NOTE

A Risk-Based Approach to Limited Liability for Individuals and Corporate Parents

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ABSTRACT

Corporate parents and individual shareholders are fundamentally different. In particular, they have different sensitivities to economic risks—yet the limited liability doctrine has failed to account for that difference. This Note argues the customary practice of mechanically applying a checklist of veil-piercing factors commonly favors corporate parents over individual shareholders. The empirical results prove as much, which raises questions about whether the modern trend makes sense in light of limited liability's evolutionary history as a shield for individuals, not corporations. Prompted by the disconnect between modern veil-piercing practices and the historical raison d'être of limited liability, this Note offers a unique theory—grounded in law and economics—for how courts can increase their fidelity to limited liability's welfare-maximizing purpose and restore balance to disparate veil-piercing trends. To do this, this Note offers the "social risk" principle.

While courts ordinarily begin every veil-piercing inquiry with the presumption against liability, the social risk principle would have them abandon that presumption where the liability shield would not incentivize welfare-maximizing behavior. After all, the ultimate purpose of limited liability for non-

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public companies is to incentivize socially beneficial risk-taking. But limited liability for corporate parents raises moral hazard concerns to a greater degree than it does for individuals. It creates a double immunity shield within the corporate enterprise, lowering personal risk to the parent's shareholders and thus diminishing incentives to refrain from excessive risk-taking. Therefore, as courts apply the social risk principle, they would end up discarding the nonliability presumption for corporations more frequently than for individuals. As corporate piercing rates climb, the disparate piercing outcomes would tend to equilibrium.

Table of Contents

Introduction

Corporations and individuals are inherently different.[1] In particular, corporations and individuals may have different sensitivities to economic risks. Corporations generally have more money, more diversified assets, better legal representation, and superior business savvy.[2] Therefore, their willingness to take investment risks often exceeds that of an individual, who might be loath to gamble his personal retirement account on a new business venture. As corporate law attempts to alleviate these risks to promote socially beneficial investments,[3] one would suspect the doctrine would account for these

1 *But see, e.g.*, Burwell v. Hobby Lobby Stores, Inc., 134 S. Ct. 2751, 2751 (2014) (corporations are "persons" for the purpose of the federal Religious Freedom Restoration Act); Citizens United v. FEC, 558 U.S. 310, 312 (2010) (corporations are "persons" for First Amendment purposes).

2 *See* John H. Matheson, *Why Courts Pierce: An Empirical Study of Piercing the Corporate Veil*, 7 Berkeley Bus. L.J. 1, 15 (2010).

3 Patrick T. Schmidt, Note, *The Internalization of Corporate Patent Infringement: Chal-*

varying degrees of risk-aversion. At least in the context of limited liability and corporate veil-piercing, however, there appears to be no meaningful consideration of this difference.

This Note focuses on limited liability and corporate veil-piercing as applied to corporate and individual shareholders of nonpublic companies. Limited liability is a kind of qualified immunity for shareholders (owners of a corporation), which are either individuals or parent companies.[4] Because a corporation and its owner are legally distinct entities under the law, the owner is shielded from liability for the corporation's debts.[5] Veil-piercing is an exception to that immunity—it is a judicial decision to disregard the liability shield in cases where the shareholder exercises so much control over the corporation that it makes little sense to treat the two as separate.[6] The piercing analysis usually involves a laundry list of factors that attempt to measure the extent of control or degree of separation.[7] Importantly, courts presume the shareholder is not liable unless the piercing inquiry raises enough red flags about the level of shareholder control.[8] This default is called the "nonliability presumption."

This nonliability presumption should not apply where the goals of limited liability are unsatisfied. To that end, this Note observes first that limited liability aims to enhance societal welfare by incentivizing

lenging the Federal Circuit's Approach to Corporate-Participant Liability, 88 TEX. L. REV. 217, 222 (2009).

4 *See* Stephen M. Bainbridge, *Abolishing Veil Piercing*, 26 J. CORP. L. 479, 480 (2001).

5 *See, e.g.*, NLRB v. Deena Artware, Inc., 361 U.S. 398, 402–03 (1959) ("The insulation of a stockholder from the debts and obligations of his corporation is the norm, not the exception."); BMC Software Belgium, N.V. v. Marchand, 83 S.W.3d 789, 798 (Tex. 2002); Salomon v. A. Salomon & Co. [1897] AC 22 (HL) 23 (appeal taken from Eng.); *see also* Robert B. Thompson, *Piercing the Corporate Veil: An Empirical Study*, 76 CORNELL L. REV. 1036, 1036 (1991); Robert B. Thompson, *Piercing the Veil Within Corporate Groups: Corporate Shareholders as Mere Investors*, 13 CONN. J. INT'L L. 379, 379 (1999).

6 *See, e.g.*, DeWitt Truck Brokers, Inc. v. W. Ray Flemming Fruit Co., 540 F.2d 681, 683 (4th Cir. 1976) (finding an individual owner to be too intertwined with the corporation to regard him as separate); Walkovszky v. Carlton, 223 N.E.2d 6, 9 (N.Y. 1966) (declaring a stockholder to be liable when he is "conducting the business in his individual capacity"); *see also* PHILLIP I. BLUMBERG, THE LAW OF CORPORATE GROUPS: TORT, CONTRACT, AND OTHER COMMON LAW PROBLEMS IN THE SUBSTANTIVE LAW OF PARENT AND SUBSIDIARY CORPORATIONS 110 (1987) ("[C]ourts do not usually consider whether implementation of the polices and objectives of the law in the area under consideration makes it desirable . . . to impose legal consequences on the components of the enterprise . . . . The legal consequences instead flow from whether the subsidiary (or controlled corporation) has been found to exist as a *separate* entity." (emphasis added)).

7 Douglas G. Smith, *Piercing the Corporate Veil in Regulated Industries*, 2008 BYU L. REV. 1165, 1171–72.

8 *See* Thompson, *Piercing the Corporate Veil: An Empirical Study*, *supra* note 5, at 1070.

socially desirable risk-taking.[9] It makes sense, then, that the nonliability presumption should not apply in cases where it would not incentivize welfare-maximizing investment decisions. In other words, courts would proceed through their traditional veil-piercing checklists but without presuming *a priori*, as they normally do, that the shareholder is off the hook. This will be called the "social risk" principle.

The problem is that courts are not adjudicating veil-piercing claims with this welfare-maximizing logic in mind. Instead, they rely on rote application of piercing checklists that inevitably favor well-heeled complex business enterprises over individual shareholders.[10] As a result, courts pierce against individuals more often than against parent corporations, a result confirmed by multiple empirical studies.[11] These disparate outcomes become especially striking when viewed against the historical background of limited liability in America, which emerged to protect individuals, not corporations.[12]

Prompted by this disconnect between history and modern practice, this Note offers a unique theory for how application of the social risk principle might restore balance to disparate piercing outcomes. The social risk principle would instruct courts to retain the nonliability presumption only for defendants who would make welfare-*maximizing* investment decisions (e.g., starting a healthy grocery store in a food-barren neighborhood). Conversely, courts would abandon the presumption for defendants that would take welfare-*diminishing* risks (e.g., creating a spinoff company to dump toxic waste with impunity). This Note argues that limited liability for corporate parents raises moral hazard concerns more than it does for individuals, and therefore corporations—on average—are more likely to take the kinds of "bad-for-society" risks that would result in tossing the presumption of nonliability.[13] If courts discard that presumption for excessively risky corporations, more corporate parents would suffer piercing while individual piercing rates would remain relatively unaffected. This trend may help rebalance disparate piercing outcomes.

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9 *See* David W. Leebron, *Limited Liability, Tort Victims, and Creditors*, 91 COLUM. L. REV. 1565, 1566 (1991).

10 *See infra* Part I.

11 Matheson, *Why Courts Pierce*, *supra* note 2, at 15; Peter B. Oh, *Veil-Piercing*, 89 TEX. L. REV. 81, 110–11 (2010); Thompson, *Piercing the Corporate Veil: An Empirical Study*, *supra* note 5, at 1056.

12 *See* Phillip I. Blumberg, *Limited Liability and Corporate Groups*, 11 J. CORP. L. 573, 575 (1986).

13 As this Note explains in Part III, individuals may have a different level of sensitivity to economic risks than corporations do, so it is plausible that a risk-alleviating device like limited liability would have different effects on individuals than on corporations.

This Note attempts to fill a void in a rich body of literature on the corporate veil and the circumstances that justify disregarding it. Scholars have offered detailed histories of limited liability in early America,[14] provided empirical assessments of piercing rates for different types of defendants,[15] and propounded numerous theories for limited liability and veil-piercing.[16] Judges have occasionally intimated that individuals should be treated differently than corporate entities,[17] but the jurisprudence lacks any consistent or coherent articulation of the different justifications for limited liability for individuals and corporations. In general, the literature and case law reveal scattered, somewhat undeveloped observations about individual and corporate shareholders, with little focused exegesis of why they are or ought to be conceptually differentiated. Here, that issue comes directly under the microscope.

The argument is made in several steps. Part I explains how the checklist approach favors corporate parents and supplements that explanation with statistical data regarding disparate piercing outcomes. Part II reviews the history of limited liability in America and outlines the animating purpose of the doctrine: to enhance social welfare. Part III presents and applies the social risk principle to corporations. This Part focuses on why corporations generally are more likely to take welfare-diminishing risks based on the excess protection created by two tiers of limited liability. Finally, Part IV addresses the probable criticisms of this theory, clarifying the value of the social risk principle as a threshold inquiry for everyday veil-piercing adjudications.

I. Disparate Outcomes and the Checklist Method

A. Evidence of Disparity

Beginning with a brief overview of the statistical findings is especially useful because scholars have consistently predicted—without the benefit of any empirical inquiry—a contrary result.[18] Quantitative

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14 *See* Blumberg, *supra* note 12, at 587–95.

15 Matheson, *Why Courts Pierce*, *supra* note 2, at 15; Oh, *supra* note 11, at 110–11; Thompson, *Piercing the Corporate Veil: An Empirical Study*, *supra* note 5, at 1056.

16 *See* Blumberg, *supra* note 12, at 625.

17 *See id.* at 592.

18 *See, e.g.*, Robert W. Hamilton & Jonathan R. Macey, Cases and Materials on Corporations Including Partnerships and Limited Liability Companies 265 (10th ed. 2007) ("Courts appear to be rather reluctant to disregard the corporate form. However, that reluctance appears to be diminished in cases brought in the parent-subsidiary context."); William P. Hackney & Tracey G. Benson, *Shareholder Liability for Inadequate Capital*, 43 U. Pitt. L. Rev. 837, 873 (1982) (citing cases for the proposition that courts are more willing to disregard

methods, however, "move our interpretation of legal phenomen[a] . . . from the realm of commentary to the province of statistical inference."[19]

Professor Robert Thompson is credited with taking a significant first stab at capturing the statistical frequency of veil-piercing in defined circumstances. According to Thompson, when the potential targets of piercing were individuals, courts pierced in 43% of cases; whereas piercing resulted in only 37% of cases when the target was a parent company.[20] Professors Peter Oh and John Matheson each have built on Thompson's foundational work and supplied their own empirical comparisons, reaching the same conclusion but finding a greater variance in piercing outcomes.[21] Professor Oh found that courts are 52% likely to pierce against individuals, but only 41% against corporations.[22] He also measured the comparative likelihoods of piercing for several types of claims, finding that for *every* type of claim, courts are more likely to pierce against an individual than against an entity.[23] Professor Matheson's findings reveal the greatest variance: courts are 39% likely to pierce against individuals, but only 21% against entities.[24] In other words, his study found that courts are almost *twice* as likely to pierce against individuals than against corporations.[25] This

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the veil separating a parent and subsidiary than one between an individual and corporation); Robert W. Hamilton, *The Corporate Entity*, 49 TEX. L. REV. 979, 992 (1971) ("[C]ourts are probably more willing to 'pierce the corporate veil' when the defendant is a corporation rather than an individual."); Comment, *Inadequately Capitalized Subsidiaries*, 19 U. CHI. L. REV. 872, 872 n.1 (1952) ("[L]iability appears to be more frequently limited when the stockholder is not a corporate entity.").

19 John A. Swain & Edwin E. Aguilar, *Piercing the Veil to Assert Personal Jurisdiction Over Corporate Affiliates: An Empirical Study of the* Cannon *Doctrine*, 84 B.U. L. REV. 445, 483 (2004).

20 Thompson, *Piercing the Corporate Veil: An Empirical Study*, *supra* note 5, at 1055. Professor Thompson's study found this to be the average disparity for corporations with three or fewer individual shareholders. *Id.* at 1054–55.

21 Matheson, *Why Courts Pierce*, *supra* note 2, at 14–15; Oh, *supra* note 11, at 110.

22 Oh, *supra* note 11, at 110.

23 *Id.* at 131 (for contract claims: 40% likelihood of piercing against an entity, 49% against an individual; for criminal actions: 50% against an entity, 70% against an individual; for fraud claims: 55% against an entity, 63% against an individual; for statutory claims: 42% against an entity, 54% against an individual; for tort claims: 38% against an entity, 54% against an individual).

24 Matheson, *Why Courts Pierce*, *supra* note 2, at 14–15.

25 This Note makes no effort to contrast the professors' statistical methodologies. For criticisms of each approach, see Jonathan Macey & Joshua Mitts, *Finding Order in the Morass: The Three Real Justifications for Piercing the Corporate Veil*, 100 CORNELL L. REV. 99, 111–13 (2014). It is enough to say that each of them found a disparity in the frequency of piercing against individuals and corporate parents.

evidence makes clear that individuals, not corporations, bear the brunt of the veil-piercing—the question is *why*?

B. The Checklist Method

State courts' piercing tests have a lot do with it. In order to understand how courts' reliance on piercing factors normally favors corporations, it is important to grasp the checklist approach itself. Each state has its own test for piercing the corporate veil, which is embedded in the state's common law of corporations.[26] The checklist method, however, is common to almost all states. Although each jurisdiction might have a slightly different formulation of the factors, the exercise of checking off specific indicators is universal, as is the substance of the factors themselves. The veil-piercing inquiry tests these factors to determine the extent of control the shareholder exercised over the corporation.[27] To be subject to veil-piercing, the shareholder must have used that control in some fashion that amounts to "abuse of the corporate form."[28] If the shareholder "dominat[ed]" the corporation and used it to effectuate the shareholder's own misconduct, then the court does not treat them as separate entities with their own autonomous personalities, but rather as "alter egos" of one another.[29] In such a case, the corporation is a mere "instrumentality" of the shareholder, eviscerating any veil of separation between the two.[30]

In his seminal 1931 book, *Parent and Subsidiary Corporations*,[31] Professor Frederick Powell formulated the "instrumentality" doctrine, providing a list of evidentiary guidelines for courts to consider in assessing the level of control exercised by the shareholder over his cor-

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26 *See* STEPHEN B. PRESSER, PIERCING THE CORPORATE VEIL § 2:01–55 (2003) (summarizing every state's, the District of Columbia's, and Puerto Rico's veil-piercing jurisprudence). Some standards, however, have been codified by state legislatures relying on the Model Business Corporation Act, which proposes specific language for legislative adoption: "a shareholder of a corporation is not personally liable for the acts or debts of the corporation . . . ." MODEL BUS. CORP. ACT § 6.22(b) (AM. BAR ASS'N 2002).

27 *See* FREDERICK J. POWELL, PARENT AND SUBSIDIARY CORPORATIONS: LIABILITY OF A PARENT CORPORATION FOR THE OBLIGATIONS OF ITS SUBSIDIARY § 6, at 8–36 (1931).

28 Smith, *supra* note 7, at 1171–72 (explaining concisely the veil-piercing inquiry most common among the states).

29 *See id.* at 1172–73, 1179.

30 Courts have struggled with this metaphor-driven inquiry. As Justice Cardozo eloquently and famously declared, the veil-piercing inquiry is "enveloped in the mists of metaphor . . . [which] are to be narrowly watched, for starting as devices to liberate thought, they end often by enslaving it." Berkey v. Third Ave. Ry. Co., 155 N.E. 58, 61 (N.Y. 1926).

31 POWELL, *supra* note 27, § 6, at 8–36.

poration.[32] These guidelines were adopted in two influential federal decisions—*Fish v. East*[33] and *Taylor v. Standard Gas & Electric Co.*[34]—from which future courts expanded dramatically, creating long laundry lists of factors.[35] In some jurisdictions, these lists include up to twenty isolated factors to be applied in determining whether the corporation is a mere "alter ego" of the shareholder.[36]

One recent California case, *Greenspan v. LADT*,[37] listed a self-proclaimed "not exhaustive" list of factors it would apply in adjudicating a veil-piercing claim, including (1) commingling of funds, (2) treatment of corporate assets as the shareholder's own, (3) failure to obtain authority to issue stock, (4) holding out by shareholder that he is personally liable for the corporate debts, (5) identical equitable ownership, (6) use of the same office or business location and employment of the same staff, (7) failure to adequately capitalize the corporation, (8) use of a corporation as "a mere shell," (9) concealment of the identity of the responsible ownership, (10) "disregard of legal formalities and the failure to maintain arm's length relationships," (11) use of the corporation to get labor, services, or merchandises from another entity, (12) diversion of assets from the corporation to another shareholder to the creditors' detriment . . . and the list continues.[38]

These laundry lists unnecessarily complicate the analysis. As Professor Blumberg insightfully explained, "[s]uch point-by-point recitation is merely the prelude to consideration of the entire record of the interrelationship between the interrelated corporations and their affiliates and their impact on affected parties . . . ."[39] These checklists "lead[ ] inevitably to distortions" and "distract from the fundamental analysis."[40]

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32 *Id.* at 8–9; PHILLIP I. BLUMBERG ET AL., THE LAW OF CORPORATE GROUPS: JURISDICTION, PRACTICE, AND PROCEDURE § 11.03 (2d ed. 2007).

33 Fish v. East, 114 F.2d 177, 191 (10th Cir. 1940).

34 Taylor v. Standard Gas & Elec. Co., 96 F.2d 693, 704–05 (10th Cir. 1938), *rev'd on other grounds*, 306 U.S. 543 (1939).

35 BLUMBERG, *supra* note 32, at 11-30–11-32.

36 *See, e.g.*, Associated Vendors, Inc. v. Oakland Meat Co., 26 Cal. Rptr. 806, 838–40 (Cal. Ct. App. 1962).

37 Greenspan v. LADT, LLC, 121 Cal. Rptr. 3d 118 (Cal. Ct. App. 2010).

38 *Id.* at 138–39. This case is one of countless examples where courts apply a long list of factors for evaluating the degree of control exercised by the shareholder. *See, e.g.*, Pepsi-Cola Metro. Bottling Co. v. Checkers, Inc., 754 F.2d 10, 16 (1st Cir. 1985) (listing factors similar to above); Baatz v. Arrow Bar, 452 N.W.2d 138, 141 (S.D. 1990) (well-known case listing six factors).

39 BLUMBERG, *supra* note 32, at 11-33.

40 *Id.* at 11-34.

Overreliance on a checklist of piercing factors is potentially dangerous as well. It makes it easier to overlook the fundamental risk-oriented logic of limited liability in favor of easy-to-apply checklists that ultimately skew outcomes against individuals. The checklist method favors corporate parents in at least four ways. First, individuals are less sophisticated business actors.[41] Second, they have fewer—and perhaps lower-quality—litigation resources.[42] Third, courts may be giving some deference to complex, experienced corporate enterprises while giving no such deference to individual shareholders.[43] Fourth, individuals are less capable of disguising their involvement with the company, making it easier for courts to discover "indicia of control" as reflected in most veil-piercing checklists.[44]

Beginning first with sophistication, an individual owner is less likely than corporate parents to have the experience and institutional know-how to artfully structure his shareholder-corporation relationship to evade piercing. Simply put, they are "*sloppier* or follow the rules less frequently than do corporate owners."[45] Indeed, "[t]he factors that often support holding individual owners of a small business liable, such as commingling of assets and failure to follow corporate formalities, may simply appear less often in entity cases."[46] The paradigmatic individual shareholder is the one struggling to keep the doors open on her new bakery—whereas the quintessential corporate parent is Alphabet, Inc., the newly-minted holding company for Google and its sister subsidiaries.[47] Companies like Alphabet, Inc. likely have teams of well-trained corporate lawyers that can advise them on how to structure and manage their subsidiaries to avoid piercing. Contrast that with the old, unhealthy, illiterate man in *Zubik v. Zubik*[48] who failed to maintain written minutes of meetings or documentation of corporate affairs because of his lack of experience.[49] Those kinds of

41 *See* Matheson, *Why Courts Pierce*, *supra* note 2, at 15.

42 John H. Matheson, *The Modern Law of Corporate Groups: An Empirical Study of Piercing the Corporate Veil in the Parent-Subsidiary Context*, 87 N.C. L. Rev. 1091, 1122 (2009).

43 *See id.* at 1115.

44 Thompson, *Piercing the Veil Within Corporate Groups*, *supra* note 5, at 380.

45 Matheson, *Why Courts Pierce*, *supra* note 2, at 15 (emphasis added).

46 *Id.*

47 *Alphabet Replaces Google as Publicly Traded Company*, N.Y. Times (Oct. 2, 2015), http://www.nytimes.com/2015/10/03/business/alphabet-replaces-google-as-publicly-traded-company.html?ref=topics.

48 Zubik v. Zubik, 384 F.2d 267 (3d Cir. 1967) (declining to pierce the veil against an elderly amateur business owner).

49 *See id.* at 270, 272.

amateurish mistakes occur less often with large megacompanies than with individual owners.

Second, and relatedly, individuals may lose the piercing claim more often than corporate parents because they likely have lower-quality legal representation during the litigation.[50] Here, legal representation matters with respect to the quality of the advocacy in defending a piercing claim once litigation has begun.[51] In general, corporations have better-financed, more coordinated litigation resources that can better defend against quintessentially complex veil-piercing challenges.[52]

Third, courts may simply defer to complex, well-established business entities. Courts may be reluctant to parse through the morass of documents and testimonial evidence to determine whether the parent's "control" over the subsidiary suffices for a piercing claim.[53] As judges sort through these convoluted corporate entanglements, they may simply drop the case into the "too hard" pile.[54] For example, the Supreme Court's decision in *United States v. Bestfoods*[55] reflects a willingness to presume the legitimacy of a corporate parent's controlling conduct.[56] The Court recognized the "well established principle [of corporate law] that directors and officers holding positions with a parent and its subsidiary can and do '*change hats*' to represent the two corporations separately, despite their common ownership."[57] There is little evidence in the case law that individual shareholders would receive the benefit of the "changing hats" presumption to the extent that corporate parents enjoy it in piercing claims.

Fourth, parent companies may be better able to disguise their abuses of the corporate form.[58] Professor Thompson argues this point succinctly: "[c]orporations, as inanimate entities that act through

50 Matheson, *The Modern Law of Corporate Groups*, *supra* note 42, at 1122.

51 *See id.* ("The quality of the representation . . . could affect . . . the presentation to the court . . . .).

52 *See id.*

53 *See id.* at 1115.

54 *Id.*

55 United States v. Bestfoods, 524 U.S. 51 (1998).

56 *See id.* at 69–70.

57 *Id.* at 69 (alteration in original) (emphasis added) (quoting Lusk v. Foxmeyer Health Corp., 129 F.3d 773, 779 (5th Cir. 1997)). For more discussion on the "changing hats" phenomenon, see Thompson, *Piercing the Veil Within Corporate Groups*, *supra* note 5, at 393–94. *See also* Edwards Co. v. Monogram Indus., Inc., 730 F.2d 977, 985–86, 986 n.14 (5th Cir. 1984); Blumberg, *supra* note 6, at 190, 495 (arguing the formalistic quality of the "hats" concept causes courts to overlook the reality of how enmeshed a corporate parent is with its subsidiary).

58 *See* Thompson, *Piercing the Veil Within Corporate Groups: Corporate Shareholders as Mere Investors*, *supra* note 5, at 380.

others, *can more easily present themselves as mere investors who have not engaged in the nasty acts* that courts usually require to pierce the veil."[59] Corporate parents may be better able to "portray everything [they do] directly as within the normal shareholder role of a mere investor."[60] In that sense, it is plausible that courts have different thresholds of permissible control, depending on whether a corporation or an individual is exercising it. For instance,

> [w]hen a corporate shareholder names . . . one of its employees[ ] as a director or officer of the subsidiary, it is only doing what shareholders normally do. If an individual shareholder names himself as a director or officer it seems more nefarious and is a factor more likely to lead to piercing. . . . When the corporate shareholder gets a report from its employee, who is a director of the subsidiary, it is merely checking on its investment. If it advances funds or guarantees the subsidiary's debt, it is merely providing financing which is what shareholders are supposed to do.[61]

Because many modern veil-piercing tests require checking "indicia of control,"[62] the individual may fall victim to this mode of analysis more frequently than corporate parents because he is simply less capable of disguising his level of control.

These rationales show that individuals and corporate parents are fundamentally different—and that difference makes the former more likely to suffer piercing than the latter. This trend, however, is more than a little curious when viewed in light of limited liability's historical evolution. Courts' mechanical reliance on piercing checklists has made corporate parents the primary beneficiaries of the limited liability doctrine, but that was not always so. A careful examination of limited liability's history reveals that corporate parents were never part of the original equation.

II. History and Purpose of Limited Liability

A. *History: Limited Liability Emerged for Individuals*

Limited liability emerged to protect individuals—not corporate parents. This Section offers a brief outline of the way limited liability developed in America, emphasizing that the grant of protection to corporate parents may have been a "historical accident" of judicial

59 *Id.* (emphasis added).

60 *Id.* at 391.

61 *Id.*

62 Thompson, *Piercing the Veil Within Corporate Groups*, *supra* note 5, at 380.

creation.[63] Given that limited liability's origin-story focused on protecting individuals, rather than corporate parents, it raises questions about whether the current application of the doctrine is sufficiently tethered to its *raison d'être*.[64] The discrepancy between history and modern practice offers a good opportunity to investigate whether current piercing trends cohere with the fundamental logic of limited liability. More specifically, a historical overview is helpful context as this Note explores the question whether the parent-subsidiary connection invokes the same conceptual justifications for limited liability as does the individual-corporation relationship.

Professor Blumberg is credited with the most thorough exegesis of limited liability's history in early America.[65] Known for his multivolume, scrupulous analysis of the law of "corporate groups," Blumberg detailed the emergence of limited liability and corporate groups in his article *Limited Liability and Corporate Groups*.[66] The most significant observation is this: limited liability predated the practice of companies owning other companies.[67] The natural conclusion is that limited liability, at least as it was originally understood, could not have been intended to apply to corporations.[68] That being said, it soon became the corporate parent's shield against legal liability, leaving individual shareholders often unprotected.

Beginning in 1783, corporations were formed when any of the thirteen states granted a corporate charter—such charters were granted readily for corporations with a "public function," such as bridges, canals, highways, banks, and insurance companies.[69] Individuals would incorporate their businesses "to achieve perpetuity of existence and ready transferability of shares," but they would still be liable for the debts of the corporation in the early period of the Republic.[70] Rapid industrialization at the beginning of the nineteenth century precipitated the rise in demand for manufacturing company charters, especially in New England, which most states were unwilling

63 *See* Blumberg, *supra* note 12, at 605.

64 *See id.* at 575.

65 Limited liability developed in America (circa 1830) before it emerged in England (1855). *Id.* at 585–87.

66 *Id.* at 587–95.

67 *Id.* at 576.

68 *But see* Radaszewski v. Telecom Corp., 981 F.2d 305, 311 (8th Cir. 1992) ("The doctrine of limited liability is intended precisely to protect a parent corporation whose subsidiary goes broke. That is the whole purpose of the doctrine . . . .").

69 Blumberg, *supra* note 12, at 587.

70 *Id.* at 588.

to grant—and even the states that did issue manufacturing charters withheld the protection of limited liability.[71]

Without statutory guidance, judges had virtually no developed precedent to consider shareholders' claims of nonliability for the debts of their corporations. Justice Story, sitting as a federal circuit court judge in 1824, opined in *Wood v. Dummer*[72] that individual owners were not liable for corporate obligations unless the charter expressly made them liable.[73] Story argued that, because some charters explicitly imposed direct liability, other charters' silence on the liability question should be interpreted to bar liability.[74] An early flavor of *expressio unius est exclusio alterius* applied to corporate law.[75]

As industrial interests grew more powerful and exerted more influence on state legislatures, limited liability statutes began to emerge for manufacturing companies.[76] By the 1850s, limited liability was enacted in every state in the union.[77] This history shows that limited liability "came as a political response to economic and political pressures, rather than as a necessary consequence" of the separate legal personalities of owner and corporation.[78] This separateness—the "entity concept"[79]—does not compel the conclusion that the corporation's obligations do not transfer to its owner. In Blumberg's words, "limited liability did not spring irresistibly from the concept of the corporation as a separate legal person."[80]

Later in the nineteenth century, decades after individuals had won limited liability protections, states began to allow corporations to own shares in other corporations, beginning with the railroads.[81] Although some corporate charters and statutes began permitting intercorporate stock ownership, others that lacked an express permission were interpreted to bar corporate ownership of another company's

71 *Id.* at 590–91.

72 Wood v. Dummer, 30 F. Cas. 435 (C.C.D. Me. 1824) (No. 17,944).

73 *Id.* at 436.

74 *Id.* A few other courts and judges shared this view. *See* Blumberg, *supra* note 12, at 592.

75 *Expressio unius est exclusio alterius* is a canon of statutory interpretation whereby judges infer an intent to exclude a phrase if it was expressly included elsewhere. *See, e.g.*, Russello v. United States, 464 U.S. 16, 23 (1983).

76 Blumberg, *supra* note 12, at 592–93.

77 *Id.* at 595.

78 *Id.*

79 *Id.* at 577.

80 *Id.* at 575–76.

81 *Id.* at 605.

shares under the doctrine of *ultra vires*.[82] In many states, corporate ownership of stock was perceived as an undesirable "means of acquiring control or accomplishing a monopoly."[83] By the mid- to late-twentieth century, however, that aversion had evaporated as states universally began authorizing intercorporate ownership.[84] Blumberg observed that this marked a turning point in the evolution of American business as companies began to acquire others "as an alternative method of expansion."[85] They sought the incorporation power "to expand their empires through the device of stock ownership in other companies, generally competitors."[86]

As it became generally established that corporations could own shares in other corporations, judges confronted two separate questions: (1) whether the parent and subsidiary have legally separate identities, and (2) even if they are separate, whether the parent is shielded from the subsidiary's debts.[87] Answering *yes* to the first question, courts simply assumed that the second question must also be answered *yes*.[88] After all, individuals were legally separate from their companies, and *they* were not liable for their corporations' debts. It appears, however, that courts skipped over the logical justification of extending the rule for individual nonliability to corporate parents. As Blumberg astutely recognized:

> [D]azzled by the concept of the corporation as a separate entity, the [nonliability rule for individuals] apparently was applied unthinkingly and automatically to the parent corporation. Limited liability was accorded to the parent without realization that the relation of parent to subsidiary, where both comprised the enterprise, was markedly different from the relation of investor to the enterprise.[89]

In this respect, limited liability for parent companies "appears to have emerged as an historical accident."[90] This creation story suggests

82 *Id.* at 606. *Ultra vires* is an act "not within the scope of the powers of the corporation to perform . . . under any circumstances or for any purpose." 20 Eugene A. Gilmore & William C. Wermuth, Ultra Vires Transactions 110 (Am. Law Blackstone Inst. 1921).

83 *See id.* at 607.

84 *Id.* at 576, 607.

85 *Id.* at 607.

86 Jonathan M. Landers, *A Unified Approach to Parent, Subsidiary, and Affiliate Questions in Bankruptcy*, 42 U. Chi. L. Rev. 589, 619 (1975).

87 *See* Blumberg, *supra* note 12, at 609–10.

88 *Id.*

89 *Id.* at 607–08.

90 *Id.* at 605; *see also* Landers, *supra* note 86, at 619 ("[L]imited liability was never intended to protect a parent corporation against liability for the debts of its subsidiary. . . . If

that the protection of corporate parents is a product of convenient judicial stumbling. Whether this is a desirable plot twist, of course, depends on whether the favorable treatment of corporate parents over individuals coheres with the animating purpose of limited liability.

B. Purpose: Welfare-Maximizing Investment

The purpose of limited liability is, and always has been, to "promote investment and incentivize socially beneficial risk-taking."[91] The essence of this rationale is risk aversion.[92] By offering shareholders some qualified protection from harm, a liability shield can make risk-averse investors more comfortable taking risks.[93] Indeed, without limited liability, individuals especially would be hard-pressed to start the new businesses that society values. For example, why open up a restaurant in a food-barren neighborhood if one knows he would be personally liable to a slip-and-fall plaintiff or a food-poisoned patron eager for redress? Why start up a biotechnology company to cure cancer if one foresees a small chance that someone gets injured in early medical trials and could force the owner to foot the enormous bill personally? Before they take risks, investors *need* assurance that they will not go bankrupt. For an individual, the unprotected risk is especially acute, for when a court pierces against him, he stands to lose his home, his personal savings, his possessions, and everything he can muster to satisfy the judgment.[94] Limited liability alleviates that risk and paves the way for a socially productive business investment.[95]

In that sense, protecting the shareholder from harm is only a means to a more fundamental end: the ultimate objective of limited

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limited liability were being considered for the first time, a strong argument could be made that it should not be extended to the corporate parent vis-à-vis its subsidiary.").

91 Schmidt, *supra* note 3, at 222.

92 *See* Landers, *supra* note 86, at 617 (Limited liability "stimulate[s] capital investment by assuring investors that their risk [will] be limited to their investment").

93 *See* Leebron, *supra* note 9, at 1566.

94 It might also be argued that this kind of harm is not a concern for corporations, which are legal fictions with no animating conscience or capacity to feel pain or suffering—they are merely the aggregate of their constituent parts, with no human connection other than their creditors, shareholders, directors and officers, and employees. As Chief Justice Marshall wrote, "[a] corporation is an artificial being, invisible, intangible, and existing only in contemplation of law." Trs. of Dartmouth Coll. v. Woodward, 17 U.S. (4 Wheat.) 518, 636 (1819). Similarly, Justice Field stated: "[Corporations] consist of aggregations of individuals united for some legitimate business." R.R. Tax Cases, 13 F. 722, 743 (C.C.D. Cal. 1882).

95 *See* Richard A. Posner, *The Rights of Creditors of Affiliated Corporations*, 43 U. CHI. L. REV. 499, 502 (1976) (arguing limited liability encourages "substantial entrepreneurial investments by risk-averse individuals").

liability "must be based on societal wealth enhancement . . . ."[96] At a broad conceptual level, society fashioned limited liability so that investors would take *good* risks, not any risk whatsoever.[97] Indeed, permitting shareholders to duck immunity entirely might create incentives for excessive risk-taking, which would diminish societal welfare and thus fly in the face of the doctrine's originating purpose.[98]

Professor Ronald Green characterized limited liability as a "social subsidy"—an insurance policy to shareholders protecting them from infinite liability in exchange for a societal demand of socially responsible behavior.[99] This limited liability rationale is the premise of what this Note calls the social risk principle. Because limited liability aims to encourage welfare-maximizing activities, the liability shield can more easily be discarded when it encourages *excessively* risky behavior that diminishes, rather than enhances, social welfare.

It should be noted that limited liability has other functions as well, most of which appear to be unique to publicly traded corporations.[100] Such companies are of a very different vintage—they are bought and sold on the open market and owned by shareholders who play a much less intimate role in the management of the company.[101] For public corporations, limited liability aims to sustain an organized securities market[102]—it decreases the need for stranger shareholders to monitor the company and incentivizes corporate managers to act

96 Robert J. Rhee, *Bonding Limited Liability*, 51 WM. & MARY L. REV. 1417, 1435 (2010).

97 Leebron, *supra* note 9, at 1566 ("[T]he traditional corporate and economic justifications for limited liability [are] the need to encourage investment in *productive*, albeit risky, activities." (emphasis added)).

98 Robert B. Thompson, *Unpacking Limited Liability: Direct and Vicarious Liability of Corporate Participants for Torts of the Enterprise*, 47 VAND. L. REV. 1, 14 (1994) (explaining that corporate limited liability may create incentives for enterprises to "not sufficiently invest in safety or . . . overinvest in hazardous activities").

99 Ronald M. Green, *Shareholders as Stakeholders: Changing Metaphors of Corporate Governance*, 50 WASH. & LEE L. REV. 1409, 1415 (1993).

100 *See generally* Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89, 93–103 (1985).

101 *See id.* at 109–10; *see also* MODEL BUS. CORP. ACT § 1.40(18A) (AM. BAR ASS'N 2008) (defining a public corporation as one that "has shares listed on a national securities exchange or regularly traded in a market maintained by one or more members of a national securities association.").

102 Paul Halpern et al., *An Economic Analysis of Limited Liability in Corporation Law*, 30 U. TORONTO L.J. 117, 129–31 (1980) (arguing limited liability is the sine qua non of an organized securities market); Henry G. Manne, *Our Two Corporation Systems: Law and Economics*, 53 VA. L. REV. 259, 262 (1967) (arguing public corporations could likely not exist without limited liability).

efficiently.[103] The existence of alternative limited liability rationales for shareholders of public corporations, however, should not distract from this Note's emphasis on welfare-maximization because courts do not typically pierce against public corporations.[104] Anytime a court is considering whether to pierce the veil, the company will likely be privately owned, not publicly traded.[105] Therefore, the other rationales for limited liability bear little relevance to this Note's theory-based argument about comparative veil-piercing against corporations and individuals.

III. The "Social Risk" Principle

The purpose of limited liability is to incentivize societally valued—rather than excessively risky—investment decisions.[106] Courts in every state should expressly incorporate this consideration into their veil-piercing frameworks. Stated another way, judges should consider, for each veil-piercing claim, whether enforcing the liability shield promotes the kind of productive risk-taking the doctrine was meant to encourage. This is the social risk principle. The proposal involves a case-by-case *ex ante* determination of whether the defendant would take risks that maximize or diminish public welfare if awarded the coveted liability shield. This, admittedly, requires judges to make what amounts to a public policy judgment about the effect of a defendant's business decisions. Veil-piercing adjudications, however, happen within the judge's equitable discretion, an area where such policy judgments often drive judicial decisionmaking.[107]

This Part begins by describing how the social risk principle would work in practice.[108] Specifically, it argues the nonliability presumption—the default premise that a shareholder is not liable for his corporation's debts—only makes sense when the welfare-maximizing purpose of limited liability is satisfied.[109] Thus, in cases where the defendant would not make socially desirable business decisions with the liability shield, there ought to be no default presumption.

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103 For substantial discussion on these and other economic rationales, see Easterbrook & Fischel, *supra* note 100, at 94–97.

104 *See id.* at 109 n.37; Thompson, *Piercing the Corporate Veil: An Empirical Study*, *supra* note 5, at 1039.

105 *See* Thompson, *Piercing the Corporate Veil: An Empirical Study*, *supra* note 5, at 1039.

106 *See id.*

107 *E.g.*, Schultz v. Gen. Elec. Healthcare Fin. Servs. Inc., 360 S.W.3d 171, 175 (Ky. 2012) ("[T]he doctrine of piercing the corporate veil arises in equity.").

108 *See infra* Section III.A.

109 *See infra* Section III.A.

This Part concludes by predicting the effect of the social risk principle on disparate piercing outcomes. Because intracorporate limited liability erects multiple tiers of immunity, shareholders of a corporate parent are less likely to refrain from excessive risk-taking. In behavioral economics terms: limited liability poses a greater moral hazard for corporate parents than for individuals. Therefore, courts applying the social risk principle would end up tossing the nonliability presumption in more cases involving corporate parents, leading to more piercings against them and tending the relative outcomes for individuals and corporations toward equilibrium.

A. Implementation—The Presumption of Nonliability

Virtually all courts begin the veil-piercing analysis with a rebuttable presumption that the shareholder defendant is *not* liable, unless the plaintiff can prove domination and some element of misconduct.[110] Against the backdrop of this nonliability presumption, courts march through a list of factors designed to assess the defendant's control over the corporation.[111] These frameworks—although imperfect—are deeply entrenched in the common laws of the states; courts are bound by their checklists and are unlikely to replace them outright with a newfangled social efficiency principle.[112] For this precise reason, this Note offers a less revolutionary, but more realistic proposal of incorporating the social risk principle into preexisting common law veil-piercing tests. The focus is on the nonliability presumption.

As a threshold inquiry, the court should decide whether enforcing the liability shield would promote the kind of welfare-maximizing investment behavior which limited liability aims to encourage. The question is: "Would the defendant shareholder, in general, take socially valuable risks with the corporation if he knew he would not be personally liable?" If *yes*, then the presumption of nonliability should be retained—after all, the purpose of limited liability would be satisfied in that case. If *no*—that is, if the liability shield would encourage welfare-diminishing, or even welfare-neutral, investment behavior—then the court should abandon the presumption. In that case, limited liability would not accomplish its welfare-maximizing priorities, so the presumption of nonliability is not appropriate.

This hypothetical exercise is a hard one. The task of the court is not only to estimate a shareholder's risk propensity, but to do so after

110 *See, e.g.*, BMC Software Belgium, N.V. v. Marchand, 83 S.W.3d 789, 798 (Tex. 2002).

111 PRESSER, *supra* note 26, at § 2:01–55.

112 *See id.*

also assuming the shareholder knows about the liability shield. There is no one-size-fits-all formula here—courts might instead consider the totality of the circumstances to decide whether the defendant has a general penchant for welfare-*diminishing* or welfare-*maximizing* risks, especially when that defendant knows he would be immune from personal liability. One starting point might be the instant action involving the parties, but that dispute alone will often not be reliably representative of a defendant's general inclination for socially detrimental risk-taking. Other potential indicators include the shareholder's prior investment behavior, personality or structural traits, capacity to absorb financial loss, and any pertinent risk tendencies of the specific industry.

After this determination is made, either retaining or discarding the presumption of nonliability, the court would proceed with its own veil-piercing test to determine whether the shareholder dominated the corporation to effectuate some fraudulent purpose. With this method of application, courts need not discard their laundry-list frameworks. Indeed, the social risk principle could coexist with states' current veil-piercing tests because it acts as a *threshold* question to assess whether—in light of limited liability's risk-oriented logic—to keep the nonliability presumption for the defendant in issue. Disregarding the presumption of nonliability at the beginning makes it more likely that the court will pierce because, even though the court retains its factor-based method, it creates a mood difference that may be dispositive in close cases. With the nonliability presumption, the plaintiff can usually only win when legal separateness would "produce injustices and inequitable consequences"[113]—even when the factors point in his direction. Thus, abandoning the presumption could make all the difference.

Of course, fidelity to the purpose of limited liability has its own independent appeal, but this Note goes further by arguing the social risk principle could help rebalance the disparate piercing outcomes that appear to favor corporations over individuals. The next Section offers a causal theory for how the principle might result in more piercings against corporations.

113 Baatz v. Arrow Bar, 452 N.W.2d 138, 141 (S.D. 1990).

B. The Double Liability Shield Creates a Relative Moral Hazard for Corporate Parents

The liability shield raises moral hazard concerns for corporate parents to a greater degree than it does for individuals. Actors are more likely to take risks if they do not bear the ultimate costs.[114] The greater the immunity from negative consequences, the more likely an actor will take a risk.[115] That is basic behavioral economics. Some risks, however, are not socially desirable.[116] Limited liability for parent companies creates a second tier of immunity that doubly shields corporate decisionmakers from the consequences of their risky behavior[117]—one shield between the parent and subsidiary; another between the parent and its shareholders. This double insulation may increase the prospect of excessive risk-taking at the expense of public welfare.[118]

Double immunity could raise the likelihood of welfare-diminishing decisions in a few ways. First, it may "reduce[ ] the shareholder's incentive to gather and process information regarding a subsidiary's potentially hazardous activities."[119] Even the most risk-averse shareholders might "make fewer attempts to encourage management to obtain more insurance, take more precautions, or avoid the risky activity altogether."[120] Second, the corporate parent might reduce investment in risk management strategies, technologies, and safeguards.[121] Even worse, instead of investing in risk management options, parent companies might instead just create a new corporate layer before investing in a high-risk initiative or business, erecting another liability wall to guard against piercing.[122]

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114 *See* Theresa A. Gabaldon, *The Lemonade Stand: Feminist and Other Reflections on the Limited Liability of Corporate Shareholders*, 45 VAND. L. REV. 1387, 1452 (1992).

115 *See id.*

116 Meredith Dearborn, *Enterprise Liability: Reviewing and Revitalizing Liability for Corporate Groups*, 97 CAL. L. REV. 195, 206 (2009) ("Corporate decision-makers twice (or more) removed from the harms they may propagate are doubly incentivized to foist risky behavior onto the public.").

117 *See* Swain & Aguilar, *supra* note 19, at 452 ("[A]llowing corporate groups to nest limited liability within limited liability results in too great a shift of risk away from the aggregate business enterprise.").

118 Judge Frank Easterbrook and Professor Daniel Fischel argue that the moral hazard problem could be an insurance issue—parent companies with the liability shield have less incentive to insure. Easterbrook & Fischel, *supra* note 100, at 111.

119 Nina A. Mendelson, *A Control-Based Approach to Shareholder Liability for Corporate Torts*, 102 COLUM. L. REV. 1203, 1233 (2002).

120 *Id.*

121 *Id.* at 1234.

122 *Id.*

The phenomenon of excessive risk-taking is not merely theoretical—it is real.[123] Professor Nina Mendelson offers several anecdotal and empirical observations to demonstrate the excessively risky behavior of parent-subsidiary enterprises.[124] In *State Department of Environmental Protection v. Ventron Corporation*,[125] for example, the parent created a subsidiary specifically for the purpose of operating a mercury processing plant.[126] The subsidiary—which was fully dominated by and acted at the behest of the parent corporation—dumped hazardous waste into a New Jersey river, causing disastrous contamination.[127] The decisionmakers in *Ventron* had a double liability shield, allowing them to externalize all risks to spin a profit.[128] This case typifies the moral hazard problem caused by intracorporate limited liability.

Enforcing a liability shield that would encourage excessively risky behavior runs contrary to the animating purpose of limited liability, which aims to promote only welfare-maximizing risks.[129] In some sense, the argument follows the "Goldilocks" logic: multiple liability shields give corporate decisionmakers *too much* immunity; unlimited liability would be *not enough* protection (as most believe that some risk-alleviation is necessary); but one liability shield separating an individual and the corporation he owns—that would be *just right*.[130]

So, how does this moral hazard affect disparate piercing outcomes? If corporate parents have a greater propensity than individuals to take "bad" risks because of this double immunity, then consistent application of the social risk principle would result in courts tossing out the nonliability presumption for corporations more frequently. This effect comes not from any kind of special targeting or higher scrutiny placed on corporate parents, but as an incident of a test that withholds the protective presumption for shareholders most prone to take socially detrimental risks. As the default presumption disappears for the riskiest corporate parents, it will become easier to pierce against them, which will increase the percentage of successful piercings. While corporate piercing rates climb, individual piercing

123 *Id.* at 1242.

124 *Id.* at 1242–43.

125 State Dep't of Envtl. Prot. v. Ventron Corp., 468 A.2d 150 (N.J. 1983).

126 *Id.* at 155.

127 *Id.* at 154.

128 *Id.* at 155.

129 Schmidt, *supra* note 3, at 222

130 *See generally* ROBERT SOUTHEY, THE DOCTOR, "THE STORY OF THE THREE BEARS" 327–29 (1848) (finding porridge temperature to be ideal when it is not excessively hot or cold).

rates would remain steady, as the logic of double immunity does not apply to individuals (who have just one tier of protection). Given that courts now pierce less often against corporations than against individuals, the social risk principle could blaze a path to equilibrium.

IV. The Counterarguments

These arguments are of course not invulnerable to criticism. First, skeptics may argue that courts cannot and should not evaluate how certain investment risks affect public welfare—that is the job of either markets or legislatures. Even worse, the argument goes, courts could not possibly predict whether a particular legal rule would lead to "welfare-diminishing" behavior, nor should they embark on such speculative adventures. Although this is a valid concern, it ignores a crucial reality of veil-piercing jurisprudence—the veil-piercing test is an exercise conducted under the broad, discretionary powers of *equity*.[131] Courts in equity are able—and, in fact, encouraged—to fashion a remedy that best advances the welfare of the parties and of the public.[132] It is commonplace for a court, exercising its equitable powers, to consider whether a particular rule would be socially desirable. "Courts of equity may, and frequently do, go much farther both to give and withhold relief in furtherance of the public interest than they are accustomed to go when only private interests are involved."[133] Even the veil-piercing test itself often invokes public interest as a consideration at least in the context of determining whether the shareholder used the corporation to engage in fraud.[134]

As for determining *ex ante* whether a particular defendant would take socially detrimental risks—that is not foreign to courts either. They often make assessments about risky defendants in exercising criminal jurisdiction and issuing sentencing and pretrial orders.[135] It might be argued that corporate investment behavior is different. The "business judgment rule," after all, cautions against judicial second-guessing of proper business choices because courts are uniquely inept

131 *See* Titchenal v. Dexter, 693 A.2d 682, 684 (Vt. 1997) ("Courts may exert equitable powers based upon . . . judicial acknowledgement of public-policy considerations . . . .").

132 *E.g.*, E. Hempfield Twp. v. Brubaker, 828 A.2d 1184, 1188 (Pa. Commw. Ct. 2003).

133 Virginian Ry. Co. v. Sys. Fed'n No. 40, 300 U.S. 515, 552 (1937).

134 *See, e.g.*, Archer v. Griffith, 390 S.W.2d 735, 740 (Tex. 1964) ("[C]onstructive fraud is the breach of some legal or equitable duty which, irrespective of moral guilt, the law declares fraudulent because of its tendency to deceive others, to violate confidence, or to *injure public interests*." (emphasis added)).

135 *E.g.*, Malenchik v. State, 928 N.E.2d 564, 568 (Ind. 2010).

at evaluating what makes good business sense.[136] But that is beside the point. Courts applying the social risk principle would evaluate what kinds of business decisions would be harmful to *society*—such as polluting a river or distributing an untested drug—and courts confront that fundamentally different question all the time.

Second, some will offer a more intuitively appealing alternative to solve the disparate outcomes problem—that courts should consider "shareholder type" as one of the factors on their checklists, with the thumb on the scales against corporate parents. This approach, although simple, would be misguided. It is overly mechanical and would not properly channel the risk-oriented logic of limited liability. In fact, some applications of this categorical approach would be antithetical to limited liability's goals. For example, it may be that a parent company is extremely vulnerable and would only take socially desirable risks if it had a liability shield. Conversely, an individual might be very capable of absorbing a loss and just as risk-indulgent even without limited liability. In either of these scenarios, a per se rule that treated individuals more leniently than corporate parents would not only miss the point, but it would lead to the wrong result.

Finally, some might contend that courts are *already* sensitive to the broader considerations that this Note advocates; it follows that there is no need to adopt a social efficiency test for express application in veil-piercing cases. This criticism might have some merit, but it is weak in at least two respects. First, it is doubtful that judges really are sensitive to these considerations. If courts were applying the logic of limited liability (including the welfare-enhancing investment rationale) to each veil-piercing case, it would be difficult to explain why courts pierce against individuals more often than against corporate parents, as confirmed by three separate empirical studies.[137]

The second problem is that if courts really are cognizant of the need to apply the bedrock rationales of limited liability to each case, then they are consistently failing to articulate it. In the vast universe of judicial opinions, few decisions reflect this kind of deliberative consideration. There may be cases where courts refuse to pierce against individuals as a matter of fairness—another valid consideration for equity cases—but even then, they appear to be merely rattling off the piercing factors and resolving them in favor of the shareholder. For instance, in *Zubik*, the court declined to pierce the veil against an old,

136 *See* Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83, 87 (2004).

137 *See supra* note 15.

unhealthy, illiterate owner who had otherwise set up a closely held corporation that was inadequately capitalized, and failed to maintain written minutes of meetings or documentation of important corporate affairs.[138] Some scholars have pointed out that in *Zubik*, it is "doubtful that a similar conclusion would have been reached in a situation where a corporation set up a subsidiary to insulate itself from similar liability."[139] It may be that, in that particular case, the Third Circuit treated the defendant leniently because, as an individual rather than a corporation, he was less sophisticated and could not be expected to behave like a well-heeled, properly advised corporation.[140]

Whether the courts should be more lenient to unsophisticated and financially struggling defendants, as the Third Circuit may have been in *Zubik*, is outside the scope of this Note. The most surefire way to maintain loyalty to the animating logic of limited liability, however, is not sympathy or leniency—it is to incorporate that logic formally into the veil-piercing test itself. The social risk principle accomplishes precisely that. In addition, it may be that switching the nonliability presumption on and off, depending on whether the liability shield would incentivize socially desirable risk-taking by that defendant, could rebalance disparate piercing outcomes.

Conclusion

Mechanical application of piercing checklists favors corporate parents over individual shareholders. The empirical results prove as much, which raises questions about whether this modern trend makes sense in light of limited liability's origin-story as a shield for individuals, not corporations.[141] Prompted by the disconnect between modern veil-piercing patterns and the historical *raison d'être* of limited liability, this Note suggests a unique theory—grounded in law and economics—for how courts can increase their fidelity to limited liability's welfare-maximizing purpose and restore balance to disparate veil-piercing trends. To do this, this Note proposes the social risk principle.

Although courts usually begin every veil-piercing inquiry with the presumption against liability, the social risk principle would have them abandon that presumption where the liability shield would not

138 Zubik v. Zubik, 384 F.2d 267, 275–76 (3d Cir. 1967).

139 Cathy S. Krendl & James R. Krendl, *Piercing the Corporate Veil: Focusing the Inquiry*, 55 Denv. L.J. 1, 44 (1978).

140 *See id.*

141 *See supra* Introduction.

incentivize welfare-maximizing behavior.[142] Because the double liability shield makes corporations more vulnerable to moral hazard concerns than individuals, courts applying the social risk principle would end up abandoning the nonliability presumption for corporate parents more than for individuals.[143] As corporate piercing rates climb, the disparate piercing outcomes may tend to equilibrium.

This argument is profoundly theory-based and admittedly leaves much to be explored. Its premises, moreover, are anything but uncontroverted. Most significantly, whether courts can accurately predict *a priori* how a liability shield will affect a particular defendant's risk-taking behavior is a question given little treatment in this Note, and it likely will raise objections by the guardians of the status quo. In that sense, this Note self-consciously situates itself not only as a prescription for judges to consider limited liability's logic, but also as an impetus for further development of corporation law. Indeed, veil-piercing is one of the most litigated and academically contested areas of corporate law,[144] and it could stand to benefit from doctrinal clarification. Despite the wealth of scholastic treatment, however, few if any commentators have put corporate parents and individual shareholders directly under the microscope in any focused fashion—this Note does precisely that.

142 *See supra* Section III.A.

143 *See supra* Section III.B.

144 *See* Kurt A. Strasser, *Piercing the Veil in Corporate Groups*, 37 CONN. L. REV. 637, 659–60 (2005).