal requirements of a dividend distribution were not followed.

a shareholder receiving an unlawful dividend is personally liable for corporate obligations to the extent of the unlawful dividend.

Since shareholders can easily circumvent the payment of personal expenses out of a corporate account by declaring dividends, the soundness of using the payment of these expenses out of corporate funds as a factor in veil piercing analysis is questionable. Courts may be troubled that shareholders can transform elements of the corporate patrimony into elements of their own patrimony so readily. However, the statutes allowing a corporation to have a single shareholder and a one-member board of directors render board approval of dividends an empty formality. A single member of a one-member board can lawfully transform the corporate assets into his own assets at will by having a board meeting and declaring a dividend as long as he does not render the corporation insolvent. Nevertheless, the legislature explicitly recognized one-member boards of directors when it revised the corporation statutes. As a result, the courts' concerns are at odds with the legislation.

This is not so in the case of commingling. It is never authorized by statute, and may sometimes become so egregious that it amounts to "fraud."<sup>70</sup> A shareholder might commingle corporate and shareholder funds to such an extent that it becomes impossible to tell where the corporation's patrimony "ends" and the shareholder's patrimony "begins." In this situation, it also becomes almost impossible for a creditor to trace the corporate transactions to determine whether or not a corporation has paid an illegal dividend or made a fraudulent transfer. In such a situation, courts might be justified in piercing the corporate veil since a creditor has been placed in such a difficult situation. Commingling of this nature, however, is very exceptional and involves more than a shareholder simply withdrawing funds from the corporation.

Another aspect of indistinguishability is the failure to follow statutory formalities.<sup>71</sup> In *Kingsman*, the court states that facts indicating a corporation's failure to conduct board or shareholders meetings, keep minutes of these meetings, and keep separate accounting records are all relevant in a veil piercing analysis absent fraud or deceit.<sup>72</sup> *Kingsman*, however, offers no guidance concerning the importance of this failure

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70. See *supra* note 67.

71. See *Robertson Tank Lines, Inc. v. Louisiana Pub. Serv. Comm'n*, 349 So. 2d 1262 (La. 1977); *Coury v. Coury Moss, Inc.*, 510 So. 2d 1316 (La. App. 3d Cir. 1987); *G.I.'s Club, Inc. v. American Legion Post #374*, 504 So. 2d 967 (La. App. 1st Cir. 1987); *G.R.W. Eng'rs, Inc. v. Elam*, 504 So. 2d 117 (La. App. 2d Cir. 1987); *Sutton's Steel & Supply, Inc. v. Van Stavern*, 496 So. 2d 1360 (La. App. 3d Cir. 1986); *West Bldg. Materials, Inc. v. Daley*, 476 So. 2d 554 (La. App. 3d Cir. 1985).

72. 339 So. 2d at 1282-83.

to follow statutory guidelines or why this failure is important to veil piercing analysis.

The courts' discussions of the failure to follow statutory formalities invariably omit any mention of the relationship between the failure to follow the formality and the inability of the corporation to meet an obligation to a creditor.<sup>73</sup> Furthermore, it is very difficult to imagine a circumstance where the failure to follow these formalities would have any effect (adverse or favorable) upon the corporation's ability to pay creditors. Failure to conduct board or shareholders' meetings is generally of no consequence to a corporate creditor, yet courts often consider these failures in their veil piercing analyses.<sup>74</sup>

These corporate formalities regulate the process by which the corporation makes decisions through its management. In other words, these formalities regulate "how" corporations must conduct their affairs. Rarely is the "how" aspect important to a corporate creditor. The creditor is simply interested in the end result of a transaction.

Some may argue, however, that there is a strong public policy demanding that corporations comply with these formalities. They may further argue that the threat of the shareholders' loss of limited liability will encourage corporate officers and shareholders to comply with the statutory requirements. Indeed, the legislature must have thought that these policy considerations were very important since the formalities have been enacted into law.

However, the courts do not require absolute compliance with the statutory requirements in order to preserve shareholders' limited liability. The Louisiana courts have previously adopted the "*de facto*" corporation<sup>75</sup> and corporation by estoppel<sup>76</sup> doctrines. The *de facto* doctrine affords corporate protection to shareholders notwithstanding a defect in incorporation.<sup>77</sup> The corporation by estoppel doctrine "estops" owners of

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73. See Downs, *supra* note 47, at 177.

74. See cases cited *supra* note 71.

75. See *Weil v. Leopold Weil Bldg. & Improvement Co.*, 126 La. 938, 53 So. 56 (1910); *Mt. Olive Bank v. Jackson Air Taxi, Inc.*, 356 So. 2d 1090 (La. App. 2d Cir.), writ denied, 359 So. 2d 207 (1978); J. Holliday & R. Norman, *Louisiana Corporations* § 2:3 (1987). Also, the official comments to La. R.S. 12:26 (1969) expressly permit the full application of the *de facto* doctrine.

76. See *American Homestead Co. v. Linigan*, 46 La. Ann. 1118, 1123, 15 So. 369, 371 (1893); *Latiolais v. Citizen's Bank*, 33 La. Ann. 1444, 1449 (1881); *North American Contracting Corp. v. Gibson*, 327 So. 2d 444, 451 (La. App. 3d Cir. 1975), writ denied, 332 So. 2d 280 (1976); Comment, *De Facto Incorporation and Estoppel to Deny Corporate Existence in Louisiana*, 37 La. L. Rev. 1121, 1131-37, 1142-52 (1977). Also, the official comments to La. R.S. 12:26 (1969) expressly permit the full application of the corporation by estoppel doctrine.

77. See Comment, *supra* note 76, at 1121-22.

unincorporated associations from denying the existence of the corporation against creditors. Traditionally, this doctrine is applied only in situations where the association is "held out" as a corporation by its owners.<sup>78</sup> The courts' adoption of these doctrines illustrates that following statutory formalities is not crucial to corporate protection. Indeed, a defective incorporation may have even greater adverse effects upon third party creditors than the failure to hold shareholders' meetings since an important aspect of incorporation is to establish a corporate name which is not the same or deceptively similar to an existing corporation and to establish a public record of the corporate entity.<sup>79</sup>

#### *Lack of Distinction Between Tort and Contract Creditors*

Another deficiency of the courts' tests for shareholder liability absent fraud or deceit is that the tests do not distinguish between tort and contract creditors. Allowing veil piercing by tort creditors absent fraud or deceit seems logical since fraud and deceit usually are not relevant factors in these cases. Generally, the tort victim has not been defrauded by a shareholder.

Nevertheless, the tests articulated in *Kingsman* and by the Louisiana Supreme Court in *Glazer* appear to apply the same criteria to both tort and contract creditors. Courts in other jurisdictions have made distinctions between tort and contract creditors in veil piercing cases.<sup>80</sup> These courts require a showing of fraud in contract cases without requiring such a showing in tort cases.<sup>81</sup> This seems to be a more sensible approach to the problem where questions of consent are not involved.

#### *Undercapitalization*

Much of the jurisprudence lists undercapitalization as one factor to be considered in veil piercing analysis.<sup>82</sup> *Kingsman* lists this as one of

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78. *Id.* at 1123-24.

79. La. R.S. 12:23, 25 (1969).

80. *United States v. Jon-T Chems., Inc.*, 768 F.2d 686 (5th Cir. 1985), cert. denied, 475 U.S. 1014, 106 S. Ct. 1194 (1986) (applying Oklahoma law); *Edwards Co. v. Monogram Indus., Inc.*, 730 F.2d 977 (5th Cir. 1984) (applying Texas law); *Bucyrus-Erie Co. v. General Prods. Corp.*, 643 F.2d 413, 419 (6th Cir. 1981) (applying Ohio law); *Valley Fin., Inc. v. United States*, 629 F.2d 162, 172 (D.C. Cir. 1980), cert. denied sub nom., *Pacific Dev., Inc. v. United States*, 451 U.S. 1018, 101 S. Ct. 3007 (1981) (applying federal common law).

81. See *supra* note 80.

82. *G.I.'s Club, Inc. v. American Legion Post #374*, 504 So. 2d 967, 968 (La. App. 1st Cir. 1987); *G.R.W. Eng'rs v. Elam*, 504 So. 2d 117, 120 (La. App. 2d Cir. 1987); *West Bldg. Materials v. Daley*, 476 So. 2d 554, 557 (La. App. 3d Cir. 1985); *Entech Sys. Corp. v. Gaffney*, 466 So. 2d 788, 790 (La. App. 4th Cir. 1985); *Harris v. Best of*



several factors which, when viewed in the totality of circumstances, tends to justify veil piercing absent fraud or deceit.<sup>83</sup> This test presents an interesting paradox. A primary advantage of transacting business within a corporate entity is the feature of limited liability. However, this limited liability is immaterial to corporate creditors unless the corporation's assets are insufficient to meet its obligations. Since a corporation's capitalization is not at issue unless the corporation's assets are insufficient to meet its obligations, piercing the corporate veil due to undercapitalization negates one of the corporate form's most important advantages—the ability of a shareholder to invest in a business without risking all of his personal assets.<sup>84</sup>

Louisiana courts have given no guidance to determine when the courts will consider a corporation undercapitalized. The courts have not articulated the factors or tests used to determine what level of capitalization is required, what point in time the adequacy of capitalization is to be determined, or what reasons for undercapitalization might be acceptable. All of these are crucial considerations in determining whether veil piercing serves the equitable interests involved.

A corporation adequately capitalized at its inception which is failing due to normal market factors might be rendered insolvent by market forces without any intentional action or fault of the shareholders. Clearly, holding shareholders liable in this situation defeats the most important aspect of corporate protection. Most people form a corporation and invest in the business knowing that they are only at risk to the extent of their investment should the business fail. Not affording this basic element of corporate protection will almost certainly have adverse effects upon individuals' willingness to invest in business enterprises.

Another important feature of corporate veil piercing due to undercapitalization is an analysis of the type of creditor asserting the claim. Many jurisdictions have been more liberal toward tort creditors than to contract creditors.<sup>85</sup> Indeed, this seems equitable since most tort victims do not deal with the corporation on a consensual basis.

Consensual creditors, on the other hand, are in a better position to protect themselves from corporate insolvency by obtaining security or guarantees from the individual shareholders. In the ordinary credit trans-

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Am., Inc., 466 So. 2d 1309, 1315 (La. App. 1st Cir. 1985); *Holley v. Palermo*, 461 So. 2d 539, 542 (La. App. 3d Cir. 1984); *Giuffria v. Red River Barge Lines, Inc.*, 452 So. 2d 793, 795 (La. App. 4th Cir. 1984); *Kingsman Enters., Inc. v. Bakerfield Elec. Co.*, 339 So. 2d 1280, 1282 (La. App. 1st Cir. 1976).

83. *Kingsman Enters., Inc. v. Bakerfield Elec. Co.*, 339 So. 2d 1280, 1282 n.1 (La. App. 1st Cir. 1976).

84. *Smith v. Cotton's Fleet Serv., Inc.*, 500 So. 2d 759, 762 (La. 1987).

85. See *supra* cases cited note 80.

action, the creditor realizes that he is doing business with an entity separate and distinct from its shareholders and he either assumes and bargains for the risks involved or protects himself from those risks.

Another issue raised by the distinction between creditors is the extent of the duty to investigate and protect that the courts should impose on relatively unsophisticated consensual creditors. The policy reasons for requiring a commercial bank to investigate a corporation's credit before extending loans may not apply to a contract laborer who performs services for a corporation before being paid. Indeed, some commercial and trade creditors are more knowledgeable and better able to analyze and bargain for risks and protect themselves than others. The Louisiana courts generally have not drawn any such distinctions.

However, one court did utilize this sophisticated analysis in *Abraham v. Lake Forest, Inc.*<sup>86</sup> In this case, Abraham, a real estate developer, sold an option to purchase land to Lake Forest, Inc. for cash and a promissory note. Lake Forest thereafter became insolvent and was unable to meet its obligation under the note. Abraham filed suit against Lake Forest and attempted to pierce the corporate veil on the grounds that Lake Forest was undercapitalized from its inception and was merely a "business conduit."<sup>87</sup>

The court refused to disregard the corporate entity. Although the court agreed that the corporation was undercapitalized, it noted that the plaintiff himself had entered into similar transactions by utilizing "shell" corporations.<sup>88</sup> Since Abraham knew of this practice and was in a position to protect himself against it, the court found no inequity in maintaining the corporation's limited liability.<sup>89</sup>

The Abraham case presents an extreme situation involving a very sophisticated creditor.<sup>90</sup> The position of the Louisiana courts regarding the undercapitalization exception for veil piercing, however, is unclear when less sophisticated contractual creditors are involved.

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86. 377 So. 2d 465 (La. App. 4th Cir. 1979).

87. *Id.* at 467.

88. *Id.* at 469.

89. *Id.* The court stated:

When plaintiff took the note, he was obviously speculating on the success of the project itself and was not relying on the credit of the parent corporation. He was apparently satisfied to take the risk concerning the fact that he stood to make a relatively quick profit on the option that he had purchased just six months previously.

*Id.*

90. See *supra* note 89. Another factor the court may have considered in rendering its opinion is that Abraham made a profit of \$150,593.50 (\$172,117.50 cash received less purchase price of \$21,524) on the transaction before considering the amounts due on the dishonored note.

The basic policy inquiry to be made is who is to bear the risk of undercapitalization. The concept of limited liability itself suggests that someone other than the shareholders should bear the risk in some circumstances in which the corporation's liabilities exceed its assets and the corporation is unable to meet these liabilities. This concept stems from the fact that the spreading of risk through society in general is preferable in certain circumstances to promote economic growth.<sup>91</sup>

A careful analysis of the causal relationship between undercapitalization and harm to third parties reveals another inquiry—to what extent should the corporate veil be pierced? Presumably, the undercapitalization exception contemplates that a certain level of capital is necessary in some circumstances to recognize the corporate existence and afford limited liability to shareholders. As a result, the corporation should have at least a certain amount of assets available to satisfy creditors' claims. If the corporation has this requisite amount of assets, the concept of limited liability provides that the shareholders will not be liable for obligations in excess of the corporate assets in the normal situation.

An interesting problem would arise if a Louisiana court found that a corporation's appropriate level of capitalization is \$50,000, but the shareholders merely contributed \$10,000 to the corporation and had third party claims of \$100,000. In the traditional veil piercing analysis, the corporation's separate existence is disregarded, thus making the shareholders liable for all \$100,000 individually. Yet, the amount which the corporation is unable to pay because of undercapitalization is only \$40,000 (the difference between proper capitalization and the amount of capital actually contributed).<sup>92</sup> In this situation, the third party claimant realizes a windfall when the corporation is undercapitalized as opposed to when the corporation is properly capitalized.

The policy reasons for affording the claimant a windfall in this situation are unclear. Courts might wish to award such a windfall in order to encourage shareholders to properly capitalize their corporations. Nevertheless, the corporation's inability to pay its third party claimant is caused by undercapitalization only to the extent that the corporation's capital level is below the appropriate capitalization amount.

#### CONCLUSIONS

The jurisprudence allowing veil piercing absent fraud or deceit needs clarification so that corporate shareholders may better assess their exposure to personal liability. If the courts clarify the tests for veil piercing

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91. See *Smith v. Cotton's Fleet Serv., Inc.*, 500 So. 2d 759, 762 (La. 1987). See also R. Clark, *Corporate Law* § 1.2 p. 8 (1986).

92. See Clark, *supra* note 58, at 547-50.

absent fraud or deceit, these tests can also offer incentives to shareholders to conduct their businesses in a manner which would promote important policy considerations. The conclusion outlines tests which would promote these policies.

First, the courts' tests place too much emphasis on dominance of the corporation by shareholders. Shareholder dominance should not, in and of itself, justify veil piercing in Type One cases.<sup>93</sup> The emphasis placed upon shareholder dominance could be interpreted to render limited liability ineffective in many closely-held corporations.

Also, the courts should set a different standard for veil piercing by delictual creditors, whose claims did not arise out of consensual dealings, than for contractual creditors. As previously stated, fraud is irrelevant to a non-consensual creditor. The courts should look solely to undercapitalization and, perhaps, to commingling in most tort cases.

Furthermore, the courts should clarify the standards for veil piercing due to undercapitalization. This writer proposes that there are two situations which justify veil piercing due to undercapitalization. First is the situation in which a corporation is undercapitalized from its inception. The second is the situation in which a corporation is not undercapitalized at its inception but becomes undercapitalized due to the shareholders' withdrawal of corporate funds. The depletion of corporate assets due to normal market forces should not be a factor in veil piercing due to undercapitalization.

Courts should measure undercapitalization as the difference between corporate assets available to creditors and the amount of corporate assets which would be necessary to satisfy the claims which the corporation may reasonably expect to occur. This analysis would allow corporations to use either money, tangible assets, or insurance to satisfy capitalization requirements.

Utilizing these capitalization standards will serve two functions. First, tort creditors will have access to assets in proportion to the risks of harm posed by the corporation since sufficient capitalization is a function of expected claims. Second, corporations will have greater incentive to conduct their businesses more responsibly. These functions will help to insure that the allocation of risks involved is not simply a shifting of risks from irresponsible parties to uninvolved parties.

For contractual creditors, courts should require some type of fraud or other conduct tending to mislead the creditor about the corporation's ability to pay or other conduct tending, through commingling, to make collection of a corporate debt exceptionally difficult. The contractual

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93. See *supra* note 60.

creditor is in a position to protect himself before extending credit to corporations. Thus, the need to protect this type of creditor is somewhat lessened. As previously discussed, "fraud" as used in veil piercing cases is not common law fraud. As a result, courts can be flexible in setting standards for wrongdoing which give rise to veil piercing.

This writer suggests that these standards for wrongdoing should not be fixed. Rather, they should depend upon what type of creditor brings suit. The court should consider a particular creditor's knowledge and his ability to protect himself. In any event, the public policies in favor of shareholders' limited liability would suggest that it be more difficult for a consensual contract creditor to prevail in a veil piercing suit than a non-consensual tort victim.

Since veil piercing is an equitable remedy, courts cannot establish a "bright line" test.<sup>94</sup> Such a test would sometimes promote unscrupulous conduct. Nevertheless, this writer believes that the clarification of veil piercing jurisprudence by adoption of the aforementioned tests would allow the courts a great deal of latitude in dealing with piercing the corporate veil while balancing the feature of limited shareholder liability with the policy of allowing creditors to collect their debts.

*Kent Bickham Payne*

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94. Some authors seem to think that the courts are purposefully vague and that any analysis of veil piercing jurisprudence attempting to find standards is largely a waste of time. R. Clark, *supra* note 91, at 81; Downs, *supra* note 47, at 176. See also Gillespie, *The Thin Corporate Line: Loss of Limited Liability Protection*, 45 N.D.L. Rev. 363 (1969).