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# Comments: Liberalizing Maryland's Approach to Piercing the Corporate Veil

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## LIBERALIZING MARYLAND'S APPROACH TO PIERCING THE CORPORATE VEIL

### I. INTRODUCTION

Due to the uncertain odds of success in the business world, the corporate form of organization is fundamental for the protection of the personal assets of Maryland investors.<sup>1</sup> With the potential for a business entity to put its shareholders at risk of contract or tort liability, a corporation's characteristic of limited liability is extremely attractive to investors.<sup>2</sup> Nevertheless, shareholders may be surprised to learn that limited liability does not shield them from the obligations of a corporation as fully as state statutes would make it seem, especially after seeing the rate with which state and federal courts will "pierce the corporate veil" and make shareholders personally responsible for a corporation's liabilities.<sup>3</sup> While many states use "piercing the corporate veil" as a protection for individuals in contract and tort claims against the abuse of the corporate shield, "Maryland views [it] as only a theoretical remedy."<sup>4</sup>

Piercing the corporate veil<sup>5</sup> is a muddled doctrine that state courts have had trouble devising any consistent and reliable approach to, which is alarming given that "[v]eil-piercing is the most heavily litigated issue in corporate law . . . ."<sup>6</sup> Different state courts have developed a range of approaches to determine whether a corporation's veil should be "pierced," which has led to unpredictable

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1. G. Michael Epperson & Joan M. Canny, *The Capital Shareholder's Ultimate Calamity: Pierced Corporate Veils and Shareholder Liability in the District of Columbia, Maryland, and Virginia*, 37 CATH. U. L. REV. 605, 605 (1988).
  2. *Id.*; see *infra* Part II. "Long the hallmark of corporate status, limited liability protects a corporation's shareholders from personal responsibility for corporate obligations. This means that a creditor who has a claim arising out of a transaction with the corporation may not look to a shareholder for payment even if the corporation is insolvent." David Millon, *Piercing the Corporate Veil, Financial Responsibility, and the Limits of Limited Liability*, 56 EMORY L.J. 1305, 1309 (2007) (footnote omitted).
  3. Epperson & Canny, *supra* note 1, at 605. A shareholder is one who owns a share, which represents ownership interest, in a company. BLACK'S LAW DICTIONARY 1500 (9th ed. 2009).
  4. Epperson & Canny, *supra* note 1, at 605.
  5. See *infra* Part III.
  6. Millon, *supra* note 2, at 1307; see Denise L. Speer, Comment, "Piercing the Corporate Veil" in Maryland: An Analysis and Suggested Approach, 14 U. BALT. L. REV. 311, 311 (1985).

outcomes among different jurisdictions.<sup>7</sup> Maryland is unique compared to the rest of the United States because Maryland courts adhere to a strict approach that permits piercing the corporate veil “only to prevent fraud or to enforce a paramount equity.”<sup>8</sup> On the contrary, other states’ courts use various different factors in deciding whether to pierce the corporate veil—often referred to as “disregarding the corporate entity—and are thus more lenient in doing so.”<sup>9</sup> In fact, Maryland is considered to have the most stringent requirements, thus rendering it the state in which piercing the corporate veil proves most difficult.<sup>10</sup>

This comment explores the consequences of Maryland’s strict approach to piercing the corporate veil, and provides an in-depth comparison to other states’ approaches.<sup>11</sup> Specifically, this comment defines and discusses the doctrine of piercing the corporate veil as well as the doctrine of limited liability, which is followed by a summary of different veil-piercing tests employed by select states.<sup>12</sup> Next, this comment looks at Maryland’s approach and evaluates it through an examination of the advantages and disadvantages of a strict standard to piercing the corporate veil.<sup>13</sup> Finally, this comment suggests a fresh and reasonable approach for the Maryland courts that considers new and different factors, along with other states’ approaches, to formulate the best veil-piercing standard for Maryland.<sup>14</sup> The overarching goal of this comment is to demonstrate the need for a more liberal veil-piercing approach in Maryland to better protect individual rights.

## II. THE DOCTRINE OF LIMITED LIABILITY

A fundamental principle of corporate law is that the “corporation” is a creation of the state and is meant to operate as a legally recognized business entity, independent from its shareholders, to

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7. See Epperson & Canny, *supra* note 1, at 612; *infra* Part V.

8. Dixon v. Process Corp., 38 Md. App. 644, 653, 382 A.2d 893, 899 (1978) (quoting Bart Arconti & Sons, Inc. v. Ames-Ennis, Inc., 275 Md. 295, 312, 340 A.2d 225, 235 (1975)); Speer, *supra* note 6, at 311–12; see *infra* Parts V–VI. The term “paramount equity” will be discussed in Part VI of this comment.

9. See Peter B. Oh, *Veil-Piercing*, 89 TEX. L. REV. 81, 132–34 (2010); Speer, *supra* note 6, at 311; *infra* Part V..

10. Oh, *supra* note 9, at 117.

11. See *infra* Part VII.

12. See *infra* Parts II–V.

13. See *infra* Parts VI–VII.

14. See *infra* Part VIII.

promote economic activity in the marketplace.<sup>15</sup> Thus, the corporation's actions and value are separate from its shareholders, allowing the corporation to act as a shield to protect the personal assets of the investors from the liabilities of the corporation.<sup>16</sup> According to the doctrine of "limited liability," a corporate shareholder can lose no more than the amount they invested in the corporation in the event of a business failure.<sup>17</sup> Thus, limited liability is a primary reason for incorporating a business, and in effect, it shifts some of the risks of operating a corporation away from its shareholders.<sup>18</sup> Furthermore, it is entirely legal to incorporate a business solely for the purpose of limiting shareholder liability.<sup>19</sup>

Shareholder limited liability allows capital investment to flourish and assists corporations in the accumulation of large amounts of money by making investment attractive to investors.<sup>20</sup> At the same time, limited liability minimizes the exposure of shareholders' personal assets to the everyday risks of doing business.<sup>21</sup> Nevertheless, some scholars criticize limited liability protection by arguing that it encourages excessive risk-taking by allowing shareholders "to avoid the full costs of their business activities while reaping the full economic reward of such activities."<sup>22</sup>

### III. CORPORATE LAW AND "PIERCING THE CORPORATE VEIL"

Piercing the corporate veil is an exception to the default rule in corporate law of shareholder limited liability protection.<sup>23</sup> "Although

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15. Epperson & Canny, *supra* note 1, at 606 ("[The corporation] is endowed with attributes designed to make it a convenient and cost-effective form in which to operate a business.").

16. See Millon, *supra* note 2, at 1309; 114 AM. JUR. 3D *Proof of Facts* § 3 (2010) ("A corporation is treated entirely separate from its shareholders even where one individual owns all of the stock.").

17. Epperson & Canny, *supra* note 1, at 606; Thomas K. Cheng, *Form and Substance of the Doctrine of Piercing the Corporate Veil*, 80 MISS. L.J. 497, 501 (2010). "[L]imited liability has been called the most attractive feature of [the] corporation." 114 AM. JUR. 3D *Proof of Facts* § 1 (2010).

18. Robert B. Thompson, *Piercing the Corporate Veil: An Empirical Study*, 76 CORNELL L. REV. 1036, 1040 (1991).

19. See I. MAURICE WORMSER, *DISREGARD OF THE CORPORATE FICTION AND ALLIED CORPORATION PROBLEMS* 18 (Beard Books 2000) (1927).

20. Epperson & Canny, *supra* note 1, at 606-07.

21. *Id.* at 607; 114 AM. JUR. 3D *Proof of Facts* § 1 (2010).

22. J. William Callison, *Rationalizing Limited Liability and Veil Piercing*, 58 BUS. LAW. 1063, 1063 (2003).

23. Cheng, *supra* note 17, at 502.

the limited liability offered by legal entities serves important public policy goals, there are times when strict adherence to the doctrine would bring about inequitable results.<sup>24</sup> In such cases, a court will “pierce” the “veil” of the corporation, disregard the shareholders’ privilege of limited liability, and provide a remedy to a contract creditor or a tort victim.<sup>25</sup> Once the veil of the corporate entity is pierced, the shareholders are personally responsible for corporate liabilities because the court determines that “the liability in question ‘is not really a debt of the corporation, but ought, in fairness[,] to be viewed as a debt of the individual or corporate shareholder or shareholders.’”<sup>26</sup> In other words, courts will use the equitable doctrine of piercing the corporate veil to disregard the separate personality of the corporation and to hold shareholders liable for the acts or obligations of the corporation to the extent that liability is unmet after a corporation becomes insolvent.<sup>27</sup>

Accordingly, limited liability protection for shareholders may in fact be ignored if a court finds that particular factors are met by a corporation’s actions, usually determined on a case-by-case basis.<sup>28</sup> Since this common law remedy is discretionary and there are numerous approaches by state courts, this doctrine has turned out to be incoherent, and a case-by-case application is difficult and dubious.<sup>29</sup> Courts have had much trouble in determining when a creditor has successfully crossed the threshold in defeating limited liability and reaching a shareholder’s personal assets; as a result, many different approaches have been developed across the country.<sup>30</sup> With the strong policy reasons urging businesses to incorporate coupled with the need to respect a business’ decision to incorporate, courts’ decisions to pierce the corporate veil are often unpredictable, and likewise, courts’ reasoning for doing so is often unclear.<sup>31</sup> Since piercing the corporate veil is an exception to a primary reason for incorporating a business, “courts addressing the issue are often

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24. 114 AM. JUR. 3D *Proof of Facts* § 1 (2010).

25. Epperson & Canny, *supra* note 1, at 608–09.

26. *In re Payroll Exp. Corp.*, 216 B.R. 344, 361 n.11 (S.D.N.Y. 1997) (quoting STEPHEN B. PRESSER, *PIERCING THE CORPORATE VEIL* § 1.01, at 1–6 (1998 West Group (1991))).

27. See 114 AM. JUR. 3D *Proof of Facts* § 1 (2010); Cheng, *supra* note 17, at 526.

28. Cheng, *supra* note 17, at 503–04.

29. Epperson & Canny, *supra* note 1, at 612.

30. Oh, *supra* note 9, at 81; see also *infra* Parts V–VI.

31. See Epperson & Canny, *supra* note 1, at 612. “Not surprisingly, veil-piercing has been decried as an . . . ‘incoherent’ doctrine whose ‘ambiguity and randomness’ resembles ‘lightning, [in that] it is rare, severe, and unprincipled.’” Oh, *supra* note 9, at 85.

caught between the conflicting goals of preserving the corporate entity and affording relief to the victim."<sup>32</sup>

In Peter B. Oh's study<sup>33</sup> on veil piercing, he found that the overall veil-piercing rate is 48.51%, which demonstrates that plaintiffs and defendants are almost equally successful in tried cases.<sup>34</sup> Many courts use metaphors to describe a theory or test when deciding whether to pierce the corporate veil.<sup>35</sup> The test that is seen most often in court decisions is known as the "alter ego test," and requires that the plaintiff prove that the corporation was an "alter ego" of the shareholder—i.e., that the shareholder had "complete control" of the corporation and used the corporation to defraud or cause an injustice against a victim.<sup>36</sup> Courts are continually changing their veil-piercing tests by adding new factors to be considered in their determination, and there is no one significant factor that is dispositive.<sup>37</sup> Furthermore, state courts rarely explain how both the old and new factors are to be weighted in their veil-piercing decisions.<sup>38</sup> The most successful veil-piercing rationale involves evidence of fraud or misrepresentation.<sup>39</sup> The other factors most frequently considered by courts in their analyses are commingling of assets, shareholder control or domination, injustice or unfairness, non-observance of corporate formalities,<sup>40</sup> and undercapitalization of the corporation.<sup>41</sup> State courts have fashioned their own veil-piercing tests by using a variety of these factors and assigning different weights to the ones they choose to incorporate.<sup>42</sup>

"In theory, the doctrine of limited liability extends with equal force to all variations on the corporate form," but in practice, closely held

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32. Epperson & Canny, *supra* note 1, at 612.

33. Oh, *supra* note 9, at 81 ("With the dataset of 2,908 cases from 1658 to 2006, this study presents the most comprehensive portrait of veil-piercing decisions yet.").

34. *Id.* at 107. From a sample of the years 2000-2006, the successful veil-piercing rate was 49.40% of 502 cases. *See id.* at 109.

35. *Id.* at 83-84.

36. *Id.* at 84 ("The inherent imprecision in metaphors has resulted in a doctrinal mess.").

37. *Id.*

38. *See* Millon, *supra* note 2, at 1327.

39. Oh, *supra* note 9, at 90.

40. Examples of a failure to observe corporate formalities are "when shareholder meetings or directors' meetings are not held[,] . . . when decisions are made by shareholders as though they were partners, when the shareholders do not sharply distinguish between corporate property and personal property, [or] when corporate funds are used to pay personal expenses." 114 AM. JUR. 3D *Proof of Facts* § 13 (2010).

41. Oh, *supra* note 9, at 90.

42. *See infra* Part V.

corporations are the most prevalent corporate veils to be pierced.<sup>43</sup> A public corporation, which typically includes a significant number of shareholders, has never had its corporate veil pierced because of the number of dispersed and unattached shareholders, which prevents the level of control necessary to justify veil piercing that is exemplified in veil-piercing cases of close corporations.<sup>44</sup> Courts understand that the ability to disregard the corporate entity should happen only in very rare cases, yet they will not allow shareholders to abuse this privilege by injuring others and then hiding behind the corporate shield.<sup>45</sup>

#### IV. TORT VERSUS CONTRACT CREDITORS

Some commentators argue that courts should be more willing to pierce the veil of a corporation in tort cases rather than in contract cases because a party will be careful in investigating and understanding the finances of the business when it enters into a contract.<sup>46</sup> Arguably, if the party has had this opportunity to understand all potential risks of the contract agreement and has had the ability to protect themselves, they should not later be able to pierce the veil of that partner if there is a breach of the contract.<sup>47</sup> On the other hand, in tort cases, the injured party is considered an involuntary creditor because they had no prior dealings with the corporation.<sup>48</sup> As a result, the shareholders of a corporation "are in a position to shift some of the social costs of their business activity onto members of the public who have not agreed to bear those costs."<sup>49</sup>

In fact, plaintiffs are indeed more successful in veil-piercing cases that involve tort claims rather than contract claims.<sup>50</sup> Depending on

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43. Epperson & Canny, *supra* note 1, at 613. As of 1997, no case of piercing the corporate veil had more than nine shareholders. 114 AM. JUR. 3D *Proof of Facts* § 3 (2010).

44. See Oh, *supra* note 9, at 110.

45. 114 AM. JUR. 3D *Proof of Facts* § 3 (2010).

46. Epperson & Canny, *supra* note 1, at 632-33.

47. *Id.* at 633.

48. *Id.* For example, "[a] pedestrian hit by a taxicab . . . has not agreed to assume the risk of corporate insolvency and shareholders' limited liability." Millon, *supra* note 2, at 1316.

49. Millon, *supra* note 2, at 1316.

50. Oh, *supra* note 9, at 90. "The results evince that veil-piercing claims prevail more often when they concern an involuntary (52.83%) versus a voluntary (47.50%) creditor." *Id.* at 141. However in Maryland, courts have allowed veil-piercing claims to consistently prevail more often in contract cases rather than tort cases. Epperson & Canny, *supra* note 1, at 634-35.

whether the litigant brings a contract or tort claim, certain factors will be more helpful to them in establishing a veil-piercing claim.<sup>51</sup> First, for example, fraud or misrepresentation are critical factors in contract cases; if a plaintiff can prove those elements, then the litigant has a much better chance of bringing a successful veil-piercing claim.<sup>52</sup> Furthermore, other important factors for contract litigants in successful veil-piercing claims are excessive shareholder control, failure to observe corporate formalities, and undercapitalization.<sup>53</sup> In contrast, plaintiffs in tort claims have a higher rate of success when demonstrating the corporation is involved in financial wrongdoing, especially if there is evidence of undercapitalization of the corporation.<sup>54</sup> Although financial misconduct, specifically undercapitalization, is a significant factor for tort claims, courts use evidence of inadequate capitalization as a factor comparably as often in both contract and tort claims.<sup>55</sup> This is somewhat surprising since the sufficiency of capital would seem to be more relevant in tort claims because the injured party did not have the prior opportunity to investigate the business entity and to protect themselves.<sup>56</sup>

## V. DIVERGING APPROACHES TO PIERCING THE CORPORATE VEIL IN THE UNITED STATES

Courts in different states have developed differing standards, but it is important to note “this is an area of law where courts adopt differing approaches even within jurisdictions.”<sup>57</sup> As a result, potential defendants to veil-piercing claims may forum shop and choose a state with a more favorable veil-piercing standard.<sup>58</sup> At the same time, an opportunity may be offered to potential plaintiffs to evaluate where to commence a veil-piercing suit.<sup>59</sup>

This section of the comment looks at five states' approaches to veil piercing: Virginia, California, Delaware, New York, and Pennsylvania. The veil-piercing approaches employed by these states will be used in this section of this comment as a means of comparison

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51. Oh, *supra* note 9, at 139.

52. *Id.*

53. *Id.*

54. *Id.*

55. *Id.* at 90. “[T]he focus [of inadequate capitalization] has expanded to include whether there was sufficient capital at the time of the alleged misconduct or . . . if assets had been siphoned for a shareholder’s own use.” *Id.* at 98–99.

56. *Id.* at 90.

57. Epperson & Canny, *supra* note 1, at 614.

58. Oh, *supra* note 9, at 113.

59. See Epperson & Canny, *supra* note 1, at 642.



to the current Maryland approach. Comparing the approaches used by Virginia, Delaware, and Maryland is particularly important because those states, situated in such close proximity to one another, compete for the same businesses.<sup>60</sup> Additionally, Delaware is the state with the best-developed general case law on corporations.<sup>61</sup> Pennsylvania, California, and New York were selected to give a diverse look at veil-piercing approaches from around the country. In fact, New York, California, and Pennsylvania are three of the top five producers of veil-piercing cases—due to each state’s wide-reaching economy consisting of numerous corporations—so they have had ample opportunity to develop case law on this subject.<sup>62</sup>

#### A. Virginia

Virginia courts usually begin their analysis by stating that the decision to ignore “the separate existence of a corporation and impos[e] personal liability on shareholders for debts of the corporation is an extraordinary act to be taken ‘only when necessary to promote justice.’”<sup>63</sup> Virginia courts continue to demonstrate that piercing the corporate veil is an extraordinary remedy because Virginia, along with Maryland, is one of three states to have a veil-piercing rate of less than 33.33%.<sup>64</sup> In fact, Virginia’s veil-piercing rate is 29.09%.<sup>65</sup> Virginia courts have explained that there is “no single rule” or approach that can be used when determining whether to pierce the veil of a Virginia corporation,<sup>66</sup> but have held that it is important to look at all of the specific actions of the corporation in question.<sup>67</sup>

Nevertheless, recent cases suggest that Virginia follows a two-part analysis to decide whether disregarding the corporate entity is justified.<sup>68</sup> Virginia courts will pierce the corporate veil “when the unity of interest and ownership is such that the separate personalities of the corporation and the individual no longer exist”; in other words, the corporation is the alter ego or “dummy” of the individual, and a

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60. *See id.*

61. *See Oh, supra* note 9, at 116.

62. *See id.* at 115–16 tbl.6.

63. *O’Hazza v. Exec. Credit Corp.*, 431 S.E.2d 318, 320 (1993) (quoting *Cheatle v. Rudd’s Swimming Pool Supply Co.*, 360 S.E.2d 828, 831 (1987)).

64. *See id.*; *Oh, supra* note 9, at 115.

65. *Oh, supra* note 9, at 116 tbl.6.

66. *O’Hazza*, 431 S.E.2d at 320.

67. *Id.* at 321.

68. *See, e.g., Millisor v. Anchor Point Ventures, L.L.C.*, No. CL08-114, 2008 Va. Cir. WL 8201369, at \*6 (Va. Cir. Ct. Nov. 7, 2008); *Brooks v. Becker*, No. 219257, 2005 Va. Cir. WL 832211, at \*2 (Va. Cir. Ct. Jan. 31, 2005).

shareholder has used the corporation to perpetrate fraud, to commit a crime, or to cause an injustice.<sup>69</sup> With the two-part test, "Virginia adheres to a rigorous standard requiring proof that the defendant" shareholder abused the privilege of the corporation by hiding his or her inequitable actions.<sup>70</sup> No single factor is dispositive for Virginia courts, but instead they will look at numerous factors in their veil-piercing decisions.<sup>71</sup> In fact, Virginia cases demonstrate that there does not need to be evidence of any fraud for Virginia courts to pierce the corporate veil.<sup>72</sup>

Undercapitalization is a major factor that Virginia courts will look to in determining whether to pierce a corporate veil to avoid an injustice.<sup>73</sup> For example, in *Dana v. 313 Freemason*,<sup>74</sup> the court observed whether the shareholders deliberately undercapitalized the corporation and if that was the reason for the unsatisfied judgments by the corporation.<sup>75</sup> In this case, when Freemason Associates, Inc. sold their building to individual unit owners, the shareholders knew that their condominium building's roof consistently leaked from the time of its installation as a result of structural defects.<sup>76</sup> The shareholders formed the corporation to decrease liability and to protect their personal assets since they knew about the defective roof as they tried to sell the property.<sup>77</sup> The court found that the evidence showed there was a "unity of interest" between the shareholders and the corporation through the absolute control of the business by the shareholders.<sup>78</sup> The court noted that "[t]he apparent inability of . . . [the corporation] to satisfy the judgment against it in this case was not the result of poor business decisions . . . or unexpected liabilities . . . [but instead] because of the deliberate acts of the incorporating stockholders."<sup>79</sup> Therefore, the corporation

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69. *C.F. Trust, Inc. v. First Flight Ltd. P'ship*, 580 S.E.2d 806, 809–10 (2003) (quoting *Greenberg v. Commonwealth ex rel. Attorney Gen. of Va.*, 499 S.E.2d 266, 272 (Va. 1998)); *Perpetual Real Estate Servs., Inc. v. Michaelson Props., Inc.*, 974 F.2d 545, 548 (4th Cir. 1992) (quoting *Cheatle v. Rudd's Swimming Pool Supply Co.*, 360 S.E.2d 828, 831 (Va. 1987)).

70. *Perpetual Real Estate*, 974 F.2d at 548.

71. *Epperson & Canny*, *supra* note 1, at 627.

72. *Id.*

73. *Dana v. 313 Freemason*, 587 S.E.2d 548, 554 (Va. 2003).

74. *Id.*

75. *Id.*

76. *Id.*

77. *Id.* at 551, 554.

78. *Id.* at 554.

79. *Id.*

insufficiently capitalized from the outset.<sup>80</sup> Furthermore, all corporate funds were deposited into a shareholder's personal checking account.<sup>81</sup> The highest court in Virginia held that it would be unjust to allow the shareholders to assert the protection of the corporate shield because of the reason for their incorporation and knowledge of the defects in the roof; and accordingly, the court decided that this was an example of an extraordinary case to allow a corporate veil to be pierced.<sup>82</sup>

### B. California

Similar to Virginia's test, the leading case in California gives a two-part test that California courts call the alter ego theory.<sup>83</sup> First, there must be such "unity of interest and ownership [between the corporation and its equitable owner] that the separate personalities of the corporation and the individual no longer exist."<sup>84</sup> Secondly, there must be an inequitable result from failing to pierce the corporate veil.<sup>85</sup> An example of satisfying the first prong is shareholder control or "domination" of the corporation, which essentially only occurs in closely held corporations.<sup>86</sup>

In *Automotriz*,<sup>87</sup> the plaintiff-seller filed an action against the defendant-buyers "for the balance due on the price of eight automobiles" sold to the defendants.<sup>88</sup> The court held that defendants' corporation, which allegedly purchased the automobiles, did not issue any stock or even apply for a permit to issue corporate stock.<sup>89</sup> Further, the trial court found no evidence of the defendants contributing to the equity of the firm, despite the defendants' testimony saying otherwise.<sup>90</sup> The state's highest court held that the trial court was not wrong in considering many different factors, including the non-issuance stock and the inadequate capitalization of the corporation from its inception, in determining whether defendants

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80. *Id.*

81. *Id.*

82. *Id.* at 555.

83. *Automotriz Del Golfo De Cal. S. A. de C. V. v. Resnick*, 306 P.2d 1, 3-4 (Cal. 1957).

84. *Id.* at 3.

85. *Id.*

86. Note, *Piercing the Corporate Law Veil: The Alter Ego Doctrine Under Federal Common Law*, 95 HARV. L. REV. 853, 854-55 (1982) [hereinafter *Alter Ego Doctrine*].

87. *Automotriz*, 306 P.2d 1.

88. *Id.* at 2.

89. *Id.* at 3.

90. *Id.*

were personally liable to the plaintiff.<sup>91</sup> Ultimately the court decided to disregard the corporate entity.<sup>92</sup> In its decision, the highest court of California implicitly acknowledged that the fact that the corporation was being closely held coupled with the failure of any issuance of stock, was sufficient to satisfy the first requirement of the two-part test.<sup>93</sup> Furthermore, the undercapitalization established the second, “inequitable result,” part of the test.<sup>94</sup>

According to California courts, when the corporate form of organization is used to defraud or for other inequitable means, the courts will “deem the corporation’s acts to be those of the persons . . . actually controlling the corporation, in most instances the equitable owners.”<sup>95</sup> Similar to Virginia, California’s alter ego doctrine also does not require a showing of actual fraud, but the California courts’ goal is to use the veil-piercing doctrine to prevent the potential injustices of sham corporations if they are allowed to carry on their dealings in the marketplace.<sup>96</sup>

Although California maintains that the alter ego test “is an extreme remedy [that is] sparingly used,”<sup>97</sup> this does not appear to be the case. Plaintiffs in California have a successful veil-piercing rate of 50.86% of tried cases.<sup>98</sup> Commentators argue that California’s relatively high veil-piercing rate is due to a “liberal standard” for veil piercing,<sup>99</sup> as the state looks at limited liability as a “statutory privilege” to be used for “legitimate business purposes.”<sup>100</sup> Also, another reason that

91. *See id.* at 4.

92. *Id.*

93. *See id.* at 3–4; STEPHEN B. PRESSER, *PIERCING THE CORPORATE VEIL* § 2:5 (2011).

94. *See Automotriz*, 306 P.2d at 4 (“If the capital is illusory or trifling compared with the business to be done and the risks of loss, this is a ground for denying the separate entity privilege.”); PRESSER, *supra* note 93, § 2:5. Disregard of corporate formalities is another factor considered in satisfying either prong of the alter ego test. *Associated Vendors, Inc. v. Oakland Meat Co.*, 26 Cal. Rptr. 806, 815 (Cal. Ct. App. 1962). In *Associated Vendors*, the court listed about fifteen factors that were important in past court decisions under particular circumstances in each case, which could then be used to satisfy either part of the test. *Id.* at 813–15; *see* PRESSER, *supra* note 93, § 2:5.

95. *Sonora Diamond Corp. v. Superior Court*, 83 Cal. App. 4th 523, 538 (2000).

96. *Associated Vendors*, 210 Cal. App. 2d at 838; 15 CAL. JUR. 3D *Corporations* § 24 (2012) (“The issue is not so much whether . . . the corporation was organized for the purpose of defrauding the innocent party, as it is whether justice and equity are best accomplished in a particular case, and fraud and unfairness defeated, by disregarding the distinct entity of the corporate form.”).

97. *Sonora Diamond Corp.*, 83 Cal. App. 4th at 539.

98. *Oh*, *supra* note 9, at 115.

99. *Id.* at 119.

100. *Id.* (quoting *Mesler v. Bragg Mgmt. Co.*, 702 P.2d 601, 606 (Cal. 1985)).

California is known as one of the states most likely to disregard the corporate entity is perhaps in part because of the California courts' use of a corporation's undercapitalization as a factor in the determination.<sup>101</sup>

### C. Delaware

The state of Delaware and its judiciary have much expertise in corporate law, and Delaware is considered to have the "best-developed general case law on corporations, owing to the efforts of the state legislature to create a flexible system that would favor managers and shareholders, and to the fact that so many important national corporations now are incorporated in the state."<sup>102</sup> As a result, with the number of corporations that choose to incorporate in Delaware, one might expect the veil-piercing cases involving corporations from Delaware to be plentiful, and in turn, the veil-piercing case law in Delaware to be well-developed.<sup>103</sup> However, there has not been a large number of veil-piercing cases in Delaware, arguably due to the fact that many publicly traded organizations, for which veil piercing has never occurred, prefer to incorporate in Delaware, along with other sophisticated incorporators that have a better understanding of corporate and veil-piercing law.<sup>104</sup> Accordingly, other states have had more opportunities to fashion particular veil-piercing approaches as compared to Delaware, but Delaware has a strict requirement of "fraud or something like it" that makes it relatively tough to pierce the veil in the state.<sup>105</sup> Conduct that is "something like fraud" would normally "involve matters of contravention of law or contract, public wrong, or otherwise present

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101. *Id.* at 118-19. The United States Court of Appeals for the Ninth Circuit stated in a 1988 decision that "the California Supreme Court has held that undercapitalization alone will justify piercing the corporate veil." Nilsson, Robins, Dalgarn, Berliner, Carson & Wurst v. Louisiana Hydrolec, 854 F.2d 1538, 1544 (9th Cir. 1988). This conclusion seems to be wrong, however, as there has never been a California case where evidence of undercapitalization, standing alone, has supported piercing the corporate veil. PRESSER, *supra* note 93, § 2:5; see *Associated Vendors, Inc. v. Oakland Meat Co.*, 210 Cal. App. 2d 825, 841-42 (1962) ("Evidence of inadequate capitalization is, at best, merely a factor to be considered by the trial court in deciding whether or not to pierce the corporate veil. To be sure, it is an important factor, but no case has been cited, nor have any been found, where it has been held that this factor alone *requires* invoking the equitable doctrine [of piercing the corporate veil] . . .").

102. PRESSER, *supra* note 93, § 2:8.

103. Oh, *supra* note 9, at 116.

104. *Id.*

105. *Id.* at 116-17; see PRESSER, *supra* note 93, § 2:8.

compelling equitable considerations.”<sup>106</sup> Other than requiring fraud or something like it, Delaware courts rarely explain in detail their reasoning behind a decision to pierce the veil of a Delaware corporation.<sup>107</sup>

Delaware has a low 34.29% veil-piercing rate.<sup>108</sup> However, the Delaware Chancery may be changing its veil-piercing approach to a more liberal one<sup>109</sup> because, in a few cases, “the Delaware courts have countenanced veil piercing in instances other than those strictly involving fraud or similar conduct.”<sup>110</sup> One factor that has served as a foundation for a successful veil-piercing claim in Delaware was a disregard for corporate formalities and other similar inequitable conduct.<sup>111</sup>

Furthermore, Delaware court decisions have focused on the alter ego theory in their veil-piercing analyses as an alternative reason to a finding of fraud in the strict sense.<sup>112</sup> According to the Delaware Court of Chancery, the alter ego analysis looks at factors such as “whether the corporation was adequately capitalized[,] . . . [whether] corporate formalities were observed[,] . . . and whether, in general, the corporation simply functioned as a façade for the dominant shareholder.”<sup>113</sup> Even federal court opinions interpreting Delaware law have stated that there is no strict requirement of fraud under the alter ego theory.<sup>114</sup> Yet, in a 2005 case, the Court of Chancery noted that Delaware courts have added a required element of fraud to the

106. Fredric J. Bendremer, *Delaware LLCs and Veil Piercing: Limited Liability Has Its Limitations*, 10 FORDHAM J. CORP. & FIN. L. 385, 391 (2005).

107. PRESSER, *supra* note 93, § 2:8.

108. Oh, *supra* note 9, at 115.

109. PRESSER, *supra* note 93, § 2:8; *see* Geyer v. Ingersoll Publ'ns Co., 621 A.2d 784, 793 (Del. Ch. 1992) (“[A] court can pierce the corporate veil of an entity where there is fraud or where a subsidiary is in fact a mere instrumentality or alter ego of its owner.”). *But see* Case Fin., Inc. v. Alden, No. 1184-VCP, 2009 WL 2581873, at \*4 (Del. Ch. Aug. 21, 2009) (“There also must be an element of fraud to justify piercing the corporate veil.”).

110. Bendremer, *supra* note 106, at 391.

111. *Id.*

112. *Id.*; *see* Fletcher v. Atex, Inc., 68 F.3d 1451, 1457 (2d Cir. 1995) (quoting Geyer, 621 A.2d at 793) (“Delaware law permits a court to pierce the corporate veil of a company ‘where there is fraud or where [it] is in fact a mere instrumentality or alter ego of its owner.’”).

113. Mason v. Network of Wilmington, No. Civ.A. 19434-NC, 2005 WL 1653954, at \*3 (Del. Ch. July 1, 2005).

114. Fletcher, 68 F.3d at 1457 (“Thus, under an alter ego theory, there is no requirement of a showing of fraud.”).

alter ego analysis in contract cases.<sup>115</sup> In that case, the Court of Chancery stated that “[p]iercing the corporate veil under the alter ego theory requires that the corporate structure cause fraud or similar injustice . . . [and] the corporation must be a sham and exist for no other purpose than as a vehicle for fraud.”<sup>116</sup> Although the Delaware Chancery has stated and demonstrated that there is no single veil-piercing test that has been created in Delaware, they have held that “our courts have only been persuaded to ‘pierce the corporate veil’ after substantial consideration of the shareholder-owner’s disregard of the separate corporate fiction and the degree of injustice . . .” plaintiffs would endure if the court refused to pierce the corporate veil.<sup>117</sup> Despite the difficulty in stating a clear test given by the Delaware Chancery, recent cases demonstrate, and commentators have suggested, that Delaware is slowly moving away from being known as very protective of the corporate entity to a state that will more likely pierce the corporate veil.<sup>118</sup>

#### D. New York

With Delaware being a favorable state for businesses to incorporate in, New York competes with Delaware for corporations; as a result, New York has been described as being reluctant, or “nearly impregnable,” to pierce the corporate veil.<sup>119</sup> However, this description is contrary to New York’s veil-piercing rate of 49.81%, which demonstrates New York corporations have their veils pierced almost half the time in tried cases.<sup>120</sup> In general, to pierce the corporate veil in New York, litigants must prove that “the individual defendants (1) exercised complete dominion and control over the corporation, and (2) used such dominion and control to commit a fraud or wrong against the plaintiff which resulted in injury.”<sup>121</sup> More specifically, a shareholder will be liable for the acts of the corporation when the corporation is simply a “dummy” and a liability shield for the shareholders to pursue their own personal business

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115. *Mason*, 2005 WL 1653954, at \*2–3.

116. *Id.* at \*3 (quoting *Wallace v. Wood*, 752 A.2d 1175, 1184 (Del. Ch. 1999)).

117. *Midland Interiors, Inc. v. Burleigh*, No. CIV.A. 18544, 2006 WL 3783476, at \*3 (Del. Ch. Dec. 19, 2006).

118. *Oh*, *supra* note 9, at 117 n.191.

119. *Id.* at 120.

120. *See id.*

121. *Samuel L. Hagan II, P.C. v. J.P. Morgan Chase Bank, N.A.*, No. 28859/10, 2011 WL 4975311, at \*19 (N.Y. Sup. Ct. Oct. 19, 2011). This is sometimes called the “instrumentality theory.” *See Speer*, *supra* note 6, at 315.

instead of the business of the corporation.<sup>122</sup> Along with Virginia and California, under New York law, it is possible for a corporation's veil to be pierced even absent fraud to prevent an injustice.<sup>123</sup>

*Port Chester Electrical Construction Corporation v. Atlas*<sup>124</sup> is "one of the most frequently cited cases" in New York.<sup>125</sup> Sol Atlas was in the business of acquiring and developing real property.<sup>126</sup> "Atlas organized his various ownership and construction ventures into a complex network of separate corporations in which he had both a controlling interest and an active leadership role."<sup>127</sup> An electrical subcontractor on a past Atlas construction project commenced a suit because it was unable "to collect a money judgment it obtained against an Atlas-controlled general contractor" for extra work the subcontractor performed.<sup>128</sup> The subcontractor was unable to obtain the judgment from the general contractor because Atlas moved the assets of the general contractor to other allied corporations to prevent the subcontractor from collecting any money, and thus the general contractor was made "virtually judgment proof."<sup>129</sup>

The Court of Appeals of New York did not pierce the corporate veil in this case and held that the "separate corporate identities were at all times maintained."<sup>130</sup> The highest court in New York decided that the complete control of the corporations by one shareholder was not enough, by itself, to disregard the corporate entity.<sup>131</sup> The court noted that the shareholder Atlas "carefully respected the separate identities of the corporations, and each corporation was pursuing its separate corporate business, rather than the purely personal business of Atlas . . . ."<sup>132</sup> Here, the court was looking for additional inequitable actions along with the shareholder control in order to justify piercing the corporate veil.<sup>133</sup>

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122. *Port Chester Elec. Constr. Corp. v. Atlas*, 40 N.Y.2d 652, 656–57 (1976) (quoting *Walkovszky v. Carlton*, 18 N.Y.2d 414, 418 (1966)).

123. *Campane v. Pisciotto Servs., Inc.*, 930 N.Y.S.2d 62, 64 (N.Y. App. Div. 2011).

124. *Port Chester Elec. Constr. Corp. v. Atlas*, 357 N.E.2d 983 (1976).

125. PRESSER, *supra* note 93, § 2:35.

126. *Atlas*, 357 N.E.2d at 984.

127. *Id.*

128. *Id.*

129. *Id.*

130. *Id.* at 986–87.

131. *Id.*

132. *Id.*

133. *See id.*



*E. Pennsylvania*

Pennsylvania courts routinely state that “there is a strong presumption in Pennsylvania against piercing the corporate veil” and protecting the corporate form of organization.<sup>134</sup> However, the court’s notion that there is a “strong presumption” against veil piercing “may be aspirational”<sup>135</sup> since veil-piercing claims using Pennsylvania law are successful in 44.44% of tried cases.<sup>136</sup>

Recent Pennsylvania veil-piercing opinions state that there is no “specific two- or three-pronged” test to determine whether to pierce the veil of a Pennsylvania corporation as seen in other states’ approaches.<sup>137</sup> The Superior Court of Pennsylvania has, however, set out a list of non-exhaustive factors to be considered in veil-piercing decisions, including “undercapitalization, failure to adhere to corporate formalities, substantial intermingling of corporate and personal affairs, . . . use of the corporate form to perpetuate a fraud,” and shareholder domination.<sup>138</sup> Furthermore, Pennsylvania courts are “basically concerned with determining if equity requires that the shareholders’ traditional insulation from personal liability be disregarded and with ascertaining if the corporate form is a sham, constituting a façade for the operations of the dominant shareholder.”<sup>139</sup> Shareholders will risk losing their limited liability shield if they disregard corporate formalities and use the corporation as a dummy to further their own personal interests instead of the corporation’s interests.<sup>140</sup> Lastly, again in Pennsylvania, there is no requirement of fraud to pierce the corporate veil, but veil piercing is necessary whenever an injustice needs to be avoided.<sup>141</sup>

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134. *Fletcher-Harlee Corp. v. Szymanski*, 936 A.2d 87, 95 (Pa. Super. Ct. 2007) (quoting *Lumax Indus., Inc. v. Aultman*, 543 Pa. 38, 41 (1995)).

135. Oh, *supra* note 9, at 119 n.208.

136. *Id.* at 115–16.

137. PRESSER, *supra* note 93, § 2:42; *see Fletcher-Harlee Corp.*, 936 A.2d at 95 (“[T]here appears to be no clear test or well settled rule in Pennsylvania . . . as to exactly when the corporate veil can be pierced and when it may not be pierced.”) (quoting *Advanced Tel. Sys., Inc. v. Com-Net Prof'l Mobile Radio*, 846 A.2d 1264, 1278 (2004)).

138. *See Fletcher-Harlee Corp.*, 936 A.2d at 95 (quoting *Lumax Indus.*, 543 Pa. at 42).

139. *Id.* at 96.

140. PRESSER, *supra* note 93, § 2:42.

141. *See Fletcher-Harlee Corp.*, 936 A.2d at 96.

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

Maryland veil-piercing law has been described as “inordinately protective of limited liability for shareholders.”<sup>142</sup> Maryland has a strict rule that a corporation in its state will be pierced only “to prevent fraud or to enforce a paramount equity.”<sup>143</sup> However, despite this claim, no “equitable interest” has been brought before the Maryland courts that they felt was more important than shareholder limited liability protection.<sup>144</sup> Thus, the Maryland courts provide shareholders a “bright line” test: even if a corporation completely disregards all corporate formalities, the only possibility of piercing the veil of a Maryland corporation is if there is a proven act of fraud.<sup>145</sup> Even better for shareholders is the fact that Maryland courts seem to make the fraud requirement more difficult to satisfy as compared to other states by requiring a showing of “clear and convincing proof.”<sup>146</sup>

Accordingly, Maryland has the “honor” of being the jurisdiction that is least likely to allow a plaintiff to be successful in a veil-piercing claim by having not only the strictest standard but correspondingly the lowest veil-piercing rate of any state in the country.<sup>147</sup> According to Oh's study, until 2006, veil-piercing claims prevailed 25.81% of the time, but this percentage includes both state and federal courts in Maryland.<sup>148</sup> According to research for this comment, Maryland state courts have only pierced the veil twice in sixteen attempts, giving plaintiffs a successful veil-piercing rate of 12.35%, which demonstrates federal courts are applying a more liberal standard to Maryland veil-piercing law than state courts.<sup>149</sup> In

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142. Epperson & Canny, *supra* note 1, at 637.

143. Dixon v. Process Corp., 38 Md. App. 644, 654, 382 A.2d 893, 899 (1978) (quoting Bart Arconti & Sons, Inc. v. Ames-Ennis, Inc., 275 Md. 295, 312, 340 A.2d 225, 235 (1975)).

144. Epperson & Canny, *supra* note 1, at 621.

145. *Id.* at 637. It also seems Maryland has rejected the “instrumentality” justification for piercing the corporate veil that is sometimes recognized in other jurisdictions. Ramlall v. MobilePro Corp. 202 Md. App. 20, 32, 30 A.3d 1003, 1010 (2011).

146. See Colandrea v. Colandrea, 42 Md. App. 421, 428, 401 A.2d 480, 484 (1979); Epperson & Canny, *supra* note 1, at 626 n.104. Maryland courts even acknowledge that they are more restrictive in applying the standard than other jurisdictions. See Ramlall, 202 Md. App. at 32, 30 A.3d at 1010.

147. Oh, *supra* note 9, at 117.

148. See *id.* at 115.

149. *Id.* Sixteen cases were found that related to the question of whether the Maryland court was going to pierce the veil of a corporation. See Hildreth v. Tidewater Equip.

fact, Maryland state courts have not disregarded the corporate entity since 1979.<sup>150</sup> This should not be surprising, as it seems Maryland courts embrace the fact that piercing the corporate veil under Maryland law is very difficult and have warned potential plaintiffs that it is a “herculean task” to bring a successful claim.<sup>151</sup>

Maryland courts support the privilege of shareholder liability protection from corporate obligations and thus are strict in their approach of requiring actual fraud by the corporation to disregard the corporate entity.<sup>152</sup> Maryland courts do not carefully scrutinize closely held corporations or consider the absence of corporate formalities as an essential factor.<sup>153</sup> Furthermore, “attempts to expand the standard to permit a mere showing of a need ‘to enforce a paramount equity’ apparently have failed.”<sup>154</sup>

Co., 378 Md. 724, 738–39, 838 A.2d 1204, 1212–13 (2003); *Starfish Condo. Ass’n v. Yorkridge Serv. Corp.*, 295 Md. 693, 718–19, 458 A.2d 805, 818–19 (1983); *Bart Arconti & Sons, Inc.*, 275 Md. at 309–13, 340 A.2d at 233–236; *Damazo v. Wahby*, 259 Md. 627, 633–34, 270 A.2d 814, 816–17 (1970); *Lopez v. Lopez*, 250 Md. 491, 502–03, 243 A.2d 588, 594–95 (1968); *William Danzer & Co. v. W. Md. Ry.*, 164 Md. 448, 457, 165 A. 463, 466–67 (1933); *Carozza v. Fed. Fin. & Credit Co.*, 149 Md. 223, 236–37, 131 A. 332, 337 (1925); *Bethlehem Steel Co. v. Raymond Concrete Pile Co.*, 141 Md. 67, 81–86, 118 A. 279, 284–86 (1922); *Ramlall*, 202 Md. App. at 32–33, 30 A.3d at 1010; *Turner v. Turner*, 147 Md. App. 350, 429, 809 A.2d 18, 64 (2002); *Residential Warranty Corp. v. Bancroft Homes Greenspring Valley, Inc.*, 126 Md. App. 294, 310, 728 A.2d 783, 791 (1999); *Travel Comm., Inc. v. Pan Am. World Airways, Inc.*, 91 Md. App. 123, 159, 603 A.2d 1301, 1319 (1992); *Colandrea*, 42 Md. App. at 426–27, 401 A.2d at 483–84; *Dixon*, 38 Md. App. at 654–56, 382 A.2d at 899–900; *United Elec. Supply Co. v. Greencastle Gardens Section III L.P.*, 36 Md. App. 70, 77–81, 373 A.2d 42, 46–48 (1977); *Quinn v. Quinn*, 11 Md. App. 638, 647–50, 276 A.2d 425, 430–31 (1971). This percentage does not even account for the number of claims that may not be brought due to Maryland’s strict veil-piercing standard.

150. See *Hildreth*, 378 Md. at 738–39, 838 A.2d at 1212–13; *Starfish Condo. Ass’n*, 295 Md. at 718–19, 458 A.2d at 818–19; *Ramlall*, 202 Md. App. at 32–33, 30 A.3d at 1010; *Turner*, 147 Md. App. at 429, 809 A.2d at 64; *Residential Warranty Corp.*, 126 Md. App. at 310, 728 A.2d at 791; *Travel Comm., Inc. v. Pan Am. World Airways, Inc.*, 91 Md. App. 123, 159, 603 A.2d 1301, 1319 (1992); *Colandrea*, 42 Md. App. at 426–27, 401 A.2d at 483–84.
151. Oh, *supra* note 9, at 117 (quoting *Dixon*, 38 Md. App. at 645–46, 382 A.2d at 895) (“[W]oe unto the creditor who seeks to rip away the corporate façade in order to recover from one sibling of the corporate family what is due from another in the belief that the relationship is inseparable, if not insufferable, for his is a herculean task.”).
152. *Epperson & Canny*, *supra* note 1, at 625.
153. *Id.* at 625–26.
154. Oh, *supra* note 9, at 118 (quoting *Residential Warranty Corp.*, 728 A.2d at 789 (“Despite the proclamation that a court may pierce the corporate veil to enforce a paramount equity, arguments that have urged a piercing of the veil ‘for reasons other than fraud’ have failed in Maryland courts.”)).

In *Bart Arconti & Sons, Inc. v. Ames-Ennis, Inc.*,<sup>155</sup> for example, general contractor Ames-Ennis, Inc. (Ames-Ennis), having three separate building construction contracts, subcontracted Bart Arconti & Sons, Inc. (Arconti) to do “masonry and related work” on each of the buildings.<sup>156</sup> Problems arose between Arconti and Ames-Ennis when each declared the other to be in breach of their contractual agreement.<sup>157</sup> While the two sides went to trial, the Board of Directors, completely dominated by two principals, Bart and George Arconti, decided to “lie dormant” and stop operations until the contractual dispute with Ames-Ennis was resolved.<sup>158</sup> Arconti was the leading corporation of the three controlled by Bart and George Arconti.<sup>159</sup> While Arconti ceased to operate, the other two corporations’ values increased, but they were using the same construction equipment of Arconti without giving compensation, were managed at the same place of business as Arconti, and shared the same workers.<sup>160</sup> Bart and George were also the sole shareholders of the three corporations during their operation.<sup>161</sup>

The trial court held “that the purpose of these activities had been to ‘evade legal obligations devolving upon (Arconti)’” while the lawsuit was ongoing, which “resulted in rendering Arconti ‘all but insolvent.’”<sup>162</sup> The trial court “found that Bart and George, as the dominant directors and sole shareholders of all three corporations,” purposely attempted to make Arconti judgment-proof through insolvency while using the other two corporations for their subcontracting operations.<sup>163</sup> Accordingly, the trial court found that piercing the corporate veil of Arconti was justified to make George and Bart personally liable for corporate obligations.<sup>164</sup> Nevertheless, the Court of Appeals reversed stating that it was “[unaware] of any Maryland case” where the court decided to pierce the corporate veil, “absent evidence of fraud or similar conduct,” simply “because it wished to prevent an ‘evasion of legal obligations’ . . . .”<sup>165</sup> Instead, the court stated that the narrow test, and “[t]he common thread

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155. *Bart Arconti & Sons, Inc. v. Ames-Ennis, Inc.*, 275 Md. 295, 340 A.2d 225 (1975).

156. *Id.* at 297, 340 A.2d at 227.

157. *Id.* at 302, 340 A.2d at 230.

158. *Id.* at 304, 340 A.2d at 231.

159. *Id.*

160. *Id.* at 304–05, 309, 340 A.2d at 231, 234.

161. *Id.* at 304, 340 A.2d at 231.

162. *Id.* at 305, 340 A.2d at 231.

163. *Id.*

164. *Id.*

165. *Id.* at 311–12, 340 A.2d at 235.

running through the Maryland cases[,] . . . is that the corporate entity will be disregarded only when necessary to prevent fraud or to enforce a paramount equity."<sup>166</sup>

In *Dixon v. Process Corporation*,<sup>167</sup> two investors, Dixon and Litty, attempted to pierce the corporate veil of The Process Corporation (TPC), a subsidiary corporation of Process Incorporated of Maryland (PIM), in order to collect a judgment Dixon and Litty had obtained against the parent corporation PIM.<sup>168</sup> PIM had eleven subsidiary corporations for the purpose of limiting the liability of PIM, and PIM managed all affairs of its subsidiaries and owned all of the subsidiaries' equipment.<sup>169</sup> Furthermore, all of the corporations had the same board of directors.<sup>170</sup> Dixon and Litty purchased and invested in a large tract of land to be developed by TPC, entering into an agreement where PIM would repurchase the tract from Dixon and Litty within one year.<sup>171</sup> Due to lack of funds, the repurchase did not occur and PIM failed to satisfy the confessed judgments against it.<sup>172</sup> Dixon and Litty argued that PIM and TPC were the "alter ego" of Garland, the controlling principal of both corporations, and thus the veils of the corporations should be disregarded.<sup>173</sup> Litty and Dixon felt that "Garland's domination of the corporations for his personal ends, without regard to their separate corporate identities, should not shield TPC from liability in equity for the actions of PIM."<sup>174</sup>

After considering a range of various veil-piercing factors in determining whether a subsidiary corporation is a "mere instrumentality" of the parent corporation and examining how the corporate formalities of PIM and TPC were disregarded, the court held that "there was legally sufficient evidence to cast doubt as to the separate corporate identities of PIM and TPC."<sup>175</sup> "The court noted that under the 'instrumentality rule' employed by some jurisdictions . . . [the facts of this case] might be enough to pierce the veil" if brought in another state.<sup>176</sup> Nevertheless, the court held that

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166. *Id.* at 312, 340 A.2d at 235.

167. *Dixon v. Process Corp.*, 38 Md. App. 644, 382 A.2d 893 (1978).

168. *Id.* at 644, 382 A.2d at 893.

169. *Id.* at 646-47, 382 A.2d at 895.

170. *Id.*

171. *Id.* at 647-48, 382 A.2d at 896.

172. *Id.* at 649, 382 A.2d at 896-97.

173. *Id.* at 651, 382 A.2d at 897.

174. *Id.* at 651, 382 A.2d at 898.

175. *Id.* at 653-54, 382 A.2d at 899.

176. *Id.* at 652-53, 382 A.2d at 898; PRESSER, *supra* note 93, § 2:21. Garland "testified that the directors for the corporations were the same, the stock of PIM was paid for but not issued, PIM owned all the equipment used by its subsidiaries, hired their

the lack of corporate formalities and the “instrumentality test” were insufficient reasons for piercing the corporate veil, and that the lower court “expressly found that there was no fraud and that no paramount equity was present . . . .”<sup>177</sup> The court firmly stated, “We make clear that the rule of law in [Maryland] is that no matter how flimsily woven is the corporate curtain, it may not be flung aside except to prevent fraud or enforce a paramount equity.”<sup>178</sup> There was no clear and convincing proof of fraud to pierce the corporate veil.<sup>179</sup>

*Colandrea v. Colandrea*<sup>180</sup> is an example of one of the rare times a Maryland court chose to pierce the corporate veil of a Maryland corporation due to proof of fraud.<sup>181</sup> A married couple—Dominic and Carmen Colandrea—incorporated a real estate business, Cortland Realty, Ltd. (Cortland Realty).<sup>182</sup> The couple subsequently divorced, ended their business relationship, and Mr. Colandrea sold all of his stock in the corporation back to Cortland Realty as part of a stock redemption agreement, in return for a total of \$100,000 that was paid yearly by seven promissory notes.<sup>183</sup> Three months after the execution of the stock redemption agreement, Mrs. Colandrea incorporated another business, Cortland, Ltd.—which took over Cortland Realty’s most profitable business of real estate sales, free of any liabilities—and also changed the name of Cortland Realty to Carmen Management Company, Inc.<sup>184</sup> Mrs. Colandrea failed to pay the seven promissory notes held by Mr. Colandrea, and thus was in default; as a result, Mr. Colandrea brought suit to pierce the corporate veil.<sup>185</sup> After reviewing evidence of the acts of Mrs. Colandrea with the corporations, the court felt that “[t]he effect of all these corporate machinations is obvious. By it Mrs. Colandrea was able to continue the profitable business of Cortland Realty, Ltd. without its attendant obligations to Mr. Colandrea.”<sup>186</sup>

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employees, . . . and managed their affairs.” *Dixon*, 38 Md. App. at 654, 382 A.2d at 899.

177. *Dixon*, 38 Md. App. at 655, 382 A.2d at 900.

178. *Id.* at 656, 382 A.2d at 900.

179. *Id.* at 657, 382 A.2d at 901.

180. *Colandrea v. Colandrea*, 42 Md. App. 421, 401 A.2d 480 (1979). This was the last time the veil of a Maryland corporation has been pierced.

181. *Id.* at 433, 401 A.2d at 487.

182. *Id.* at 422, 401 A.2d at 481.

183. *Id.* at 422–23, 401 A.2d at 482.

184. *Id.* at 423, 430, 401 A.2d at 482, 486.

185. *Id.* at 423–24, 401 A.2d at 482.

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

The court found that Mrs. Colandrea's actions, as the sole shareholder and director, constituted proof of fraud, but required that the elements be shown with clear and convincing proof.<sup>187</sup> The court held that Mrs. Colandrea, at the time she executed the stock redemption agreement for the corporation, never intended to permit payment of the promissory notes, and the evidence met the all of the elements for fraud.<sup>188</sup> The court then pierced the corporate veil of Mrs. Colandrea's corporation and imposed personal liability upon her because her "dealings, through the corporation, with Mr. Colandrea, can be termed nothing short of fraudulent."<sup>189</sup> Even in recent decisions, Maryland courts still adhere to this strict approach.<sup>190</sup>

In regard to Maryland's veil-piercing standard, the Maryland Court of Special Appeals has explained that, absent fraud, a Maryland court may only pierce the corporate veil to enforce a paramount equity, which arises when an individual owns a "substantial" amount of a corporation's stock, and other factors—including undercapitalization, commingling of corporate and personal assets, and disregard for corporate formalities—exist to show an abuse of the privilege of the corporate form.<sup>191</sup> However, the intermediate appellate court has noted that, to date, no Maryland court has found sufficient evidence to justify piercing the veil based on a need to enforce a paramount equity, and likewise, arguments "'for reasons other than fraud' have failed in Maryland courts."<sup>192</sup> And thus, while Maryland courts consistently insist that a veil may be pierced to enforce a paramount equity, it remains unclear when enforcing a paramount equity would be sufficiently necessary for a Maryland court to pierce the corporate veil independent of any fraud.<sup>193</sup>

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187. *Id.* at 424, 426, 401 A.2d at 483.

188. *Id.* at 430, 401 A.2d at 485. The five elements proven were:

- (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.

189. *Id.* at 428, 432–33, 401 A.2d at 484, 486–87.

190. *See Ramlall v. MobilePro Corp.*, 202 Md. App. 20, 31, 30 A.3d 1003, 1009 (2011).

191. *Residential Warranty Corp. v. Bancroft Homes Greenspring Valley, Inc.*, 126 Md. App. 294, 307, 728 A.2d 783, 789 (1999) (quoting *Travel Comm., Inc. v. Pan Am. World Airways, Inc.*, 91 Md. App. 123, 158–59, 603 A.2d 1301 (1992)).

192. *Id.*

193. *PRESSER*, *supra* note 93, § 2:21; *see Iceland Telecom, Ltd. v. Info. Sys. & Networks Corp.*, 268 F. Supp. 2d 585, 591 (D. Md. 2003) ("It is not the province of this Court,

The Court of Appeals of Maryland, in *Starfish Condominium Assocaion v. Yorkridge Service Corporation*,<sup>194</sup> indicated that absent fraud, a plaintiff attempting to pierce the veil of a Maryland corporation would need to establish “an equity which requires enforcement, and which is paramount to the ordinary expectation of limited liability on the part of the shareholder.”<sup>195</sup> One commentator believes that this language, if it is “broadly construed,” essentially means that a Maryland court could pierce the corporate veil whenever it found “that there had been *any* abuse of the corporate form . . . [that] created a paramount equity in favor of the plaintiff and against limited liability.”<sup>196</sup> An abuse of this kind would most likely include “avoidance of a statute, . . . undercapitalization, . . . [and] any other grounds in addition to fraud that have regularly supported veil-piercing in other jurisdictions.”<sup>197</sup>

Furthermore, in *Hildreth v. Tidewater Equipment Company*,<sup>198</sup> the Court of Appeals of Maryland listed five factors courts may consider in imposing personal liability on a shareholder, and even discussed whether those factors were met based on the facts of the case.<sup>199</sup> Yet

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but rather the state courts of Maryland, to flesh out and expand the factual scenarios that could warrant a court's piercing of the corporate veil.”); *Travel Comm., Inc. v. Pan Am. World Airways, Inc.*, 91 Md. App. 123, 158, 603 A.2d 1301, 1318 (1992) (“Notwithstanding its hint that enforcing a paramount equity might suffice as a reason for piercing the corporate veil, the Court of Appeals to date has not elaborated upon the meaning of this phrase or applied it in any case of which we are aware.”). In *Ramlall v. MobilePro Corp.*, because the court had no guidance on what constituted “paramount equity,” the court refused to impose shareholder liability based on the paramount equity justification. 202 Md. App. at 31, 30 A.3d at 1009–10 (“With no precedent approving this extraordinary remedy, we decline to pierce the corporate veil of CloseCall (MD) to impose liability on MobilePro based on the paramount equity justification.”).

194. *Starfish Condominium Ass'n v. Yorkridge Serv. Corp.*, 295 Md. 693, 458 A.2d 805 (1983).

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

196. PRESSER, *supra* note 93, § 2:21.

197. *Id.*

198. *Hildreth v. Tidewater Equip. Co.*, 378 Md. 724, 838 A.2d 1204 (2003).

199. *Id.* at 734, 736, 838 A.2d at 1210–11. The five factors were:

- (1) whether the corporation is inadequately capitalized, fails to observe corporate formalities, fails to issue stock or pay dividends, or operates without a profit, (2) whether there is commingling of corporate and personal assets, (3) whether there are non-functioning officers or directors, (4) whether the corporation is insolvent at the time of the transaction, and (5) the absence of corporate records.

*Id.* at 735, 838 A.2d at 1210.



the court, in adhering to Maryland's strict standard for piercing the corporate veil, still refused to disregard the corporate entity because it believed the conduct in this case was no worse than the conduct in *Bart Arconti & Sons, Inc. v. Ames-Ennis, Inc.*, where the court refused to pierce the corporate veil.<sup>200</sup> Nevertheless, the court's enunciation of these five factors could potentially be the foundation of a more liberal approach in Maryland veil-piercing law, and proves that Maryland shows promise in shifting slowly from its strict approach.<sup>201</sup> However, for now, as recent cases demonstrate, Maryland courts continue to apply the strict veil-piercing standard and continue to make it "a herculean task" for a plaintiff to overcome shareholder limited liability protection.<sup>202</sup>

## VII. EVALUATION OF MARYLAND'S STRICT VEIL-PIERCING POLICY

### *A. Advantages of a Strict Veil-Piercing Standard*

Before announcing this comment's suggested approach to veil piercing in Maryland, it is important to explain the purpose of veil-piercing law generally, as well as the effects of utilizing such a strict approach. As demonstrated above, veil-piercing law would not be appealing to "those who like tidy doctrines that admit of easy application."<sup>203</sup> However, Maryland courts come very close to employing a bright-line rule, as it seems judicial discretion is seldom applied in Maryland's veil-piercing cases, which is unusual in this area of law.<sup>204</sup> A bright-line test prevents the randomness of veil-piercing standards that is sometimes evident in a number of jurisdictions.<sup>205</sup> Some jurisdictions that use a "laundry list" of factors fail to give any guidance regarding the weight to be assigned to any particular factor, making decisions unpredictable.<sup>206</sup> Moreover, those who believe in a strict veil-piercing doctrine will argue that the privilege of limited liability is "socially desirable" and thus should be firmly protected.<sup>207</sup> The strict approach and protection of shareholder limited liability will "spur substantial investment and long term

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200. *Id.* at 738–39, 838 A.2d at 1212–13.

201. PRESSER, *supra* note 93, § 2:21 n.27.

202. See *Ramlall v. MobilePro Corp.*, 202 Md. App. 20, 32, 30 A.3d 1003, 1010 (2011); PRESSER, *supra* note 93, § 2:21.

203. Stephen M. Bainbridge, *Abolishing Veil Piercing*, 26 J. CORP. L. 479, 513 (2001).

204. See *supra* Part VI.

205. See Bainbridge, *supra* note 203, at 506–07; *supra* Part V.

206. See Bainbridge, *supra* note 203, at 510.

207. *Id.* at 487.

planning on the basis of such a relatively secure and certain business environment."<sup>208</sup> Accordingly, piercing the corporate veil more frequently would discourage investment and discourage firms from doing business within a certain state, which would then generate an overall decline in economic activity.<sup>209</sup>

Furthermore, some commentators suggest that businesses may change their behavior and be "deterred from engaging in socially desirable activities," or may take unnecessary preventative measures if the risk of a potential veil-piercing claim cannot be highly predicted.<sup>210</sup> With a consistent standard, corporations "know their legal obligations with a high degree of certainty and are free to shift the burdens by contract . . . on the noncorporate party."<sup>211</sup> Thus, Maryland would be appealing to businesses seeking to incorporate because of Maryland's strict veil-piercing law and strong support of shareholder limited liability.<sup>212</sup> Consequently, Maryland investors "can reasonably rely on the expectation that their limited liability will be upheld, even in a situation that would be borderline in another state."<sup>213</sup>

### *B. Disadvantages of a Strict Veil-Piercing Standard*

The argument that a more liberal veil-piercing doctrine would render Maryland's approach too vague and unpredictable—due to the difficulty in determining what constitutes "improper conduct"—and would in effect deter potential investors, is unfounded.<sup>214</sup> No court in the United States has ever pierced the veil of a public corporation, but rather, courts have only pierced the veils of closely held corporations.<sup>215</sup> Thus, public corporations, where most "passive [capital] investments" end up, would not be affected by a more liberal standard.<sup>216</sup> Since the only people who could potentially be at risk for personal liability are those shareholders who perform the acts in question, "[p]assive shareholders are almost never implicated, even in

208. Epperson & Canny, *supra* note 1, at 638.

209. *See id.* at 637 n.180.

210. Bainbridge, *supra* note 203, at 514.

211. Epperson & Canny, *supra* note 1, at 637 n.180 (claiming that uncertainty raises the cost of business by forcing parties to estimate their obligations and to act on expected probabilities).

212. *Id.* at 638.

213. *Id.*

214. *See* Cheng, *supra* note 17, at 513.

215. *Id.*

216. *See id.*

close corporations.”<sup>217</sup> Therefore, passive investments are virtually not affected or discouraged by veil piercing.<sup>218</sup> And when it comes to “the culpable shareholders, there should be little disagreement that they should be deterred,” especially when most agree that the conduct that has led courts to disregard a corporate entity has been quite inequitable.<sup>219</sup>

Those in favor of the strict Maryland test may argue that a more liberal application will make Maryland courts less effective at deterring improper conduct because there will be less predictability in advance for corporations of what actions could lead to a disregard of their corporate entity.<sup>220</sup> They may claim that if a standard is not clear, then “these [potential] perpetrators will find it difficult to adjust their conduct accordingly.”<sup>221</sup> However, some clearly important factors will remain if Maryland liberalizes its approach; for example, fraud would still be a highly predictive factor in Maryland veil-piercing decisions.<sup>222</sup> In fact, a more liberal standard to veil piercing may actually help a court “deter [wrongful conduct] by encouraging potential perpetrators to steer clear of the boundary of permissible conduct.”<sup>223</sup> A strict rule will allow potential unjust actors to shape their conduct around the veil-piercing threshold, as in Maryland where anything short of fraud would not result in shareholder liability.<sup>224</sup> Some closely held corporations might attempt to walk the line of impermissible behavior.<sup>225</sup>

Accordingly, Maryland’s “fierce protection” of the corporate shield and limited liability is favorable to dishonest corporations, including those companies that are “undercapitalized[] or mismanaged.”<sup>226</sup> Thus, “the kinds of businesses that are likely to incur liability [in a different state] may incorporate in Maryland to escape legal obligations.”<sup>227</sup> With confidence in a stronger liability shield, these types of businesses in Maryland are not as worried about engaging in risky and potentially harmful behavior than they would in another jurisdiction with a more lenient veil-piercing standard.<sup>228</sup> Although

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217. *Id.*

218. *Id.*

219. *Id.*

220. *See id.* at 548.

221. *Id.*

222. *See id.*

223. *Id.*

224. *Id.* at 548–49; *see also supra* Part VI.

225. Cheng, *supra* note 17, at 549.

226. Epperson & Canny, *supra* note 1, at 638.

227. *Id.*

228. Millon, *supra* note 2, at 1324–25.

intelligent risk-taking is important to any business and something that limited liability protects, an overly strict veil-piercing standard may also assist socially undesirable behavior.<sup>229</sup>

A new liberal standard for Maryland would still attract legitimate businesses to incorporate if they feel they have “nothing to fear” from this new standard.<sup>230</sup> Thus, limited liability should be limited to such businesses that are managed responsibly and legally.<sup>231</sup> Additionally, these businesses will conduct themselves more appropriately to reduce the risk of a possible veil-piercing claim.<sup>232</sup> Accordingly, new competent and honest corporations are exactly the type of business entity that would be beneficial to any state.<sup>233</sup>

### *C. Maryland Should Adopt a More Liberal Veil-Piercing Standard*

Along with these positive effects, a new approach would also put Maryland in line with the wisdom of other states nationally, because Maryland is on the extreme side with their strict approach to piercing the corporate veil.<sup>234</sup> Delaware, which is the leading state for corporation law<sup>235</sup> and a competitor with Maryland for incorporating businesses,<sup>236</sup> seems to be reconsidering its strict approach to veil piercing.<sup>237</sup> As noted earlier, New York, California, and Pennsylvania are three of the top five producers of veil-piercing law,<sup>238</sup> and they have not adopted this strict Maryland approach.<sup>239</sup> As demonstrated above, the disadvantages appear to outweigh the advantages of a strict veil-piercing standard.<sup>240</sup>

Limited liability is an important business creation, but the standard for veil piercing should not be so strict as to be at the expense of tort victims and contract creditors.<sup>241</sup> By liberalizing the standard to pierce the corporate veil, Maryland courts may “seek to protect consumers and improve their bargaining position with

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229. *See id.* at 1325.

230. *See Epperson & Canny, supra* note 1, at 639 n.185.

231. *See id.*

232. *Id.* at 639 n.184.

233. *See id.* at 639 n.185.

234. *See supra* Parts V–VI.

235. PRESSER, *supra* note 93, § 2:8.

236. *See Epperson & Canny, supra* note 1, at 642.

237. *See supra* Part V.C.

238. *See Oh, supra* note 9, at 115.

239. *See supra* Part V.

240. *See supra* Parts VII.A–B.

241. *See Cheng, supra* note 17, at 516, 550.

corporations.”<sup>242</sup> Tort and contract creditors will have more security by their increased ability to be awarded damages by Maryland courts after being victims of the actions of improper Maryland corporations.<sup>243</sup> Accordingly, this may be a time when Maryland should overturn its common law veil-piercing precedent, because the Maryland Court of Appeals has held that precedent should be overturned when it is no longer useful or sensible.<sup>244</sup> Overall, Maryland will ultimately benefit from a more liberal standard in their approach to piercing the corporate veil.

### VIII. SUGGESTED APPROACH TO PIERCING THE CORPORATE VEIL IN MARYLAND

As demonstrated in the small selection of states above, Maryland has a unique standard for piercing the corporate veil.<sup>245</sup> This comment’s suggested fix is an increased liberal standard, which will put Maryland law more in line with what other states are currently practicing throughout the country. This comment is not endorsing an overly lenient standard, but something more relaxed than the current Maryland approach. Furthermore, this comment does not argue for any specific two- or three-part test, such as the alter-ego theory or the instrumentality theory, in order to stay away from using metaphors, which can at times be difficult to apply.<sup>246</sup> Instead, this comment recommends an examination of numerous factors, some seen in other jurisdictions, in evaluating the injustice of a Maryland corporation’s actions.<sup>247</sup>

Maryland courts should look to use other factors besides “common law fraud” when deciding whether to disregard the corporate entity.<sup>248</sup> There is a range of factors Maryland courts could use, but at the very least, the factors of shareholder control, adherence to corporate formalities, and undercapitalization should be considered in a decision to pierce the corporate veil to protect creditors and consumers and to enforce a paramount equity.<sup>249</sup> Furthermore, Maryland courts should adopt a looser definition of fraud to include

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242. See Epperson & Canny, *supra* note 1, at 637 n.180.

243. See *id.*

244. See Mortimer N. S. Sellers, *The Doctrine of Precedent in the United States of America*, 54 AM. J. COMP. L. 67, 74–75 (2006).

245. See *supra* Part V.

246. See Oh, *supra* note 9, at 84; *supra* Part V.

247. See *supra* Part V.

248. See *supra* Part VI.

249. See *supra* Part VI.

misrepresentation or actions akin to fraud that do not meet Maryland's strict definition of common law fraud.<sup>250</sup>

### A. Shareholder Control

Shareholder control is essentially the first prong under the alter ego and instrumentality veil-piercing tests seen in Virginia's, California's, and New York's approaches to veil piercing.<sup>251</sup> "In short, there must be pervasive control exercised by the shareholders over the corporation."<sup>252</sup> This is normally demonstrated through a closely held corporation of nine or less shareholders, as no publicly traded corporation has ever had its veil pierced.<sup>253</sup> Also, interested and active shareholders in a closely held corporation having "complete dominion" over all of the important financial and strategic business decisions of a corporation would demonstrate shareholder control.<sup>254</sup> Furthermore, active shareholders using a corporation for their personal business instead of the interests of the corporation, such that the corporation is simply a "dummy" and a liability shield for the shareholders, also demonstrates pervasive control.<sup>255</sup> This factor of shareholder control alone is not enough to justify piercing the corporate veil, but some type of injustice coupled with shareholder control should be a consideration to pierce the corporate veil in both contract and tort claims.<sup>256</sup> If shareholder control by itself were enough to pierce the veil of a closely held corporation, "limited liability is rendered largely illusory."<sup>257</sup>

### B. Observance of Corporate Formalities

One criterion identified by Peter Oh's study as being frequently applied by courts is the non-observance of corporate formalities.<sup>258</sup> Creditors sometimes may be confused about the identity of the

250. See *supra* Part VI.

251. See *supra* Part V.

252. Speer, *supra* note 6, at 322; see 114 AM. JUR. 3D *Proof of Facts* § 6 (2010).

253. See Cheng, *supra* note 17, at 513; *Alter Ego Doctrine*, *supra* note 86, at 854–55; 114 AM. JUR. 3D *Proof of Facts* § 3 (2010).

254. See Speer, *supra* note 6, at 316, 322.

255. 114 AM. JUR. 3D *Proof of Facts* § 5 (2010); see *supra* Part V.

256. See Speer, *supra* note 6, at 322; 114 AM. JUR. 3D *Proof of Facts* 403, at § 6 (2010).

257. 114 AM. JUR. 3D *Proof of Facts* § 6 (2010).

258. See Oh, *supra* note 9, at 138. It is noted that in some instances, non-observance of corporate formalities has no causation between lack of formalities and harm to a creditor, so courts may only want to consider a lack of corporate formalities to the extent it leads to corporate confusion whether the creditor is dealing with shareholders or a corporation.

defendant, such as whether they are dealing with the “corporation or its shareholders in their individual capacity because of non-compliance with these [corporate] formalities requirements.”<sup>259</sup> In such cases, “courts have been willing to find misrepresentation by the corporation and impose shareholder liability” because shareholders fail to be clear to the creditor that they are doing business with a corporation, which may lead to an inequitable situation.<sup>260</sup> Veil piercing will thus encourage shareholders to ensure that creditors understand that they are dealing with the corporation and not the shareholders themselves.<sup>261</sup>

The fact that Maryland courts do not look at corporate formalities in their veil-piercing decisions “increases the uncertainties of doing business with Maryland corporations.”<sup>262</sup> Since corporate formalities are a way to warn a creditor whether they are transacting with a legitimate corporation, this gives dishonest Maryland corporations the opportunity to deceive creditors and give less information about themselves than corporations in other states.<sup>263</sup> With Maryland’s strict approach, which does not include observance of corporate formalities, corporations will not fear a veil-piercing claim for failure to meet the formality requirements.<sup>264</sup> Although disregard of corporate formalities, standing alone, should not result in shareholder personal liability, it is an important factor in making a case for veil piercing in contract claims when combined with other factors, as it is evidence that the corporation has no identity that is distinct from its shareholders.<sup>265</sup> Including this factor in Maryland veil-piercing decisions will push shareholders to respect the privilege and “formal integrity” of the corporate entity.<sup>266</sup>

### C. Undercapitalization

One commentator has suggested that the main purpose of veil-piercing law is “the prevention of the unjust enrichment of the shareholders at the expense of the corporation’s creditors,” if limited

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259. Cheng, *supra* note 17, at 518.

260. *Id.* at 518–19.

261. *Id.* at 519.

262. Epperson & Canny, *supra* note 1, at 638 n.182.

263. *Id.*

264. *Id.*

265. See 114 AM. JUR. 3D *Proof of Facts* § 13 (2010). Formality requirements arguably should not be a factor in tort cases since the victim is an involuntary creditor and did not have any prior dealings or opportunity to investigate the corporation. Epperson & Canny, *supra* note 1, at 633.

266. See Cheng, *supra* note 17, at 520.

liability is strictly adhered to.<sup>267</sup> Veil piercing should focus on conduct that results in shareholders' unjust enrichment that ultimately injures creditors.<sup>268</sup> How shareholders ultimately benefit at the expense of these creditors depends on whether the plaintiff at issue was a contract creditor or a tort creditor.<sup>269</sup> For contract creditors, the unjust enrichment by shareholders is the goods or services received by the corporation without giving full payment for them.<sup>270</sup> "For a tort victim, the main benefit will be the unpaid tort liability that would have compensated the victim [or] reduced accident prevention costs, the incurrence of which would have prevented the tort at issue."<sup>271</sup> By not paying these costs, the shareholders retain the savings.<sup>272</sup> However, it is important to keep in mind that courts should resort to veil piercing only when the benefit to the corporation resulted from improper actions.<sup>273</sup>

With this idea in mind, undercapitalization should have greater importance as a factor in Maryland veil-piercing decisions, since "inadequate capitalization" fits squarely with the purpose of preventing unjust enrichment of shareholders.<sup>274</sup> Shareholders need to act in good faith and need to reasonably attempt to have sufficient capital in their corporations to account for potential liabilities.<sup>275</sup> If the corporation is not adequately capitalized, then tort and contract creditors' liabilities are not satisfied, and instead the shareholders profit by the extra capital that should have been obtainable by those creditors.<sup>276</sup>

The fact that a creditor is incapable of recovering any damages is not the inquiry courts examine under the undercapitalization factor to determine whether a corporation's veil should be pierced.<sup>277</sup> Instead, since determining a proper test for capital adequacy has given courts trouble, Maryland courts should investigate whether a corporation

267. *Id.* at 499.

268. *Id.* at 499–500.

269. *Id.* at 543–44.

270. *Id.* at 544.

271. *Id.*

272. *Id.*

273. *Id.* at 545 ("If limited liability is to be upheld, the corporate veil doctrine cannot deem non-payment of corporate liabilities absent shareholder impropriety to be unjust. Otherwise limited liability would be practically overturned.")

274. *Id.* at 570.

275. 114 AM. JUR. 3D *Proof of Facts* § 16 (2010).

276. Cheng, *supra* note 17, at 570.

277. Geoffrey Christopher Rapp, *Preserving LLC Veil Piercing: A Response to Bainbridge*, 31 J. CORP. L. 1063, 1089 (2006).



recklessly or deliberately incurred “an obligation that grossly exceeded the corporation’s [resources],” especially after having a prior opportunity to determine whether they could financially repay that liability.<sup>278</sup> Furthermore, for tort obligations, the inquiry should depend on the “foreseeability of risk.”<sup>279</sup> Thus, shareholders would be acting recklessly if a corporation was initially capitalized with few assets, used for high-risk activities, and it is foreseeable that major potential liabilities will occur and are unable to be repaid.<sup>280</sup> Overall, businessmen in Maryland should not be able to protect their wealth and use the limited liability shield to engage in potentially harmful activities without being able to compensate possible victims.<sup>281</sup>

On the other hand, inadequate capitalization should not be used as a factor in those situations where a business loses money due to reasonably unanticipated events.<sup>282</sup> “[I]f evidence shows that when the contractual obligation was incurred, there was at least some reasonable basis for the shareholders to believe that the corporation could generate sufficient revenue to cover the liability[,]” then this would not be an instance of an undercapitalization problem.<sup>283</sup> Essentially, corporations in Maryland should act responsibly in their financial decisions.

This new factor may lead to shareholders overcapitalizing their businesses; however, this would be beneficial to Maryland corporations by reducing “the risk that a business will face a successful veil piercing claim[,] [b]ut it also reduces the risk that the business will fail[]” since it will be adequately capitalized.<sup>284</sup> Although undercapitalization, by itself, may not be sufficient to warrant piercing the corporate veil, it should still be an important factor that goes into the Maryland courts’ decisions in both contract and tort claims in denying shareholders their limited liability shield.<sup>285</sup> When shareholders recklessly undercapitalize their

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278. Cheng, *supra* note 17, at 572, 578; see 114 AM. JUR. 3D *Proof of Facts* § 16 (2010).

279. Cheng, *supra* note 17, at 578.

280. *Id.*

281. See Millon, *supra* note 2, at 1346.

282. See *id.* at 1308.

283. Cheng, *supra* note 17, at 579.

284. Rapp, *supra* note 277, at 1085.

285. See 114 AM. JUR. 3D *Proof of Facts* § 16 (2010). It is noted that undercapitalization may not be an important factor in a veil-piercing case if a sophisticated creditor had a prior opportunity to look at a corporation’s balance sheet and financial position, and therefore, a prior opportunity to bargain with a corporation for additional protection. See generally Speer, *supra* note 6, at 319–20.

corporations, "it is unjust to make an innocent plaintiff bear the cost of tort injury or contract breach."<sup>286</sup>

#### *D. Overall More Liberal Standard for Veil Piercing*

Maryland courts should relax their standard of proof of actual common law fraud in contract claims to include evidence of misrepresentation and conduct akin to fraud. Maryland courts are defining fraud more strictly than other states.<sup>287</sup> In fact, at least compared to the states discussed in this comment, Maryland is the only state with a clear and convincing standard for veil piercing.<sup>288</sup> This demonstrates that Maryland should become more in line with the wisdom of other states and liberalize their veil-piercing standard because Maryland is currently on the extreme side.<sup>289</sup> This would include Maryland courts loosening up their definition of fraud and lowering their burden of proof to disregard the corporate entity.

Indeed, a corporation must be viewed as a legally recognized business entity independent from its shareholders, but this privilege must not be used in an inequitable manner.<sup>290</sup> "There is always danger, when a fiction [such as a corporation] becomes so deeply rooted in the case law, that judges no longer remember its object and purpose . . . ."<sup>291</sup> Under this new approach, Maryland courts would be able to provide injured tort and contract creditors with a better opportunity for compensation than is currently available for them in Maryland. "There may be situations in which the factors of undercapitalization, control, abuse of formalities, and unfairness are present, yet [Maryland's strict view of] fraud is not."<sup>292</sup> In these cases, there still may be such inequitable actions, even absent fraud, that would justify piercing the corporate veil as comparably as under Maryland's current veil-piercing standard.<sup>293</sup> Thus, Maryland courts should work their way to a new vision of their veil-piercing doctrine to protect individuals more fully when shareholders abuse the corporate privilege.

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286. Rapp, *supra* note 277, at 1089.

287. Epperson & Canny, *supra* note 1, at 626 n.104 ("Maryland courts appear to construe the fraud requirement more strictly than in most states, where it is given an interpretation closer to 'unfairness' or 'inequity.'").

288. See *supra* Part V-VI.

289. See *supra* Part VI.

290. PRESSER, *supra* note 93, § 1:5.

291. *Id.*

292. Speer, *supra* note 6, at 330.

293. *Id.*

## IX. THE LIMITED LIABILITY COMPANY

Although the corporation is the business entity primarily focused on in this comment, this suggested approach could also be applied to a limited liability company (LLC), with a slight variation.<sup>294</sup> The LLC is an entity that “combine[s] the positive characteristics of the various types of business organizations, in particular the limited liability of corporations and the flow-through taxation of partnerships.”<sup>295</sup> “Maryland courts have not yet addressed whether the doctrine of piercing the corporate veil applies with equal force to LLCs.”<sup>296</sup> Nevertheless, Maryland courts should apply the doctrine of piercing the corporate veil to the liability shields of LLCs, since LLCs have the same goal of limited liability for their members as corporations have for their shareholders.<sup>297</sup>

Maryland courts could not apply the suggested approach to veil piercing exactly as discussed in Part VIII because “the LLC form differs from the corporate form in several respects.”<sup>298</sup> Most importantly, the courts in Maryland should not use failure to observe formalities in their veil-piercing decisions for LLCs, since LLCs are not required to follow formalities like corporations are obligated to follow.<sup>299</sup> In Maryland, there is flexibility in what the members can put in the operating agreement regarding “management and economic relationships of the LLC.”<sup>300</sup> Thus, “[p]iercing the veil of this entity

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294. This suggested approach may also apply to limited liability partnerships, but this discussion is limited to LLCs because of the growth in popularity of the LCC. See PRESSER, *supra* note 93, § 4:1. The LLC is attractive due to its characteristics and is the “dominant business form for small businesses.” Rapp, *supra* note 277, at 1063.

295. See PRESSER, *supra* note 93, § 4:1. Flow-through taxation allows a business to “not be subjected to double taxation.” *Id.* “Thus, instead of being taxed at both the entity and the personal level, income is taxed only at the personal level.” *Id.* This is a tax advantage as compared to corporations since they are subject to double taxation. *Id.*

296. Jeffrey S. Quinn, Allen v. Dackman: *Doing Away With Limited Liability in Maryland*, 70 MD. L. REV. 1171, 1198 (2011). In *Allen v. Dackman*, the Court of Appeals of Maryland held that an individual member of an LLC may be held personally liable for injuries under the Baltimore City Housing Code, but the court did not address whether the members would be held liable by applying the doctrine of piercing the corporate veil to the liability shield of LLCs. See *Allen v. Dackman*, 413 Md. 132, 160, 991 A.2d 1216, 1232–33 (2010); Quinn, *supra*, at 1198–204.

297. Quinn, *supra* note 296, at 1223–24.

298. PRESSER, *supra* note 93, § 4:2.

299. *Id.* Some states, not including Maryland, have rejected the observance of formalities as a basis for LLC veil piercing in their LLC statutes. See Bendremer, *supra* note 106, at 395 n.77; but see Quinn, *supra* note 296, at 1198–99.

300. Quinn, *supra* note 296, at 1185. “The [Maryland Limited Liability Company Act] was designed to provide . . . flexibility in establishing the rights of its members.” *Id.* at 1182.

for a failure to observe formalities would contradict one of the LLC's most appealing aspects, its design to relieve member-managers from the excessive burdens of the formalities required of . . . [corporations]."<sup>301</sup> Accordingly, failure to observe formalities should not be used when deciding to pierce the veil of an LLC. However, the other aspects of the suggested approach could be applied to piercing an LLC's veil in Maryland under appropriate circumstances.

## X. CONCLUSION

This comment explores Maryland's current approach to piercing the corporate veil. After comparing Maryland's approach to a select group of five states, Maryland is on the extreme side of piercing the corporate veil with their strict veil-piercing test.<sup>302</sup> The rule in Maryland is "that the corporate entity will be disregarded only when necessary to prevent fraud or to enforce a paramount equity."<sup>303</sup> Despite the assertion that Maryland common law allows for the veil to be pierced when a paramount equity is present, Maryland courts have not found sufficient facts to justify piercing the corporate veil to enforce a paramount equity.<sup>304</sup> This demonstrates that Maryland courts consider a corporation's limited liability protection as being more important than protecting victims of shareholders' conduct in certain inequitable cases.<sup>305</sup>

As a result, this comment recommends that Maryland courts use other factors, in addition to fraud, when deciding to disregard a corporate entity, including shareholder control, failure to follow corporate formalities, and undercapitalization.<sup>306</sup> Furthermore, the factor of fraud should be relaxed to include misrepresentation or conduct that is akin to fraud but does not meet the Maryland courts' strict definition of common law fraud.<sup>307</sup> Maryland would benefit from a more liberal standard since corporations would be more cautious and conduct themselves more appropriately so as to avoid the risk of losing the shield of limited liability, which will, in turn,

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301. PRESSER, *supra* note 93, § 4:2.

302. *See supra* Parts V–VI.

303. *Dixon v. Process Corp.*, 38 Md. App. 644, 654, 382 A.2d 893, 899 (1978) (quoting *Bart Arconti & Sons, Inc. v. Ames-Ennis, Inc.*, 275 Md. App. 295, 312, 340 A.2d 22, 235 (1975)); *see also supra* Part VI.

304. *Residential Warranty Corp. v. Bancroft Homes Greenspring Valley, Inc.*, 126 Md. App. 294, 307, 728 A.2d 783, 789 (1999); *see supra* Part VI.

305. *See supra* Part VI.

306. *See supra* Part VIII.

307. *See supra* Part VIII.D.

confer a benefit upon the community.<sup>308</sup> By lowering the standard in Maryland to pierce the corporate veil, the courts would better protect consumers in the marketplace and care for their individual rights.<sup>309</sup> Accordingly, injured creditors in tort and contract claims would benefit from the increased possibility of collecting damages when shareholders abuse the corporate privilege.<sup>310</sup>

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308. *See supra* Part VII.

309. *See supra* Part VII.C.

310. *See supra* Part VII.C.

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