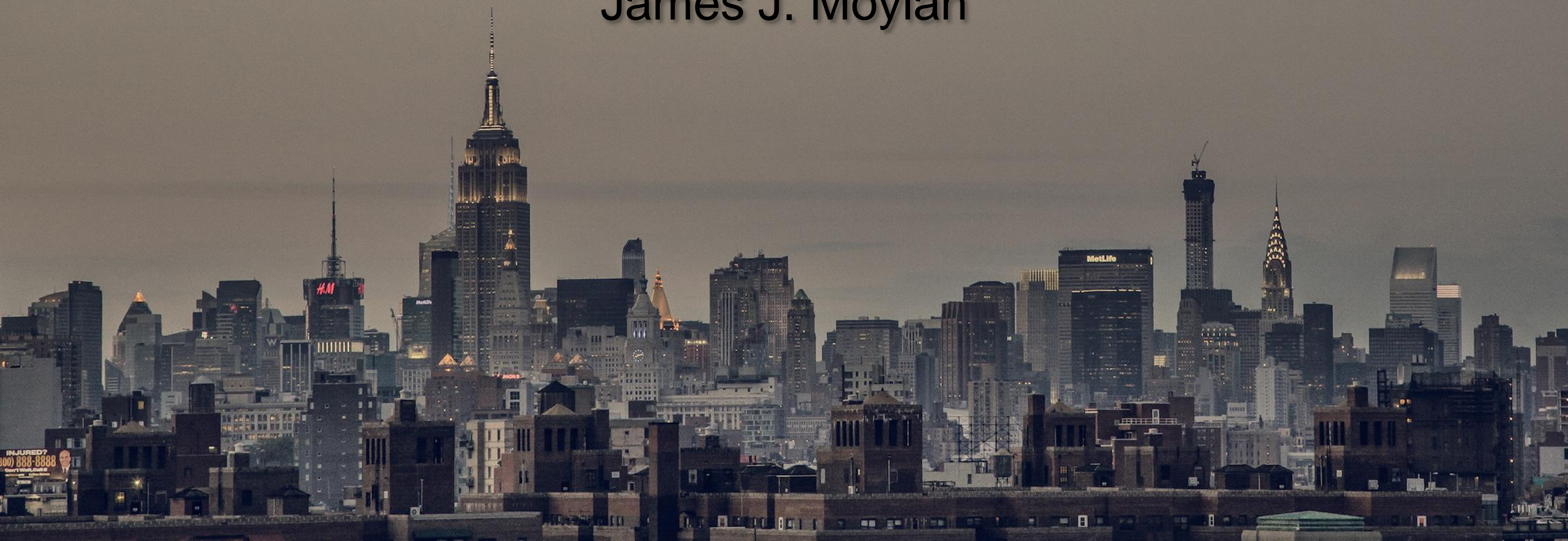


# Piercing the Corporate Veil and the Corporate Alter Ego Doctrine

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# WHEN IS A GOOD TIME TO TALK TO YOUR CLIENT ABOUT: “PIERCING THE CORPORATE VEIL,” AND THE CORPORATE ALTER EGO DOCTRINE?

- Right Away
- In the beginning
- In connection with preparing the corporate documents
- As soon as the retainer check clears
- **You get the point – never too early**

# HOW DO YOU BROACH THE TOPIC WITH YOUR CLIENT?

- The law provides you with the ability to “birth” a new entity.
- The new entity – the corporation – is a legal person.
- The corporation has a name.
- The corporation can engage in activities and be compensated or earn revenue based upon those activities.
- The corporation is taxed on its earnings.
- The corporation must observe certain filing formalities to maintain its existence.
- The corporation must pay certain fees to maintain its existence.
- Keep the corporate “personality” separate from you so that the corporate form can insulate you from personal liability.

# HERE ARE SOME DO'S AND DON'TS

# Do's – (Top 10)

- ✓ Accurately complete and file with the appropriate fees your Articles of Incorporation
- ✓ Adopt appropriate By-Laws, Shareholder Agreements and related documents as well as provide for adequate capitalization.
- ✓ Hold Board of Director and Shareholder meetings.
- ✓ Maintain written minutes of those meetings, accurately record votes, etc.
- ✓ Hold an Annual Meeting of Shareholders – proxies, etc.
- ✓ File Annual and related reports as required.
- ✓ If your corporation is operating as a “Doing Business As” (“D/B/A”) comply with local laws e.g. Fictitious Name Act, County recordings, etc.
- ✓ Federal/State - Trade Names, Trade Marks, Service Marks, etc.
- ✓ File timely federal and state tax income, franchise, payroll, FICA, sales, 1099's, etc. returns
- ✓ Establish separate: phone numbers, business address (P.O. Box), bank accounts, stationary, etc.

DO – FOLLOW-UP SEMI-ANNUALLY WITH YOUR CLIENT THAT THE CORPORATE FORMALITIES ARE BEING OBSERVED.

# Don'ts – (Top 5)

- Don't co-mingle funds.
- Don't use corporate funds for personal expenses.
- Don't put family members on the payroll unless they actually perform work for the corporation.
- Don't let your “personality” become identified with the “personality” of the corporation.
- What else would you advise?

FOLLOW-UP AT LEAST SEMI-ANNUALLY WITH YOUR CLIENT THAT THE “DON'TS  
- TREATING THE CORPORATION AS YOUR ALTER EGO - ARE BEING OBSERVED.

**WHY ARE THE DO'S AND  
DON'T'S IMPORTANT?**

# When all this is boiled down - what are we really trying to do?

- A. Protect the client's personal assets from the claims of voluntary and involuntary business (contract) and tort creditors.
- B. Protect subsidiaries and affiliates from having assets seized to answer for the debts of corporate parents, (when applicable).



Begin with the premise that our society and the law recognizes that we promote economic growth if we permit entrepreneurs to implement their ideas without fear of losing their personal assets in the process.

Thus, our corporate law creates a shield against personal liability for business owners by creating the fiction that a corporation is a legal person with all the rights and responsibilities, privileges and obligations attendant to any human being.

**That is:** The limited liability of a shareholder is a bed-rock principle of corporate law and should not be violated without the clearest showing of substantial injustice.

U.S. v. Bestfoods, 524 U.S. 51, 61-62 (1998)

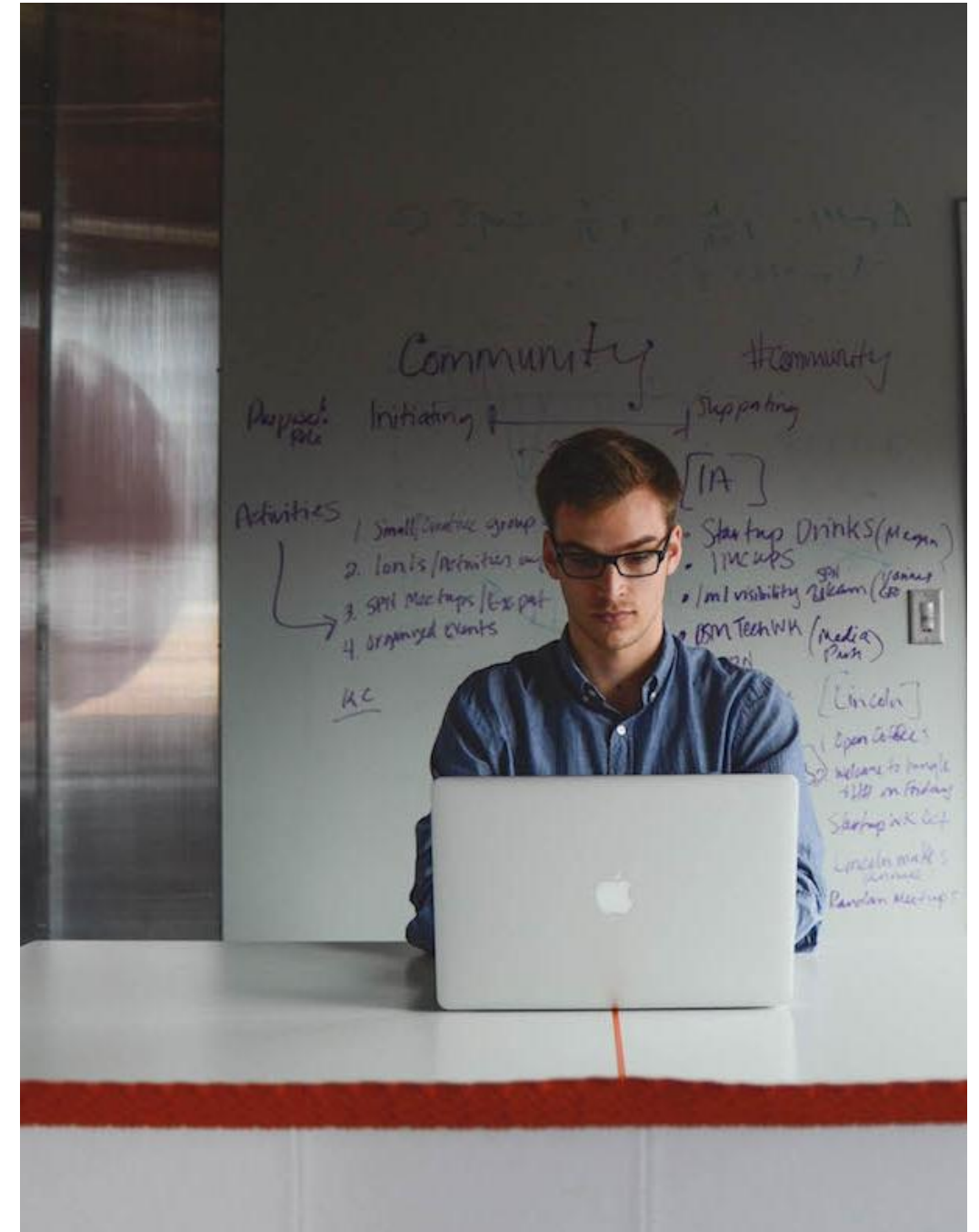
Piercing the Corporate Veil and the Corporate Alter Ego Doctrine are equitable remedies created by the judiciary when the corporate owners abuse the insulation from personal liability that the corporate law provides.

WHEN WILL THE COURTS PIERCE THE CORPORATE  
VEIL OR APPLY THE CORPORATE ALTER EGO  
DOCTRINE TO REACH THE PERSONAL ASSETS OF  
BUSINESS OWNERS?

# As a general rule:

The “separateness” of the corporation and the business owners will be set aside: if it appears that the business owner, subsidiary or affiliate of the parent corporation functions entirely as an instrumentality or adjunct of the corporation and circumstances require disregard of the separateness to avoid fraud or injustice.

See generally, Taylor v. Standard Gas and Electric Co., 306 U.S. 307 (1939) “Deep Rock Case.”



Let's take a moment to leave the arena of individual business owners in close corporations and look at issues in the context of parent corporations, subsidiaries and affiliates.

What factors do courts consider in: "Piercing the Corporate Veil" between a parent corporation and its subsidiaries and affiliates?

1. The parent corporation owns all or most of the subsidiary's stock,
2. The corporations have common directors or officers,
3. The parent provides financing to its subsidiary,
4. The dominant corporation subscribes to all the other's stock,
5. The subordinate corporation is grossly undercapitalized,
6. The parent pays the salaries, expenses or loses of the subsidiary,
7. Almost all of the subsidiary's business is with the parent or the assets of the former were conveyed from the latter,
8. The parent refers to its subsidiary as a division or department,
9. The subsidiary's officers or directors follow directions from the parent corporation and
10. Legal formalities for keeping the entities separate independent are observed.\* See *generally, Frazer v. Bryan Memorial Hospital Authority*, 775 P.2d 281, 288 (OK. 1989)

# “Cliff Notes” Version – For Business Owners and Parent Corporations – most important considerations, two ways to look at it:

1. Fraud – Misrepresentation

2. Injustice unfairness

3. Domination

1. Control

2. Fraud

3. Unjust Loss



# SOME QUICKIES!

## **Types of Creditors:**

Contract – Voluntary

Tort – Involuntary

## Easiest states to pierce:

North Dakota, South Dakota, Hawaii, Montana

## Hardest states to pierce:

Maryland, New Hampshire, Virginia

## Major Corporate States:

Delaware – 35%

California – 50%\*

New York – 50%\*

Key to easiest v. hardest state – "unfairness" versus "fraud"

Empirical Studies show:

Most Dominant in case law– Close corporations

Individual owners 99%

Public Corporations – less than 1%

# UNCONVENTIONAL REASONS TO PIERCE THE CORPORATE VEIL

1. Create jurisdiction over an absent shareholder in an action against the corporation.
2. Create diversity jurisdiction.
3. Create estoppel by judgment against an affiliated corporation.
4. Reverse Piercing – Creditor – make corporation liable for debts of shareholder.
5. Reverse Piercing – Shareholder – pierce veil of own corporation to attain some advantage (usually unsuccessful).

# PIERCE CORPORATE VEIL - CORPORATE ALTER EGO CASES – SUBJECT MATTER

1. Creditor – Dominant
2. Bankruptcy
3. Taxation
4. Environment (“Deep Rock Case”) *supra.* – CERCLA)
5. Workers compensation
6. Etc.

# CONCLUSION

Piercing the Corporate Veil or applying the Corporate Alter Ego Doctrine is an extraordinary equitable remedy that should be used sparingly recognizing the bed-rock principle of corporate law conferring insulation from personal liability to advance the entrepreneurial basis of our economic system.

However, the separate personality of a corporation is a statutory privilege and when used for legitimate business purposes it will not be disturbed, but when the statutory privilege is perverted and abused, the corporate form will be disregarded. *See generally, Messer v. Bragg Mgmt. Co., 702 P.2d 601 (CA. 1985)*