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# COMMENT

## “PIERCING THE CORPORATE VEIL” IN MARYLAND: AN ANALYSIS AND SUGGESTED APPROACH

*In Maryland, it is well settled that the veil of a corporate entity may be pierced only to prevent fraud or to enforce a paramount equity. This test, formulated to balance the policy of limited shareholder liability with the interest of serving justice, has produced disparate results. This comment surveys the tests employed by other jurisdictions, reviews and criticizes the policies and application of the Maryland standard, and advocates the adoption of a more equitable approach in veil piercing cases - a “many factors” analysis.*

### I. INTRODUCTION

Piercing the corporate veil,<sup>1</sup> or disregarding the corporate entity, is a concept with which American courts have struggled for many years.<sup>2</sup> A variety of tests have been employed by courts to determine whether a situation warrants the piercing of the corporate veil.<sup>3</sup> These different tests have led to a confusion in policy and an inconsistency in results among the various courts.<sup>4</sup> While many jurisdictions consider a number

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1. Piercing the corporate veil is defined as the “judicial process whereby [a] court will disregard [the] usual immunity of corporate officers or entities from liability for corporate activities . . . .” BLACK’S LAW DICTIONARY 1033 (5th ed. 1979).

2. See *DeWitt Truck Brokers, Inc. v. W. Ray Flemming Fruit Co.*, 540 F.2d 681 (4th Cir. 1976); *G.E.J. Corp. v. Uranium Aire, Inc.*, 311 F.2d 749 (9th Cir. 1962); *Luckenbach S.S. Co. v. W.R. Grace & Co.*, 267 F. 676 (4th Cir. 1920); *Marr v. Postal Union Life Ins. Co.*, 40 Cal. App. 2d 673, 105 P.2d 649 (1940); *Carozza v. Federal Fin. & Credit Co.*, 149 Md. 223, 131 A. 332 (1925). See generally 1 W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 41 (rev. perm. ed. 1983) (a general statement of the piercing concept and summary of the varying caselaw); H. HENN & J. ALEXANDER, LAWS OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES § 146 (3d ed. 1983) (a concise background of the piercing concept and summary of the relevant caselaw).

With regard to federal courts, no general federal rule for piercing the corporate veil has been adopted, primarily because state substantive law applies under choice of law principles. See *Erie R.R. v. Tompkins*, 304 U.S. 64 (1938). For a general discussion of piercing the corporate veil in federal courts, see Comment, *Piercing the Corporate Veil in Federal Courts: Is Circumvention of a Statute Enough?*, 13 PAC. L.J. 1245 (1982); Note, *Piercing the Corporate Veil: The Alter Ego Doctrine Under Federal Common Law*, 95 HARV. L. REV. 853 (1982).

3. See *infra* notes 20-86 and accompanying text.

4. An application of the Maryland test in two similar situations demonstrates the inconsistency in results. Compare *Bart Arconti & Sons, Inc. v. Ames-Ennis, Inc.*, 275 Md. 295, 340 A.2d 225 (1975) (corporate veil not pierced where assets of one corporation were transferred to other corporations to evade a legal obligation) with *Colandrea v. Colandrea*, 42 Md. App. 421, 401 A.2d 480 (corporate veil pierced where assets of one corporation were transferred to other corporations to evade a legal obligation), *cert. denied*, 286 Md. 745 (1979).

In both of these cases, the Maryland courts applied the same test for determin-

of factors in deciding whether to pierce the corporate veil,<sup>5</sup> the Maryland courts have steadfastly held that a piercing of the corporate veil is warranted only to prevent fraud, or to enforce a "paramount equity."<sup>6</sup> This comment considers the possible inequities resulting under existing Maryland law due to the strict application of these principles. The discussion begins with an overview of the concept of piercing the corporate veil, followed by a survey of the various tests espoused in decisional law. After this general background, the comment focuses on Maryland's approach, examining its underlying policies and possible inequities. Finally, the comment concludes with a suggested approach for the Maryland courts; an equitable approach that considers many factors in situations where the corporate veil is at issue.

## II. "PIERCING THE CORPORATE VEIL"—THE CONCEPT

The corporate entity, while generally recognized as being separate and distinct from its shareholders,<sup>7</sup> does not always insulate its shareholders from personal liability.<sup>8</sup> Frequently, a plaintiff or other claimant will seek to have the corporate entity disregarded and liability imposed upon the shareholders of the corporation. This circumstance may arise in situations involving corporations and their individual owners,<sup>9</sup> parent and subsidiary corporations,<sup>10</sup> employee-labor union cases,<sup>11</sup> and even medicare situations.<sup>12</sup> Piercing the corporate veil is an equitable doctrine available to creditors as well as parties injured by a corporation whose

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ing whether to pierce the corporate veil. The results were different despite the extremely similar fact patterns of the cases. See *infra* text accompanying notes 125-42.

5. See *infra* notes 60-86 and accompanying text.
6. Carozza v. Federal Fin. & Credit Co., 149 Md. 223, 238, 131 A. 332, 338 (1925) (first Maryland case to use the term "paramount equity"); see also Starfish Condo. Ass'n v. Yorkridge Serv. Corp., 295 Md. 693, 458 A.2d 805 (1983); Bart Arconti & Sons, Inc. v. Ames-Ennis, Inc., 275 Md. 295, 340 A.2d 225 (1975); Dixon v. Process Corp., 38 Md. App. 644, 382 A.2d 893, cert. denied, 282 Md. 731 (1978).
7. 18 AM. JUR. 2D Corporations § 13 (2d ed. 1965); 13A W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 6213 (rev. perm. ed. 1961); 1 H. OLECK, MODERN CORPORATION LAW § 10 (1958); F. POWELL, PARENT & SUBSIDIARY CORPORATIONS § 1 (1931).
8. 18 AM. JUR. 2D Corporations § 14 (2d ed. 1965).
9. See DeWitt Truck Brokers, Inc. v. W. Ray Flemming Fruit Co., 540 F.2d 681 (4th Cir. 1976); Zubik v. Zubik, 384 F.2d 267 (3d Cir. 1967); Weissner v. Mursam Shoe Corp., 127 F.2d 344 (2d Cir. 1942).
10. See Starfish Condo. Ass'n v. Yorkridge Serv. Corp., 295 Md. 693, 458 A.2d 805 (1983); Bartle v. Home Owners Coop., Inc., 309 N.Y. 103, 127 N.E.2d 832 (1955); see also F. POWELL, *supra* note 7, § 6, at 8-34 (discussion of many characteristics that are important in determining whether to pierce the corporate veil in the context of parent/subsidiary corporations). For a discussion of practical arguments relating to piercing the corporate veil in parent/subsidiary cases, see Posner, *The Rights of Creditors of Affiliated Corporations*, 43 U. CHI. L. REV. 499 (1976).
11. See United Paperworkers Int'l Union v. Penntech Papers, Inc., 439 F. Supp. 610 (D. Me. 1977), (piercing analysis used to determine whether a parent corporation is bound by a subsidiary's union contracts), *aff'd sub nom.* United Paperworkers Int'l Union v. T.P. Property Corp., 583 F.2d 33 (1st Cir. 1978).
12. See United States v. Healthwin-Midtown Convalescent Hosp. & Rehab. Center,

separate existence they question. The goal is to have the shareholders held personally liable for either contractual obligations purportedly entered into by the corporation, or for tortious injuries to a plaintiff where the corporation is alleged to have been the tortfeasor. Where the plaintiff is able to demonstrate the presence of certain factors<sup>13</sup> with respect to a particular corporation, the corporate veil may be pierced, but not without hesitancy.

Conflicting policy considerations have made courts hesitant to pierce the corporate veil. On one hand, there is the strong policy of allowing limited liability for shareholders in order to promote capital growth and investment.<sup>14</sup> On the other hand, there is the competing interest of serving justice in a particular situation where upholding the theory of limited liability would be inequitable.<sup>15</sup> The clash between these considerations has resulted in the absence of any uniform standards to be applied in any given case. Accordingly, courts are often inconsistent in delineating which factors are dispositive when confronted with a veil piercing case.<sup>16</sup>

### III. VARIOUS JURISDICTIONS' APPROACHES TO PIERCING THE CORPORATE VEIL

Although several theories have been specifically designated, courts frequently decide the issue of piercing the corporate veil without stating precisely the theory on which the decision rests.<sup>17</sup> Moreover, where specific theories are mentioned by a court, often the names of the various theories are used as if they are synonomous.<sup>18</sup> While the names may be

Inc., 511 F. Supp. 416 (C.D. Cal. 1981); *United States v. Normandy House Nursing Home, Inc.*, 428 F. Supp. 421 (D. Mass. 1977).

13. See *infra* text accompanying notes 60-86.

14. See N. LATTIN, *THE LAW OF CORPORATIONS* §§ 11-12 (2d ed. 1971); Dobbyn, *A Practical Approach to Consistency in Veil-Piercing Cases*, 19 U. KAN. L. REV. 185, 185 (1971); see also *Louisville Banking Co. v. Eisenman*, 94 Ky. 83, 84, 21 S.W. 531, 532 (1893) (forming a corporation invites the investment of capital which encourages trade).

15. See Dobbyn, *supra* note 14, at 185; see also *United States v. Milwaukee Refrigerator Transit Co.*, 142 F. 247, 255 (E.D. Wis. 1905) (corporation will be looked upon as a legal entity unless that entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime).

16. See *infra* notes 20-80 and accompanying text.

17. Rather than specifying a certain theory for determining whether to pierce the corporate veil, many courts have merely listed situations whereby one corporation may become a mere agent, instrumentality, alter ego, tool, or department of another corporation. See *International UAW v. Cardwell Mfg. Co.*, 416 F. Supp. 1267 (D. Kan. 1976); *Henderson v. Rounds & Porter Lumber Co.*, 99 F. Supp. 376 (W.D. Ark. 1951); *State ex rel. Porterie v. Gulf, Mobile & N. R. Co.*, 191 La. 163, 184 So. 711 (1938); *A.W. Fiur Co. v. Ataka & Co.*, 71 A.D.2d 370, 422 N.Y.S.2d 419 (1979).

18. *Fisser v. International Bank*, 282 F.2d 231, 234-38 (2d Cir. 1960) (court used the term alter ego several times but actually applied the instrumentality theory); *National Bond Fin. Co. v. General Motors Corp.*, 238 F. Supp. 248, 255 (W.D. Mo.)

confusing, it is clear that certain factors must be present regardless of the theory applied.<sup>19</sup>

### A. Agency Theory

According to general principles of agency law, for a principal to be held liable for the acts of his agent, it must be shown that there was authority for the agent to act.<sup>20</sup> This authority may arise in three ways: (1) express;<sup>21</sup> (2) implied;<sup>22</sup> or (3) apparent.<sup>23</sup>

While it is sometimes said that a corporation is merely an agent of its shareholders,<sup>24</sup> if this were true then the shareholders would always incur liability, providing authority could be shown for the corporation's acts. This, of course, would frustrate the policy behind the theory of limited liability,<sup>25</sup> and afford no protection to shareholders.

There are, however, cases where corporate owners have been held liable for the corporation's acts solely based on principles of agency law.<sup>26</sup> In *Darling Stores Corp. v. Young Realty Co.*,<sup>27</sup> the court held that a subsidiary corporation (Darling Stores, Ltd.) acted as an agent for its parent corporation (Darling Stores Corp.), an undisclosed principal, in the negotiation of a lease arrangement.<sup>28</sup> The subsidiary was an assignee of a lease of property that was owned by the plaintiff, Young Realty Company.<sup>29</sup> The property was then subleased to the parent corporation by the subsidiary. Subsequently, the lease was abandoned and the plaintiff sued the parent. In imposing liability upon the parent, the court

(court treated instrumentality and alter ego theories as synonymous), *aff'd*, 341 F.2d 1022 (8th Cir. 1964).

With respect to the use of such labels, one commentator asserts that statements indicating that certain acts make the corporation the shareholder's "alter ego" or "instrumentality" are meaningless. Hamilton, *The Corporate Entity*, 49 TEX. L. REV. 979, 990 (1971).

19. For a concise review of factors that courts have found sufficient to warrant piercing, see Barber, *Piercing the Corporate Veil*, 17 WILLAMETTE L.J. 371, 374-75 (1981).
20. RESTATEMENT (SECOND) OF AGENCY § 7 (1957).
21. *Id.* § 26 (express authority created where principal expressly gives agent authority to act through written or spoken words).
22. *Id.* (implied authority created where, due to circumstances, agent reasonably believes he has authority to act).
23. *Id.* § 27 (apparent authority created where principal makes manifestation to third party that agent has authority to act).
24. See *Platt v. Bradner Co.*, 131 Wash. 573, 576, 230 P. 633, 635 (1924).
25. See *supra* notes 14-15 and accompanying text.
26. *Darling Stores Corp. v. Young Realty Co.*, 121 F.2d 112 (8th Cir. 1941); *Morgan v. Jackson Ready-Mix Concrete*, 247 Miss. 863, 157 So. 2d 772 (1963); *cf. Ace Dev. Co. v. Harrison*, 196 Md. 357, 366-67, 76 A.2d 566, 570 (1950) (court, while refusing to pierce the corporate veil because of the lack of fraud on the defendant's part, did recognize that agents cannot hide behind the corporate shield when they have been acting in a conspiracy).
- It has been suggested by one commentator that in those cases where the agency theory is used to pierce the corporate veil, it is actually the instrumentality theory that the courts are employing. F. POWELL, *supra* note 7, § 21, at 89.
27. 121 F.2d 112 (8th Cir. 1941).
28. *Id.* at 117.
29. *Id.* at 113.

noted that it is "uniformly held [by Iowa courts] that the corporate entity of a corporation may be disregarded where it is organized and controlled, and its affairs are so conducted as to make it merely an instrumentality, agency, conduit or adjunct of another corporation."<sup>30</sup>

The lack of clear delineation between the affairs of the parent and subsidiary is one circumstance where liability may be imposed under the agency theory. Another possible basis for liability arises when an individual acting for a subsidiary is also an agent of the parent.<sup>31</sup> In this situation, an argument may be made that the individual was acting on behalf of the parent rather than the subsidiary.<sup>32</sup> It is therefore important that the individual's status be clearly stated when he acts.

The presence of an agency relationship between a parent and subsidiary corporation does not automatically indicate a basis for piercing the corporate veil. These agency relationships will be valid so long as necessary distinctions between the parent and subsidiary are preserved.<sup>33</sup> It has been urged that an application of strict agency principles to piercing cases would "largely destroy the protection afforded stockholders by incorporation."<sup>34</sup>

### B. Instrumentality Theory

The instrumentality theory<sup>35</sup> focuses on the amount of control exercised in a given situation. The following elements trigger liability under the instrumentality theory: (1) control or complete domination over the fiscal, policy, and business practices regarding the transaction in question such that the corporate entity has no separate mind, will, or existence of its own; (2) use of such control to commit a fraud or other wrong; and (3) injury or unjust loss proximately caused by the use of such control.<sup>36</sup> Thus, in determining whether one corporation is a mere instrumentality of another, or whether a corporation is a mere instrumentality of a shareholder,<sup>37</sup> the element of control is important.

The courts have applied the instrumentality theory primarily in situations where the plaintiff is seeking to hold a parent corporation liable for the acts of its subsidiary. An application of the instrumentality theory is found in *National Bond Finance Co. v. General Motors Corp.*<sup>38</sup> In *Na-*

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30. *Id.* at 116 (emphasis supplied).

31. Hamilton, *supra* note 18, at 991-93.

32. *Id.*

33. *Id.*

34. F. POWELL, *supra* note 7, § 22, at 94.

35. Professor Powell was the first to formulate this theory. *Id.* §§ 5-6.

36. Lowendahl v. Baltimore & O. Ry., 247 A.D. 144, 157, 287 N.Y.S. 62, 76, *aff'd*, 272 N.Y. 360, 6 N.E.2d 56 (1936); F. POWELL, *supra* note 7, § 5.

37. Fish v. East, 114 F.2d 177, 191 (10th Cir. 1940); Brown v. Magrande Compania Naviera, S.A., 281 F. Supp. 1004, 1006 (E.D. Va. 1968); Lowendahl v. Baltimore & O. Ry., 247 A.D. 144, 158, 287 N.Y.S. 62, 76-77, *aff'd*, 272 N.Y. 360, 6 N.E.2d 56 (1936).

38. 238 F. Supp. 248 (W.D. Mo. 1964).

*tional Bond*, the plaintiff sought damages from General Motors (G.M.) for transactions involving the purchase of conditional sales contracts for the sale of motor vehicles.<sup>39</sup> These sales contracts were entered into by the plaintiff with the Lincoln Park Buick Company (Lincoln Park), a G.M. dealership. The plaintiff sought to pierce the corporate veil of Lincoln Park, and impose liability upon G.M. based on the following "control" factors: (1) G.M. controlled all the voting stock of Lincoln Park; (2) Lincoln Park's Board of Directors was controlled by G.M.; (3) G.M., through its Motors Holding Division, provided the initial capital for Lincoln Park; (4) all accounting procedures used by Lincoln Park were G.M. procedures; (5) G.M. supervised the liquidation of Lincoln Park; (6) the minutes of the Lincoln Park Board meetings indicated that they were dominated by G.M.; and (7) a Board Director, who also served as President of Lincoln Park, claimed that the Board meetings were controlled by G.M. Board members.<sup>40</sup> Despite these facts, the court found that the actual existence of the dealership (Lincoln Park) as a separate entity was maintained.<sup>41</sup> The court held that the elements required by the instrumentality theory<sup>42</sup> were not satisfied,<sup>43</sup> notwithstanding the exercise of considerable control by G.M. over Lincoln Park.

Control is not gauged merely by the amount of capital stock owned; instead, the inquiry is whether there is complete dominion over the financial matters, policies, and business practices of the corporation.<sup>44</sup> Of course, the control aspect in the context of the instrumentality theory has little meaning where sole shareholder corporations are involved. In such situations, there will be complete dominion exerted over the fiscal and business practices, yet absent unusual circumstances, such control will be insufficient to pierce the corporate veil.<sup>45</sup>

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39. *Id.* at 249.

40. *Id.* at 254-55.

41. *Id.* at 258. There was evidence of separate books and premises, as well as employees. Additionally, Lincoln Park purchased vehicles from G.M., paying cash on delivery. For all intents and purposes, the actual businesses of the two companies were separate and distinct. There was little intermingling between the two corporations as far as the formal requisites of the corporate entity were concerned. *Id.* at 254.

42. *Id.* at 256-58.

43. *Id.* at 258. The *National Bond* court explicitly determined that the corporate veil of Lincoln Park should not be pierced because of the facts of this particular case. There, plaintiff relied upon the guaranty of Lincoln Park to safeguard its lien upon certain cars. With regard to this specifically, the court noted that G.M.'s Board of Directors had no personal knowledge that the plaintiff's liens against Lincoln Park were not being protected. Because these matters were solely within the administrative functions of Lincoln Park's President, G.M. could not be held liable. *Id.* The court did note, however, that because of the degree of control that G.M. generally exerts over dealerships such as Lincoln Park, situations could arise where piercing the corporate veil of such dealerships would be appropriate. *Id.*

44. *Lowendahl v. Baltimore & O. Ry.*, 247 A.D. 144, 154, 287 N.Y.S. 62, 72-73, *aff'd*, 272 N.Y. 360, 6 N.E.2d 56 (1936).

45. *See Texas Indus., Inc. v. Dupuy & Dupuy Developers, Inc.*, 227 So. 2d 265 (La. App. 1969). For examples of "unusual circumstances," see *Iron City Sand &*

Unusual circumstances, or an element of unfairness, generally must be present in addition to control to warrant piercing the corporate veil. As one court stated, “[s]omething more [than control] is needed, such as fraud, illegality, or wrongdoing which produced the injury or complaint, otherwise the corporate entity will stand.”<sup>46</sup>

### C. *Alter Ego Theory*

Closely resembling the instrumentality theory is the alter ego theory.<sup>47</sup> While the elements of these theories are slightly different, decisions founded on either theory tend to exhibit one prominent characteristic: a loss of individuality of the corporation.<sup>48</sup> The elements of the alter ego theory have been stated as: (1) a unity of interest and ownership causing the individuality of the corporation to cease; and (2) allowing the observance of the separate existence would approve a fraud or promote an injustice.<sup>49</sup> As with the instrumentality theory, the alter ego theory requires more than a mere showing that one individual or corporation owns all the stock of another corporation.<sup>50</sup>

The alter ego theory was applied in *Marr v. Postal Union Life Insurance Co.*,<sup>51</sup> where the plaintiff trustees claimed that the defendant corporations, Postal Union Life Insurance Company (Insurance) and Postal Underwriters Incorporated (Underwriters), were “alter egos” of each other.<sup>52</sup> Underwriters, the corporation that issued a promissory note to plaintiffs for the sale of hotel property,<sup>53</sup> was a subsidiary of Insurance. When Underwriters defaulted on the note, and plaintiffs learned of Underwriters’s relationship to Insurance, they sought to pierce Underwriters’s corporate veil. In applying the alter ego theory, the *Marr* court held

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Gravel Div. v. West Fork Towing Corp., 298 F. Supp. 1091 (N.D. W. Va. 1969) (corporation operated so that it was always insolvent); Zaist v. Olson, 154 Conn. 563, 227 A.2d 552 (1967) (shareholder conducted business in such a way as to cause confusion between individual and corporate finances).

46. *Brown v. Magrande Compania Naviera, S.A.*, 281 F. Supp. 1004, 1007 (E.D. Va. 1968).

47. See N. LATTIN, *supra* note 14, § 18, at 86-87.

48. See *G.E.J. Corp. v. Uranium Aire, Inc.*, 311 F.2d 749 (9th Cir. 1962); *Fisser v. International Bank*, 282 F.2d 231 (2d Cir. 1960); *Marr v. Postal Union Life Ins. Co.*, 40 Cal. App. 2d 673, 105 P.2d 649 (1940). The alter ego theory, like the instrumentality theory, has the element of control as its basic characteristic. See *infra* text accompanying notes 49-50. For this reason, it also should have no application in the context of sole shareholder corporations. If applied in those situations, corporate veils of virtually all sole shareholder corporations theoretically would warrant piercing.

49. *Marr v. Postal Union Life Ins. Co.*, 40 Cal. App. 2d 673, 105 P.2d 649 (1940). For decisions employing the alter ego theory, see *Leavard Petroleum Ltd. v. Mene Grand Oil Co.*, 415 F. Supp. 158 (D. Del. 1976); *Vantage View, Inc. v. Bali E. Dev. Corp.*, 421 So. 2d 728 (Fla. Dist. Ct. App. 1982).

50. *G.E.J. Corp. v. Uranium Aire, Inc.*, 311 F.2d 749 (9th Cir. 1963); *Chichester v. Polikowsky*, 231 F.2d 183 (9th Cir. 1955).

51. 40 Cal. App. 2d 673, 105 P.2d 649 (1940).

52. *Id.* at 677, 105 P.2d at 653-54.

53. *Id.* at 676, 105 P.2d at 652.



that the circumstances warranted piercing Underwriters's corporate veil.<sup>54</sup> The court found that the stock of Underwriters had never been issued, that the Vice-President of Underwriters, who also served on the Board of Directors, was paid a salary by Insurance, that all active workers promoting the interests of Underwriters were paid employees of Insurance, that Insurance owned the building where both corporations were located, and that a common PBX board was used for handling the telephone service for both corporations.<sup>55</sup> Accordingly, the *Marr* court concluded that the defendant corporations lacked individuality, and to recognize the fiction of their separate existences would be tantamount to approving a fraud or promoting injustice.<sup>56</sup>

#### D. The "Many Factors" Approach

Unlike the aforementioned theories, the "many factors" approach is a suggested analysis that has no uniform set of standards. Instead, this approach proposes the examination of the factors discussed below, and a weighing of the equities in each case to determine whether to pierce the corporate veil.<sup>57</sup>

Using this type of analysis, courts have eliminated the problem of confusing the various piercing theories. In this respect, the importance of the presence of the elements of the "instrumentality" or "alter ego" theories no longer exists. Likewise, it is insignificant whether a court labels its rationale for piercing as being derived from either theory. While under this "many factors" approach there are no clear-cut standards to be applied, decisional law that has used this approach, without labeling it as such, suggests certain factors that should be present to impose liability.<sup>58</sup> It is unclear which factors are the most important in determining whether to disregard the corporate entity. Similarly, the number of factors required to be present is also unresolved. In all instances, however, where courts adopted this equitable approach and pierced the corporate

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54. *Id.* at 680, 105 P.2d at 656.

55. *Id.* at 677-78, 105 P.2d at 654-55. Additional facts influencing the court's decision were that Insurance arranged to have \$4,100 advanced to Underwriters to consummate the purchase of the hotel property from plaintiffs, that Underwriters agreed to execute a \$90,000 trust deed in favor of Insurance upon the hotel property, and that the taxes were paid on behalf of Insurance by its president. *Id.* at 680, 105 P.2d at 656. Concerning the evidence, the court stated:

The foregoing recital of the evidence convinces us that there were here present all the necessary elements to constitute an alter ego relationship between two corporations, namely, (1) control of one by the other; (2) that one was but the mere conduit of the business of the other; (3) that recognition of the separate existence of the Underwriters would sanction a fraud and permit oppression and injustice.

*Id.* at 680, 105 P.2d at 656.

56. *Marr v. Postal Union Life Ins. Co.*, 40 Cal. App. 2d 673, 680, 105 P.2d 649, 656 (1940).

57. This basic idea was proposed by Professor Latty although not named as such. See E. LATTY, *SUBSIDIARIES & AFFILIATED CORPORATIONS* 191 (1936).

58. See *infra* notes 60-86 and accompanying text.

veil,<sup>59</sup> at least two of the factors discussed below were present.

Concededly, under a "many factors" analysis, the determination whether to pierce the corporate veil rests on a subjective analysis by the court, and as with any other subjective analysis, some inconsistencies in results may remain. It is suggested, however, that adoption of this approach would go far to eliminate inconsistencies in the application of the various piercing standards, provided that the factors listed below are thoroughly analyzed.

### 1. The Undercapitalization Factor

Many courts consider the adequacy of the corporation's capitalization to be an important factor in piercing cases.<sup>60</sup> Inadequate capitalization, which may prevent a corporation from meeting its prospective liabilities, suggests that the corporation's promoters never intended it to have a separate existence. Where undercapitalization occurs, it seems logical to pierce the corporate veil. This, however, is not always the case. Although inadequate capitalization may increase the probability that a court will pierce the corporate veil, this factor alone is seldom dispositive,<sup>61</sup> and problems are inherent in its application.

One problem associated with the undercapitalization factor is differentiating between underlying contract and tort actions. Inadequate or nominal capitalization should not be a factor in contract cases because the parties have voluntarily chosen to deal with each other. Absent some form of misrepresentation or fraud by a corporation, a creditor who voluntarily enters into a contract with the corporation should be treated as having assumed the risk of the adequacy of the corporation's capitalization. Hence, in contract actions, there is authority for the proposition that inadequate capitalization alone is not a basis for piercing the corporate veil.<sup>62</sup>

Inadequate capitalization in tort actions, however, presents a different situation. Tort actions generally arise from nonconsensual transactions, and as such warrant treatment different from the contract cases. Because of the nature of tort actions, the argument that the plaintiff or claimant "assumed the risk" by dealing with a nominally capitalized corporation is without merit. One commentator, noting inadequate capitali-

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59. Some courts have taken this approach without specifically labeling it the "many factors" approach. See *Hollander v. Henry*, 186 F.2d 582 (2d Cir.), *cert. denied*, 341 U.S. 949 (1951); *Kingston Dry Dock Co. v. Lake Champlain Transp. Co.*, 31 F.2d 265 (2d Cir. 1929).

60. See *DeWitt Truck Brokers, Inc. v. W. Ray Flemming Fruit Co.*, 540 F.2d 681 (4th Cir. 1976); *Fisser v. International Bank*, 282 F.2d 231 (2d Cir. 1960); *Stone v. Eacho*, 127 F.2d 284 (4th Cir. 1942); *Luckenbach S.S. Co. v. W.R. Grace & Co.*, 267 F. 676 (4th Cir. 1920).

61. *Fisser v. International Bank*, 282 F.2d 231, 240 (2d Cir. 1960); *Harris v. Curtis*, 8 Cal. App. 3d 837, 841, 87 Cal. Rptr. 614, 617-18 (1970).

62. *Carlismo v. Schwebel*, 87 Cal. App. 2d 482, 197 P.2d 167 (1948); *Bartle v. Home Owners Coop., Inc.*, 309 N.Y. 103, 127 N.E.2d 832 (1955).

zation as an important factor to be considered in tort actions, summarized the policy as follows:

[A]n inadequately capitalized corporation [in a risky business in effect transfers the risk of loss to innocent members of the general public. While the corporation need not be capitalized to ensure that all conceivable liabilities will be discharged, a corporation should be reasonably capitalized in light of the nature and risks of the business.<sup>63</sup>

Two other significant issues arise in the consideration of a corporation's capitalization: first, how to measure the capitalization; and second, when in time the capitalization is to be measured. With respect to measuring the adequacy of the corporation's capitalization, some courts merely arrive at a capitalization figure that they consider reasonable.<sup>64</sup> Commentators have suggested that courts should either apply a reasonable man standard,<sup>65</sup> or use a comparative analysis of companies in the same industry.<sup>66</sup> In determining when the capitalization of the corporation should be measured, courts have viewed the measurement date at the time of incorporation,<sup>67</sup> as well as later in time when mismanagement has occurred.<sup>68</sup>

## 2. The Abuse of Formalities Factor

The abuse of, or failure to maintain, corporate formalities is another factor that courts consider in determining whether to pierce the corporate veil.<sup>69</sup> The abuse of formalities issue requires analysis in two specific respects: (1) the observance of formalities between parent and subsidiary corporations, or between individual shareholders and a corporation; and (2) whether the underlying action lies in contract or tort.

In situations involving an abuse of formalities between parent and subsidiary corporations, one or more of the following factors may be

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63. Hamilton, *supra* note 18, at 988; see *Walkovszky v. Carlton*, 18 N.Y.2d 414, 223 N.E.2d 6, 276 N.Y.S.2d 585 (1966).

64. These courts often determine the amount without stating the basis upon which their decision rests. *E.g.*, *Automatriz del Golfo de California v. Resnick*, 47 Cal. 2d 792, 306 P.2d 1 (1957) (court merely looked at the numerical figures and without any discussion, determined the original contribution to capital to be inadequate); *Claremont Press Publishing Co. v. Barksdale*, 187 Cal. App. 2d 813, 10 Cal. Rptr. 214 (1960) (where a printer advised the defendant that \$10,000 of initial capital was necessary to fund the publication of a newspaper, the court accepted the printer's advice without question and made no further inquiry).

65. See *Symposium on the Close Corporation*, 52 NW. U.L. REV. 345, 369 (1957).

66. See N. LATTIN, *supra* note 14, § 15, at 77-78.

67. See *G.E.J. Corp. v. Uranium Aire, Inc.*, 311 F.2d 749 (9th Cir. 1962); see also Hamilton, *supra* note 18, at 986 ("[i]nadequate capitalization is measured at the time of the formation of the corporation").

68. See *DeWitt Truck Brokers, Inc. v. W. Ray Flemming Fruit Co.*, 540 F.2d 681, 685-86 (4th Cir. 1976) (court discussed both initial and ongoing financial responsibility as factors for determining whether to pierce the corporate veil).

69. See Hamilton, *supra* note 18, at 989-94.

present: (1) a commingling of the assets of both corporations; (2) a lack of stock issuance by one of the corporations; (3) a failure to maintain separate corporate records; and (4) a failure to hold directors or shareholders meetings for each corporation.<sup>70</sup>

The same factors may be present in the context of a corporation and its single owner. In this situation, the individual owner's funds are often commingled with the corporation's finances.<sup>71</sup> Regardless of whether the abuse of formalities occurs in the parent/subsidiary context or in the individual shareholder/corporation context, the policy behind the formalities requirement remains constant. Corporate owners should not impair the interests of other parties by carrying their unity of interests too far.<sup>72</sup>

Commentators have suggested that the formalities factor should yield different results depending upon whether the action is in contract or tort.<sup>73</sup> In contract actions, the corporate entity should not be disregarded regardless of any abuse of formalities.<sup>74</sup> This position, like the argument for the undercapitalization factor, is premised on the notion that when a third party enters into a contract with a corporation or a corporate owner, he does so voluntarily and at his own risk.<sup>75</sup> Therefore, in contractual situations where an abuse of formalities is present, the third party has the ability to determine whether the corporate entity is separate from its owner, and accordingly should have determined with whom he dealt.

Where the underlying action lies in tort, however, the plaintiff cannot be said to have assumed the risk<sup>76</sup> of dealing with the corporation.<sup>77</sup>

70. *See* *Bernardin, Inc. v. Midland Oil Corp.*, 520 F.2d 771 (7th Cir. 1975) (transfer of funds by one corporation to another without the formalities of a loan, or having common bank account may be an abuse); *Dixon v. Process Corp.*, 38 Md. App. 644, 382 A.2d 893 (the parent and subsidiary corporations had the same directors, the parent owned all the subsidiary's equipment, no separate board meetings were held, and the parent hired all of the subsidiary's employees), *cert. denied*, 282 Md. 731 (1978); *see also* *Hamilton, supra* note 18, at 989-94 and cases cited therein (concise discussion of abuse of formalities).

71. *Zaist v. Olson*, 154 Conn. 563, 227 A.2d 552 (1967); *Dillman v. Nobles*, 351 So. 2d 210 (La. App. 1977); *Bart Arconti & Sons, Inc. v. Ames-Ennis, Inc.*, 275 Md. 295, 340 A.2d 225 (1975).

72. F. O'NEAL, *CLOSE CORPORATIONS: LAW & PRACTICE* § 1.10 (1971 & Supp. 1984).

73. *See* *Hamilton, supra* note 18, at 983; Note, *Disregarding the Corporate Entity: Contract Claims*, 28 OHIO ST. L.J. 441 (1967); Note, *Should Shareholders be Personally Liable for the Torts of Their Corporations?*, 76 YALE L.J. 1190 (1967).

74. *Bradley, A Comparative Evaluation of the Delaware and Maryland Close Corporation Statutes*, 1968 DUKE L.J. 525, 554.

75. *Id.*

76. W. PROSSER & W. KEETON, *PROSSER AND KEETON ON THE LAW OF TORTS* § 68 (W. Keeton 5th ed. 1984).

In its most basic sense, assumption of risk means that the plaintiff, in advance, has given his *express* consent to relieve the defendant of an obligation of conduct toward him, and to take his chances of injury from a known risk arising from what the defendant is to do or leave undone.

*Id.* at 480 (emphasis in original).

77. Note, *Should Shareholders be Personally Liable for the Torts of Their Corporations?*, 76 YALE L.J. 1190, 1193 (1967).

The plaintiff has rarely had prior dealings with the corporation-tortfeasor, and usually will not even learn of such abuse of formalities until well after the injury.

While the suggested distinction between contract and tort actions is logical, it is one most courts have failed to make.<sup>78</sup> Generally, an abuse of formalities alone is insufficient to warrant piercing the corporate veil, regardless of the basis for the underlying action.<sup>79</sup>

### 3. The Control Factor

The determination of control under the "many factors" approach is much the same as that made under the instrumentality and alter ego theories.<sup>80</sup> In short, there must be pervasive control exercised by the shareholders over the corporation.<sup>81</sup> The unity of ownership and interest, and complete domination by the shareholders over the corporation's finances, policies, and business practices are factors evidencing pervasive control.<sup>82</sup> As with the presence of undercapitalization and an abuse of formalities, the presence of control alone is insufficient to warrant a piercing of the corporate veil.

### 4. The Unfairness Factor

In many situations, a basic element of unfairness is present, and is another factor considered by many courts in determining whether to pierce the corporate veil.<sup>83</sup> An estoppel situation often arises when a

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78. These distinctions have been proposed by commentators rather than by courts. See Hamilton, *supra* note 18, at 988; see also *supra* note 74 and accompanying text.

79. While the abuse of formalities factor generally can be applied to all corporations, it is necessary to note at least one situation where this factor should not be used. In Maryland, a statutory close corporation may be formed pursuant to Title 4 of the Maryland Annotated Code. Where a statutory close corporation is involved, such formalities as a board of directors and regular meetings may be eliminated. MD. CORPS. & ASS'NS CODE ANN. §§ 4-302, -402 (1975). While the abuse of formalities factor should not be used in this context, it is important to note that in such situations the need to pierce the corporate veil may be even greater than where no Title 4 election has been made. Where there has been a Title 4 election, and the corporation has elected to eliminate such formalities as meetings and a board of directors, it is unlikely that a lack of those formalities may lead to the merging of the corporation and its shareholders into one. Although the lack of formalities technically is not an "abuse" due to the statutory provisions, an innocent third party may easily be misled into believing that he was dealing with an individual rather than a corporation.

80. See *supra* notes 35-56 and accompanying text.

81. See Consolidated Sun Ray, Inc. v. Oppenstein, 335 F.2d 801 (8th Cir. 1964); G.E.J. Corp. v. Uranium Aire, Inc., 311 F.2d 749 (9th Cir. 1962); Fisser v. International Bank, 282 F.2d 231 (2d Cir. 1960); Zaist v. Olson, 154 Conn. 563, 227 A.2d 552 (1967).

82. See *supra* notes 35-56 and accompanying text. The presence of these factors in a sole shareholder corporation cannot be said to constitute pervasive control, and as such should not be considered in determining whether to pierce its corporate veil.

83. See DeWitt Truck Brokers, Inc. v. W. Ray Flemming Fruit Co., 540 F.2d 681, 687

corporation or a corporate owner makes a misrepresentation to the detriment of a third party.<sup>84</sup> In such cases, the element of unfairness, coupled with undercapitalization, pervasive control, or an abuse of formalities, requires piercing the corporate veil because of the obvious inequity in upholding the corporate owners' limited liability.

Misrepresentations frequently occur in the form of promises or guarantees made by a controlling shareholder.<sup>85</sup> They also occur where a third party is led to believe that he is dealing with a particular individual rather than a corporation,<sup>86</sup> where the capitalization of a corporation is misrepresented,<sup>87</sup> or where a third party is tricked into dealing with the corporation.<sup>88</sup>

#### IV. MARYLAND'S APPROACH TO PIERCING THE CORPORATE VEIL

##### A. *Historical Background*

In 1831, the concept of piercing the corporate veil was alluded to in *The Bellona Company's Case*.<sup>89</sup> In *Bellona*, the chancellor discussed, in dictum, the defendant's allegation that the plaintiff lacked corporate capacity.<sup>90</sup> Although the claim could not properly be heard in the proceeding to dissolve an injunction,<sup>91</sup> the chancellor nevertheless expounded upon the implications of the defendant's assertions for future reference, "when the Court shall be called on for its judgment upon such a case."<sup>92</sup> The chancellor stated, in effect, that a corporation composed of many stockholders could be dissolved if one incorporator obtained possession

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(4th Cir. 1976); *G.E.J. Corp. v. Uranium Aire, Inc.*, 311 F.2d 749, 757 (9th Cir. 1962).

84. See *DeWitt Truck Brokers, Inc. v. W. Ray Flemming Fruit Co.*, 540 F.2d 681 (4th Cir. 1976); *G.E.J. Corp. v. Uranium Aire, Inc.*, 311 F.2d 749 (9th Cir. 1962); *Weisser v. Mursam Shoe Corp.*, 127 F.2d 344 (2d Cir. 1942).

85. See *Dewitt Truck Brokers, Inc. v. W. Ray Flemming Fruit Co.*, 540 F.2d 681, 689 (4th Cir. 1976) (shareholder promised to pay for goods personally if corporation did not, and supplier relied on his promise); *G.E.J. Corp. v. Uranium Aire, Inc.*, 311 F.2d 749, 757 (9th Cir. 1962) (parent corporation assured plaintiff that it would back subsidiary's obligations).

86. *Shafford v. Otto Sales Co.*, 149 Cal. App. 2d 428, 430, 308 P.2d 428, 430 (1957).

87. *DeWitt Truck Brokers, Inc. v. W. Ray Flemming Fruit Co.*, 540 F.2d 681, 688-89 (4th Cir. 1976).

88. See *Weisser v. Mursam Shoe Corp.*, 127 F.2d 344, 345 (2d Cir. 1942).

89. 37 Md. 435 (1831). The *Bellona* Gunpowder Company of Maryland had obtained an injunction against the Baltimore and Susquehanna Railroad Company preventing the construction of a road that *Bellona* claimed would encroach upon its property. In the present proceeding, the defendant railroad company sought to have the injunction dissolved. *Id.* at 435.

90. *Id.* at 439.

91. The plaintiff's lack of corporate capacity was deemed by the chancellor to be a new matter in avoidance of the plaintiff's claim since it was not properly responsive to the bill. *Id.*

92. *Id.*

of all the corporation's stock.<sup>93</sup> In such a case, if one acted "under the disguise of being a body politic, to protect himself from a personal responsibility for his debts,"<sup>94</sup> that conduct could constitute fraud. The implication of *Bellona* is that the corporate entity may be disregarded in situations where all of its corporate stock is owned by one person. This, however, is not the law in Maryland.<sup>95</sup> This theory was cited with approval in only one case after *Bellona*,<sup>96</sup> and was subsequently discredited.<sup>97</sup>

The Court of Appeals of Maryland first espoused the requirements for piercing the corporate veil in *Bethlehem Steel Co. v. Raymond Concrete Pile Co.*,<sup>98</sup> and these requirements have remained virtually unchanged. The court stated that the corporate entity could be disregarded, and the owners of the capital stock and the corporation treated as one, "when there is fraud, or some good ground for its action, in furtherance of the ends of justice."<sup>99</sup>

In *Bethlehem Steel*, a foreman for the Raymond Concrete Pile Company was killed by a backward moving train while he was constructing a railroad trestle.<sup>100</sup> Because the steel company owned nearly all of the stock of the railroad company,<sup>101</sup> the plaintiff sought to impose liability upon the former. The court found that the two companies actually were separate organizations despite the ownership of the stock by the steel company. Further, it reasoned that because there was neither fraud, nor any attempt to evade the law, the corporate existence would not be disregarded.<sup>102</sup>

As in *Bethlehem Steel*, much of the early Maryland case law demonstrates unsuccessful attempts by claimants to impose individual liability upon shareholders when the shareholders owned all, or nearly all, of the

93. *Id.* The chancellor considered that such conduct might be a fraudulent evasion of the law. *Id.* at 439-40.

94. *Id.* at 440.

95. *See infra* notes 103-35 and accompanying text.

96. *Swift v. Smith, Dixon & Co.*, 65 Md. 428, 5 A. 534 (1886) (dictum) ("In *Bellona* . . . the Chancellor says, the ownership by one person of all the stock of a private corporation aggregate virtually dissolves the corporation. For the time being it certainly does suspend corporate action. . . ." *Id.* at 434, 5 A. at 537.).

97. *Dollar Cleansers & Dyers, Inc. v. McGregor*, 163 Md. 105, 161 A. 159 (1932).

We are not prepared to hold under the present state of the law in relation to corporations that under no circumstances could a corporation, in which all of the stock was held by one person, make a valid mortgage to that person. The expressions in *Swift v. Smith, Dixon & Co.*, 65 Md. 428, 5 A. 534, which would lead to that conclusion . . . cannot now be accepted. . . .

*Id.* at 108, 161 A. at 161; *see also State v. General Stevedoring Co.*, 213 F. 51, 77 (D. Md. 1914) ("The acquirement by a single individual or corporation of all the stock of another corporation does not suspend the corporate life.").

98. 141 Md. 67, 118 A. 279 (1922).

99. *Id.* at 81, 118 A. at 284.

100. *Id.* at 72, 118 A. at 280.

101. *Id.* at 81, 118 A. at 284.

102. *Id.* at 82, 118 A. at 284.

corporation's capital stock.<sup>103</sup> In all instances, the factor of sole ownership, in the absence of fraud, was insufficient to warrant the disregarding of the corporate entity.<sup>104</sup>

In 1925, the Maryland court of appeals first introduced the term "paramount equity."<sup>105</sup> While maintaining "fraud" as an actionable basis for piercing the corporate veil, the court added this elusive language: "or to enforce a paramount and superior equity."<sup>106</sup>

### B. Current Test

It is now well settled in Maryland that the corporate veil will be pierced only to prevent fraud, or to enforce a "paramount equity."<sup>107</sup> The Maryland courts have applied this test whether liability is sought to be imposed upon an individual shareholder,<sup>108</sup> or a parent corporation.<sup>109</sup> Likewise, the standards are unyielding whether the underlying action be in contract<sup>110</sup> or tort.<sup>111</sup>

In *Starfish Condominium Association v. Yorkridge Service Corp.*,<sup>112</sup> the most recent Maryland case discussing the issue of piercing the corporate veil, an attempt was made to pierce the corporate veil of a subsidiary

103. See *William Danzer & Co. v. Western Md. Ry.*, 164 Md. 448, 165 A. 463 (1933); *Carozza v. Federal Fin. & Credit Co.*, 149 Md. 223, 131 A. 332 (1925); see also *Cotten v. Tyson*, 121 Md. 597, 89 A. 113 (1913) (requirements for disregarding corporate entity not set forth); *Pott & Co. v. Schmucker*, 84 Md. 535, 36 A. 592 (1897) (same).

104. *William Danzer & Co. v. Western Md. Ry.*, 164 Md. 448, 16 A. 463 (1933); *Carozza v. Federal Fin. & Credit Co.*, 149 Md. 223, 131 A. 332 (1925).

105. *Carozza v. Federal Fin. & Credit Co.*, 149 Md. 223, 238, 131 A. 332, 338 (1925).  
106. *Id.*

107. *Starfish Condo. Ass'n v. Yorkridge Serv. Corp.*, 295 Md. 693, 458 A.2d 805 (1983); *Bart Arconti & Sons, Inc. v. Ames-Ennis, Inc.*, 275 Md. 295, 340 A.2d 225 (1975); *Damazo v. Wahby*, 259 Md. 627, 270 A.2d 814 (1970); *Fuller v. Horvath*, 42 Md. App. 671, 402 A.2d 134, *cert. denied*, 286 Md. 748 (1979); *Colandrea v. Colandrea*, 42 Md. App. 421, 401 A.2d 480, *cert. denied*, 286 Md. 745 (1979); *Dixon v. Process Corp.*, 38 Md. App. 644, 382 A.2d 893, *cert. denied*, 282 Md. 731 (1978); *United Elec. Supply Co. v. Greencastle Gardens Section III Ltd. Partnership*, 36 Md. App. 70, 373 A.2d 42 (1977).

108. *Bart Arconti & Sons, Inc. v. Ames-Ennis, Inc.*, 275 Md. 295, 309-11, 340 A.2d 225, 234-35 (1975); *Damazo v. Wahby*, 259 Md. 627, 633-34, 270 A.2d 814, 817 (1970); *Ace Dev. Co. v. Harrison*, 196 Md. 357, 366-69, 76 A.2d 566, 570-71 (1950); *Fuller v. Horvath*, 42 Md. App. 671, 684, 402 A.2d 134, 142, *cert. denied*, 286 Md. 748 (1979); *Colandrea v. Colandrea*, 42 Md. App. 421, 427-28, 401 A.2d 480, 484, *cert. denied*, 286 Md. 745 (1979).

109. See *Starfish Condo. Ass'n v. Yorkridge Serv. Corp.*, 295 Md. 693, 713, 458 A.2d 805, 816 (1983); *Dixon v. Process Corp.*, 38 Md. App. 644, 654-55, 382 A.2d 893, 899, *cert. denied*, 282 Md. 731 (1978).

110. *Starfish Condo. Ass'n v. Yorkridge Serv. Corp.*, 295 Md. 693, 458 A.2d 805 (1983) (contract action); *Fuller v. Horvath*, 42 Md. App. 671, 402 A.2d 134 (same), *cert. denied*, 286 Md. 748 (1979); *Colandrea v. Colandrea*, 42 Md. App. 421, 401 A.2d 480 (same), *cert. denied*, 286 Md. 745 (1979).

111. *Damazo v. Wahby*, 259 Md. 627, 270 A.2d 814 (1970) (action for tortious interference); *Bethlehem Steel Co. v. Raymond Concrete Pile Co.*, 141 Md. 67, 118 A. 279 (1922) (negligence action).

112. 295 Md. 693, 458 A.2d 805 (1983).



of a federal savings and loan association.<sup>113</sup> The Maryland court of appeals refused to hold the association liable for its subsidiary's obligations, not only because there was no indication of fraud, but also because there was no "identification of an equity which require[d] enforcement, and which [was] paramount to the ordinary expectation of limited liability. . . ."<sup>114</sup> It thus appears from *Starfish* that the policy of upholding limited liability outweighs the policy of promoting justice in Maryland. Furthermore, the *Starfish* court employed the principle of "paramount equity," yet as in previous decisions, the court never clearly defined the term.<sup>115</sup>

With respect to the term "paramount equity," the court in *Dixon v. Process Corp.*,<sup>116</sup> alluded to a definition:

Unless the party against whom the application of the doctrine is sought has been blameworthy "of some unconscientious, inequitable or fraudulent act of commission or omission upon which another has relied and been misled to his injury, the doctrine will not be applied."<sup>117</sup>

An illustration of the court enforcing a "paramount equity" is found in *United Electric Supply Co. v. Greencastle Gardens Section III Ltd. Partnership*.<sup>118</sup> In *United Electric*, the plaintiff corporation United Electric Supply Company (United Electric) was solely owned by one Joe Penovich, who also was president and sole owner of a licensed electric company. After a third party unlicensed company contracted to do electrical work for Greencastle Gardens, Penovich gave the unlicensed company permission to use his licensed company's name on the electrical permit to meet county requirements. In return for the use of his company's name, Penovich secured a promise that the unlicensed company would purchase all necessary supplies from United Electric.<sup>119</sup> The use of the licensed company's name for the purpose of obtaining a permit was clearly in violation of a regulatory statute.<sup>120</sup> Ultimately, United Electric was not paid for the materials it supplied because of work improperly performed by the subterfuge company, and sought to enforce a mechanics lien against Greencastle Gardens.<sup>121</sup> The court, relying on

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113. *Id.* at 713, 458 A.2d at 816.

114. *Id.* at 714, 458 A.2d at 816.

115. For opinions in which the Court of Appeals of Maryland has considered the concept of "paramount equity," but provided no genuine definition, see *Bart Arconti & Sons, Inc. v. Ames-Ennis, Inc.*, 275 Md. 295, 340 A.2d 225 (1975); *Damazo v. Wahby*, 259 Md. 627, 270 A.2d 814 (1970); *William Danzer & Co. v. Western Md. Ry.*, 164 Md. 448, 165 A. 463 (1933); *Carozza v. Federal Fin. & Credit Co.*, 149 Md. 223, 131 A. 332 (1925).

116. 38 Md. App. 644, 382 A.2d 893, *cert. denied*, 282 Md. 731 (1978).

117. *Id.* at 658, 382 A.2d at 901 (citations omitted).

118. 36 Md. App. 70, 373 A.2d 42 (1977).

119. *Id.* at 73, 373 A.2d at 44.

120. *Id.* at 72, 373 A.2d at 44.

121. *Id.* at 74, 373 A.2d at 45.

the violation of the regulatory statute as sufficient grounds for piercing the corporate veil, refused to treat the Penovich owned United Electric as a separate corporate entity from the Penovich owned licensed electric company. The court treated the actions of both corporations as if Penovich had been acting as an individual. The corporate entity was ignored in this case because it was "necessary to enforce the public policy of a regulatory statute."<sup>122</sup> Further, the court stated: "Corporate veils were not intended to provide false fronts as conveyances for pecuniary gain made from conduct that is statutorily proscribed."<sup>123</sup>

Not only is it unclear precisely what constitutes a "paramount equity," but determining what constitutes fraud may be equally as difficult. Most recently, the Maryland court of special appeals defined fraud as "a scienter tort consisting of the representation of a material fact that is false, deceptive and injurious."<sup>124</sup> In deciding the issue of fraud in piercing cases, the Maryland appellate courts reached different results in *Bart Arconti & Sons, Inc. v. Ames-Ennis, Inc.*<sup>125</sup> and *Colandrea v. Colandrea*,<sup>126</sup> despite similar fact patterns.

*Bart Arconti*, decided in 1975 by the Maryland court of appeals, involved a breach of contract action brought by a general contractor (Ames-Ennis) against a subcontractor (Bart Arconti & Sons). Named as defendants in the action were Bart Arconti & Sons, its sole shareholders Bart and George Arconti, and two controlled affiliated corporations, G & L Construction Company and Atlas Tile and Terraza, Inc.<sup>127</sup> Because of the contractual dispute, Bart and George Arconti took precautions to minimize the assets of Bart Arconti & Sons. Specifically, Bart Arconti & Sons, the most profitable of the three corporations owned by the Arcontis, ceased to operate and was permitted by its owners to become dormant.<sup>128</sup> All business which normally would have been performed by Bart Arconti & Sons was thereafter directed to and completed by the two affiliated corporations. Moreover, the assets of Bart Arconti & Sons were

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122. *Id.* at 80 n.5, 373 A.2d at 48 n.5. The court reasoned that Penovich, acting through his licensed electric company, had "soiled" his hands by making the illegal agreement with the third party unlicensed company. United Electric's claim relied upon that illegal contract. The court reasoned that Penovich's behavior, if not overtly fraudulent, "smacked thereof sufficiently," such that his soiled hands were also the hands of United Electric. United Electric's claim was therefore precluded under the equitable doctrine of unclean hands. *Id.* at 80, 373 A.2d at 47.

123. *Id.* at 80, 373 A.2d at 47. Even though the violation of a statute was enough to warrant piercing in *United Electric*, thereby making the determination of fraud unnecessary, it would seem that absent such a violation, the approach would be two-tiered: (1) determine if fraud is present; and (2) if fraud is lacking, look to see if there is the need to enforce a "paramount equity."

124. Fuller v. Horvath, 42 Md. App. 671, 685, 402 A.2d 134, 142, *cert. denied*, 286 Md. 748 (1979).

125. 275 Md. 295, 340 A.2d 225 (1975).

126. 42 Md. App. 421, 401 A.2d 480, *cert. denied*, 286 Md. 745 (1979).

127. *Bart Arconti & Sons, Inc. v. Ames-Ennis, Inc.*, 275 Md. 295, 303-04, 340 A.2d 225, 230-31 (1975).

128. *Id.* at 309, 340 A.2d at 233-34.

transferred to the affiliated corporations.<sup>129</sup>

The court also noted that the construction equipment owned by the three companies was commingled, all three corporations operated out of the same place of business, the same workmen were shared by each corporation, all the stock of the three corporations was owned by Bart and George Arconti, certain loans were made to the Arcontis by Bart Arconti & Sons, and certain insurance policies were transferred to the former by the latter.<sup>130</sup> Despite these findings, the court would not pierce the corporate veil of Bart Arconti & Sons, nor impose liability upon its individual owners or the affiliated corporations.<sup>131</sup> The trial court, which *had* pierced the corporate veil, viewed the diversion of the business and the commingling of the corporations's assets as merely being an attempt to evade a legal obligation.<sup>132</sup> In reversing the lower court's decision, the court of appeals stated that it was "[un]aware of any Maryland case where, on facts resembling those here, the Court has allowed the corporate identity to be disregarded merely because it wished to prevent an 'evasion of legal obligations,' — absent evidence of fraud or similar conduct."<sup>133</sup>

In *Colandrea v. Colandrea*,<sup>134</sup> a corporation, Cortland Realty, Ltd., was formed by Dominic and Carmen Colandrea, then husband and wife. Marital problems arose, and ultimately a divorce agreement was reached whereby the corporation was sold to Carmen by way of a stock redemption agreement. Pursuant to this agreement, a substantial portion of the redemption price was evidenced by notes that were to be paid to Dominic by the corporation in annual installments.<sup>135</sup> Three months after the execution of the stock redemption agreement, Carmen incorporated Cortland, Ltd. to divert the residential sales operation from Cortland Realty, Ltd. — its most profitable component.<sup>136</sup> Sometime later, the name of Cortland Realty, Ltd. was changed to Carmen Management Company, Inc.<sup>137</sup> When Dominic failed to receive payment from the corporation, he brought suit to pierce the corporate veil, and named as defendants Carmen and the two corporations she had formed after the stock redemption agreement.<sup>138</sup> The complaint alleged that the business and assets of Cortland Realty, Ltd. had been completely transferred to

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129. *Id.* at 304-05, 340 A.2d at 231.

130. *Id.*

131. *Id.* at 313-14, 340 A.2d at 236.

132. *Id.* at 309, 340 A.2d at 234.

133. *Id.* at 311-12, 340 A.2d at 235. The trial court, in deciding to pierce the corporate veil, relied exclusively on H. BRUNE, JR., MARYLAND CORPORATION LAW & PRACTICE § 371 (rev. ed. 1953), which states that a corporate veil can be pierced in order to prevent evasion of legal obligations. *Id.* at 434-35.

134. 42 Md. App. 421, 401 A.2d 480, *cert. denied*, 286 Md. 745 (1979).

135. *Id.* at 423, 401 A.2d at 482.

136. *Id.*

137. *Id.* at 424, 401 A.2d at 482.

138. *Id.* at 425, 401 A.2d at 483.

Carmen's two newly formed corporations,<sup>139</sup> just as the assets were transferred in *Bart Arconti*. In *Colandrea*, however, the court of special appeals disregarded the corporate entity and imposed individual liability upon Carmen Colandrea.<sup>140</sup>

The distinction between the two cases appears to be the factual evidence presented. In *Colandrea*, a legal obligation was undertaken by the defendant in her capacity as officer/director of the corporation to make payment to the plaintiff, but, as the court of special appeals found, at the time this agreement was made, the defendant had no intention of honoring the obligation.<sup>141</sup> Thus, the new corporations, formed specifically to avoid liability for this agreement, were part of the defendant's fraudulent scheme. The fraud finding, though sound in *Colandrea*, was based upon the defendant's own admission in a deposition that she had no intention of repaying the obligation. Had the defendant not disclosed her fraudulent intention, the *Colandrea* court may not have made a finding of fraud, provided the defendant could have demonstrated sound business reasons for the creation of the corporations.<sup>142</sup> By comparison, the court of appeals in *Bart Arconti* found no fraud even where events similar to those in *Colandrea* were undertaken to evade a legal obligation. Had there been an admission in *Bart Arconti* such as the one in *Colandrea*, the court

139. *Id.* at 424, 401 A.2d at 482.

140. *Id.* at 432-33, 401 A.2d at 486-87.

141. *Id.* The *Colandrea* court stated the following requirements for fraud, which must be satisfied by clear and convincing proof:

(1) a material representation of a party was false, (2) falsity was known to that party or the misrepresentation was made with such reckless indifference to the truth as to impute knowledge to him, (3) the misrepresentation was made with the purpose to defraud (scienter), (4) the person justifiably relied on the misrepresentation, and (5) the person suffered damage directly resulting from the misrepresentation.

*Id.* at 428, 401 A.2d at 484 (citations omitted).

142. The court stated that normally it would not interfere with a trial court's finding of "sound corporate reasons." It concluded, however, that there were no sound business reasons for the creation of Cortland, Ltd. and Carmen Management Company, Inc. *Id.* at 429, 401 A.2d at 485. Moreover, the court stated:

Regardless of whether there were sound corporate reasons for the creation of the new corporations . . . we think the trial court clearly erred in failing to consider Mrs. Colandrea's admission in a deposition . . . that at the time she signed the agreement on behalf of the corporation, she had no intention of paying the notes.

*Id.* at 430, 401 A.2d at 485.

From this analysis, it appears that the court could not have determined fraud without the deposition of Mrs. Colandrea. Absent such a deposition, the basis for determining fraud would have rested on Mrs. Colandrea's assertion that the "sound corporate reason" for the creation of the new corporations was due to the filing of a race discrimination suit against Cortland Realty, Inc. While the court of special appeals found this statement to be "actionable fraud," *id.*, it conceded that the other elements of fraud would also have to be demonstrated by "clear and convincing" proof. Since the court determined that the deposition was far more convincing, it neglected to make a finding concerning the presence of all elements of fraud with respect to Mrs. Colandrea's statement about the race discrimination suit constituting a "sound corporate reason." *Id.*

might have pierced the corporate veil of Bart Arconti & Sons. Thus, absent expressed intentions of fraud, it seems unlikely that the Maryland courts will pierce the corporate veil.

## V. DOCTRINAL REFORM FOR "PIERCING THE CORPORATE VEIL" IN MARYLAND: A SUGGESTED APPROACH

The current law in Maryland for determining whether to disregard the corporate entity is unduly narrow, and oftentimes inequitable. Maryland courts consistently refuse to pierce the corporate veil for anything less than a "clear and convincing" showing of fraud.<sup>143</sup> The appellate decisions appear to consider only the policy concerns behind the theory of limited liability, while ignoring the policy of serving justice in a particular case.<sup>144</sup> A more equitable approach would place equal emphasis upon the latter consideration, one which the Maryland courts seem to have obliterated. The policy of serving justice in a particular case cannot be preserved under the current test of fraud or "paramount equity" because of the stringent standards for determining fraud, and because of concomitant obscurities associated with the term "paramount equity." Accordingly, the standards enunciated by the Maryland courts should be revamped to take into account the real equities of a given factual scenario.

### A. *Adoption of the "Many Factors" Approach in Maryland*

Utilizing the various considerations enumerated in the "many factors" analysis — including factors such as undercapitalization, abuse of formalities, control, and unfairness — Maryland courts would be able to provide injured claimants with a remedy that at present is not available. Although the current Maryland test is stable because it is the accepted standard, the elimination of its stringent requirements would help advance the policy of promoting justice in a particular case. Moreover, the adoption of the "many factors" approach would certainly not undermine the policy behind limited liability.<sup>145</sup>

Under the "many factors" approach, even in the absence of fraud, an injured claimant might be entitled to recovery. There may be situations in which the factors of undercapitalization, control, abuse of formalities, and unfairness are present, yet fraud is not.<sup>146</sup> In such situations, it may be equally as equitable to disregard the corporate entity as it is where fraud occurs. In addition, demonstrating an element of unfair-

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143. See *supra* note 141.

144. The only other policy consideration mentioned by Maryland courts has been that of enforcing public policy proscribed by a regulatory statute. See *United Elec. Supply Co. v. Greencastle Gardens Section III Ltd. Partnership*, 36 Md. App. 70, 80 n.5, 373 A.2d 42, 47-48 n.5 (1977).

145. See *supra* notes 14-15 and accompanying text.

146. See *supra* notes 60-88 and accompanying text.

ness without having to demonstrate the elusive ingredient of enforcing a "paramount equity," will lead to fewer ambiguities in situations where the burden of proving fraud is too great, yet where liability should be imposed in order to serve justice in a particular situation. Regardless of whether liability is to be imposed upon an individual or upon a parent corporation, the decision to pierce the corporate veil should proceed upon a finding of more than one of the mentioned factors, and a balancing of *both* conflicting policy considerations.<sup>147</sup>

*B. Application of the "Many Factors" Analysis to Maryland Decisions*

Applying the "many factors" analysis to several Maryland decisions demonstrates the possibility, if not probability, of different results being reached under this approach. A brief discussion of three cases where the court refused to disregard the corporate veil underscores this point.

In *Bart Arconti & Sons, Inc. v. Ames-Ennis, Inc.*,<sup>148</sup> the Maryland court of appeals, holding that there was neither fraud present nor a "paramount equity" to be enforced, refused to pierce the corporate veil. Applying the "many factors" analysis to the facts of *Bart Arconti*, two of the previously mentioned factors are evident: control and an abuse of formalities.<sup>149</sup> Clearly, pervasive control was exercised by Bart and George Arconti over the three companies.<sup>150</sup> Bart Arconti & Sons lost its individuality as a separate entity when the owners took steps to transfer its assets and thus render it dormant. Similarly, all three corporations lost their individuality with respect to the types of work in which they were engaged,<sup>151</sup> and as such, should not have been allowed to profit from the separate entity privilege.

In addition to the pervasive control present in *Bart Arconti*, the commingling of the construction equipment and other assets constituted an abuse of formalities. One dealing with these corporations could easily be misled into believing that there was no distinction between the three corporations because Bart Arconti & Sons's assets and business had been shifted to the two sister corporations.<sup>152</sup>

The same type of shifting of assets occurred in *Colandrea v. Colan-*

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147. See *supra* notes 14-15 and accompanying text. The courts should focus on the policy that seems to be most important in a particular case; to wit, whether limiting liability in a particular circumstance outweighs the policy of "doing justice in a particular case," and vice versa.

148. 275 Md. 295, 340 A.2d 225 (1975).

149. See *supra* notes 69-82 and accompanying text.

150. *Bart Arconti*, 275 Md. at 304, 340 A.2d at 231. Not only were Bart and George Arconti the only stockholders of the corporations, but they also controlled the day-to-day management affairs of the businesses.

151. *Id.* at 304, 340 A.2d at 231. Bart Arconti & Sons's specialties were ceramic tile and masonry construction. G & L Construction Company, a sister corporation, specialized in masonry construction, while Atlas Tile and Terrazo, Inc., the other affiliate, specialized only in ceramic tile.

152. Concededly, in *Bart Arconti* there was no such confusion, but this is not to say that such conduct could not create confusion in another situation.

*drea*,<sup>153</sup> yet there, the court pierced the corporate veil. Apparently, anything short of demonstrating actual fraud by way of an admission<sup>154</sup> will be insufficient to pierce the corporate veil. In *Bart Arconti*, there was not only the presence of control and an abuse of formalities, but also an element of unfairness: the ability of individuals to avoid contractual obligations by maneuvering assets among corporate bodies. This avoidance tactic, in many respects, was similar to that in *Colandrea*. It is the element of unfairness that needs more consideration by the Maryland courts to promote the policy of doing justice in a particular case. If the unfairness factor, a component in the proposed "many factors" approach, had been considered in *Bart Arconti*, Bart Arconti & Sons would not have been able to avoid its legal obligations to Ames-Ennis, and therefore, Ames-Ennis would have recovered the damages to which it was entitled.

Following *Bart Arconti*, the Maryland court of special appeals discussed piercing the corporate veil in *Dixon v. Process Corp.*<sup>155</sup> The plaintiff in *Dixon*, alleging a breach of contract, obtained a judgment against the parent corporation ("PIM") and attempted to obtain a decree that the parent and subsidiary corporations were one in the same, so as to have the judgment collectible from the subsidiary ("TPC").<sup>156</sup> At all times, the plaintiff in *Dixon* believed he was dealing with only one corporation: (1) the directors for the corporations were the same; (2) the stock of PIM was paid for but not issued; (3) PIM owned all the equipment that was used by its subsidiary; (4) PIM hired all of its subsidiary's employees, rented their offices, operated their payroll, attended to unemployment matters, and managed its affairs; and (5) separate board meetings for TPC were never held.<sup>157</sup> These factors indicate the presence of control and an obvious abuse of formalities.

After reviewing the above facts, the Court of Special Appeals of Maryland stated: "We think there was legally sufficient evidence to cast doubt as to the separate corporate identities of PIM and TPC."<sup>158</sup> Nonetheless, the *Dixon* court held that the corporate veil could not be pierced because there was no showing of fraud or a "paramount equity."<sup>159</sup> Had the "many factors" approach been employed, the doubts expressed by the court could and would have dictated that the corporate veil be pierced.

The federal court in the district of Maryland has also applied this

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153. 42 Md. App. 421, 401 A.2d 480, *cert. denied*, 286 Md. 745 (1979); see *supra* text accompanying notes 116-23.

154. *Colandrea*, 42 Md. App. at 430, 401 A.2d at 485. In fact, in no Maryland case found to date has the corporate veil been pierced solely to enforce a "paramount equity."

155. 38 Md. App. 644, 382 A.2d 893, *cert. denied*, 282 Md. 731 (1978).

156. *Id.* at 650, 382 A.2d at 897.

157. *Id.* at 654, 382 A.2d at 899.

158. *Id.* at 655, 382 A.2d at 900.

159. *Id.*

rigid standard,<sup>160</sup> as illustrated by *Gordon v. S.S. Vedalin*.<sup>161</sup> In *Gordon*, an individual, Johnson, purchased a vessel, the S.S. Vedalin. The purchase was not made in his own name, but rather in the name of a corporation, Harold's Trading Post, which Johnson solely owned.<sup>162</sup> After Harold's Trading Post defaulted on the payment, an order of resale was issued. Pursuant to this resale order, the defaulting first purchaser, Harold's Trading Post, was "responsible for all costs in connection with the resale, and maintenance of the vessel."<sup>163</sup> When the various expenses were not paid, the libelants of the vessel brought suit to have the corporate veil of Harold's Trading Post pierced and individual liability imposed upon Johnson.<sup>164</sup> In support of their argument that the veil should be pierced, the plaintiffs in *Gordon* relied upon the following: (1) the corporation was never properly capitalized; (2) there was doubt that corporate formalities, such as the formal issuance of stock and regular corporate meetings, had ever been observed; and (3) the corporation was initiated to give Johnson a chance to engage in business that he otherwise could not engage in because of outstanding judgments against him.<sup>165</sup> In fact, the only indication of Harold's Trading Post's separate existence was the filing of its articles of incorporation.<sup>166</sup> The district court described the proof of the corporation's separate existence as being "tenuous at best,"<sup>167</sup> however, with Maryland law controlling, the court held that the corporate veil could not be pierced.

Using the "many factors" approach, as opposed to the strict Maryland requirements, the outcome in *Gordon* most likely would have been different. The district court's finding of the corporation's tenuous separate existence would have, in all likelihood, yielded a conclusion that recognizing the separateness would be unfair or inequitable; hence, the corporate veil would have been pierced. In rendering its decision, however, the *Gordon* court was confined to the well settled Maryland law,

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160. See *Cawley v. Bloch*, 544 F. Supp. 133 (D. Md. 1982); *Gordon v. S.S. Vedalin*, 346 F. Supp. 1178 (D. Md. 1972); *Winand v. Case*, 154 F. Supp. 529 (D. Md. 1957); see also *supra* note 2 and accompanying text (law review articles discussing the federal court's problems with piercing the corporate veil).

161. 346 F. Supp. 1178 (D. Md. 1972).

162. *Id.* at 1180.

163. *Id.*

164. *Id.*

165. *Id.* at 1181.

166. *Id.* This apparently is sufficient to determine the corporate existence. This thought was stated with approval by the *Dixon* court following *Gordon*. See *Dixon*, 38 Md. App. at 655, 382 A.2d at 900. In Maryland, the acceptance of articles of incorporation by the State Department of Assessments and Taxation conclusively establishes the existence of the corporation as a legal entity. MD. CORPS. & ASS'NS CODE ANN. §§ 1-205, 2-102(b) (1975).

167. "Even though the proof of the existence of the corporation as a separate entity and not as the mere alter ego of Harold Johnson is tenuous at best, it seems that, under Maryland law, the corporate entity cannot be disregarded in this case." *Gordon*, 346 F. Supp. at 1181.



and thus unable to pierce the corporate veil.<sup>168</sup>

## VI. CONCLUSION

Several theories have been formulated through the years to determine whether to pierce the corporate veil. Although these theories have been given various names by both courts and commentators, certain factors are repeatedly present and analyzed by the courts. Generally, the presence of these factors, coupled with an element of unfairness, provides the rationale for a court's decision to pierce the corporate veil.

Maryland also considers these factors, but in a different manner. Specifically, the presence of certain factors coupled with an element of unfairness does not justify piercing the corporate veil unless doing so would prevent fraud or achieve a "paramount equity."

Decisional law applying the rigid Maryland requirements demonstrates that the Maryland courts regard the policy behind limiting liability as being tantamount to the policy of promoting justice in a particular case. The import of this latter policy concern needs to be reconsidered by the Maryland courts in piercing cases. It is submitted that a more equitable approach is needed in Maryland, and that the suggested "many factors" analysis provides the best alternative. Concededly, limited shareholder liability should be maintained whenever possible to encourage capital growth and investment, but not to the point that such maintenance causes a blatant disregard for basic principles of justice and fairness. Only after the Maryland courts make an honest attempt to balance these policies will equity be achieved in situations involving piercing the corporate veil.

*Denise L. Speer*

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168. *Id.*