I n an age of corporate dissolutions and reorganizations, pursuing a corporation for its misconduct can be challenging. One of the main advantages of corporate status is protection of its officers and shareholders from personal liability. For example, if Betty’s Backyard BBQs Inc. negligently installs a BBQ, which causes a fire, the homeowner can only sue Betty’s Backyard BBQs Inc., not Betty herself. In most case, if Betty’s Backyard BBQs Inc. is bankrupt, the homeowner is simply out of luck. In some cases, however, the law will take away those protections afforded to the officers and stockholder (i.e. Betty) in the interests of justice. Under a doctrine called “piercing the corporate veil,” or the “alter ego doctrine,” officers or shareholders can be personally liable for the actions of their corporations if their corporation was essentially a sham to escape personal liability from creditors. Courts commonly consider a multitude of factors to determine if justice would best be served by disregarding the corporate structure and allowing claims against the shareholders and officers. The factors vary by jurisdiction but the following are example of the considerations:

- Commingling of funds and other assets;
- Spending the corporation's funds as if they were the shareholder's personal assets;
- Issuing stock without authority;
- Falsely stating that an individual is personally liable for the debts of the corporation;
- Failing to maintain minutes or adequate corporate records;
- Identical equitable ownership in two entities;
- Sole ownership of all of the stock in a corporation by one individual or the members of a family;
- Use of the same office or business location by two corporations;
- Failure to adequately capitalize a corporation;
- Total absence of corporate assets and undercapitalization;
- Concealment and misrepresentation of the identity of the responsible ownership, management and financial interest, or concealment of personal business activities;
- The manipulation of assets and liabilities between entities so as to concentrate the assets in one and the liabilities in another.

The following is a sampling of the doctrine in California, Florida, Kentucky, New York, North Carolina, and Texas.

CALIFORNIA
In limited circumstances, California courts will hold shareholders liable for actions of a corporation. Mesler v. Bragg Management Co., 702 P.2d 601, 606 (Cal. 1985). The alter ego doctrine has two general requirements: “(1) that there be such unity of interest and ownership that the separate personalities of the corporation and the individual no longer exist and (2) that, if the acts are treated as those of the corporation alone, an inequitable result will follow.” Id. Whether to ignore the corporate form is usually a question of fact for the trier of fact and not a question of law. Associated Vendors, Inc. v. Oakland Meat Co., 26 Cal. Rptr. 806, 837 (Cal. Dist. Ct. App. 1962). While actual fraud is not a necessary element, some form of bad faith must be found when the alter ego doctrine applies. Id. at 838. Undercapitalization is one factor, but is not alone enough to pierce the corporate veil. Id. at 841-42. Only stockholders may be liable under an alter ego theory in California. Riddle v. Leuschner, 335 P.2d 107, 111 (Cal. 1959).

FLORIDA
Under Florida law, the corporate veil will not be pierced absent a showing of improper conduct. Dania Jai-Alai Palace, Inc. v. Sykes, 450 So. 2d 1114 (Fla.1984); Ally v. Naim, 581 So. 2d 961 (Fla. 3d DCA 1991); Sky Lake Gardens Recreation, Inc. v. Sky Lake Gardens, 574 So. 2d 1135, 1137 (Fla. 3d DCA 1991). Therefore, the corporate veil will not be penetrated either at law or in equity unless it is shown that the corporation was organized or employed to mislead creditors or to work a fraud upon them. Dania Jai-Alai, 450 So. 2d at 1120.
KENTUCKY
Kentucky courts will only pierce the corporate veil in the presence of a combination of the following factors: (1) undercapitalization; (2) a failure to observe the formalities of corporate existence; (3) nonpayment or overpayment of dividends; (4) a siphoning off of funds by the dominant shareholder(s); and (5) the majority shareholders having guaranteed corporate liabilities in their individual capacities. White v. Winchester Land Development Corporation, 584 S.W.2d 56, 62 (Ky. Ct. App. 1979).

NEW YORK
Courts in New York will pierce the corporate veil whenever it is necessary. Morris v. State Dept of Taxation & Fin., 623 N.E.2d 1157, 1160 (N.Y. 1993). The court explained, “Broadly speaking, the courts will disregard the corporate form, or, to use accepted terminology, ‘pierce the corporate veil,’ whenever necessary to prevent fraud or to achieve equity.” Id. While complete domination is important to pierce the corporate veil, there must also be a showing of “a wrongful or unjust act toward the plaintiff.” Id. at 1161. “The party seeking to pierce the corporate veil must establish that the owners, through their domination, abused the privilege of doing business in the corporate form to perpetrate a wrong or injustice against that party such that a court in equity will intervene.” Id. While inadequate capitalization is a factor, it is not alone enough to invoke the doctrine of veil piercing. Brito v. DILP Corp., 723 N.Y.S.2d 459, 460 (N.Y. Sup. Ct. 2001). It is not enough that the corporation does not have sufficient assets to meet a creditor’s claims. Id.

NORTH CAROLINA
North Carolina courts “will disregard the corporate form or ‘pierce the corporate veil,’ and extend liability for corporate obligations beyond the confines of a corporation’s separate entity, whenever necessary to prevent fraud or to achieve equity.” Glenn v. Wagner, 313 N.C.450, 454, 329 S.E.2d 326, 330 (1985). The “instrumentality rule” operates in the following situation:

[When a] corporation is so operated that it is a mere instrumentality or alter ego of the sole or dominant shareholder and a shield for his activities in violation of declared public policy or statute of the State, the corporate entity will be disregarded and the corporation and the shareholder treated as one and the same person, it being immaterial whether the sole or dominant shareholder is an individual or another corporation.


TEXAS
The alter ego doctrine in Texas is an exception to the general rule that the corporate form should not be disregarded. Lucas v. Texas Industries, Inc., 696 S.W.2d 372, 374 (Tex. 1984). The exception only applies “where it appears the corporate entity of the subsidiary is being used as a sham to perpetrate a fraud, to avoid liability, to avoid effect of a statute, or in other exceptional circumstances.” Id. Texas law requires there to be something more than mere “unity of interest, ownership, and control.” Id. The defendant must use the corporate form to “bring about results which are condemned by the general statements of public policy which are enunciated by the courts as ‘rules’ which determine whether the courts will recognize their own child.” Id. “The plaintiff must prove that he has fallen victim to a basically unfair device by which a corporate entity has been used to achieve an inequitable result.” Id. at 375.

What the plaintiff must prove depends on whether the cause of action sounds in tort or in contract. Id. In tort there is no need to prove fraud. Id. Alternatively, in contract cases the corporate structure will not be disregarded in the absence of fraud. Id. See Tex. Business Organizations Code § 21.223-21.225 (Vernon 2009) (preempting common law actions to preserve limited liability for shareholders when corporations enter into contracts); see also Willis v. Donnelly, 199 S.W.3d 262, 271-273 (Tex. 2006) (detailing statutory backlash to judicial extensions of contractual liability to shareholders).

For additional information, please feel free to contact the author of this Subro Alert, or any members of Cozen O’Connor’s National and International Subrogation and Recovery Department.