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The seal of the University of California, Berkeley, is a large, light blue watermark on the left side of the slide. It features a central five-pointed star above an open book. A hand holding a torch is positioned to the right of the book. A banner below the book reads "LIGHT". The outer ring of the seal contains the text "CALIFORNIA BERKELEY" and "1868".

## Corporate Law, Veil Piercing, and Single Economic Parcel

Presentation to the California Coastal  
Commission; May 11, 2011

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# Background and Motivation

- Takings override, and the question of what constitutes a *Single Economic Parcel*
  - Coastal Act § 30010; “Denominator problem”
- Common Ownership (or Unity of Ownership)
  - Judicial factor in determining relevant econ. parcel
- Emerging Practice:
  - Parcels formally owned by distinct “corporate” entities (e.g., corporations, LLCs, LLPs, LLLPs, etc<sup>\*</sup>).
  - Not expressly addressed in Cal. Coastal Act.

*\* I will use “corporation” to refer collectively to all of these business entity forms, since they are treated similarly under alter ego law. (E.g., Cal Corp Code § 17101)*



## Basic Question

- Under principles of corporate law, when do courts find it appropriate to “pierce” the formal legal boundaries separating corporations from one another and/or from their respective owners?
- While there is little precedent in the constitutional takings context, elsewhere this question has been labeled *the most litigated issue in corporate law*
  - See, e.g., Thompson (1991)



# My Central Points

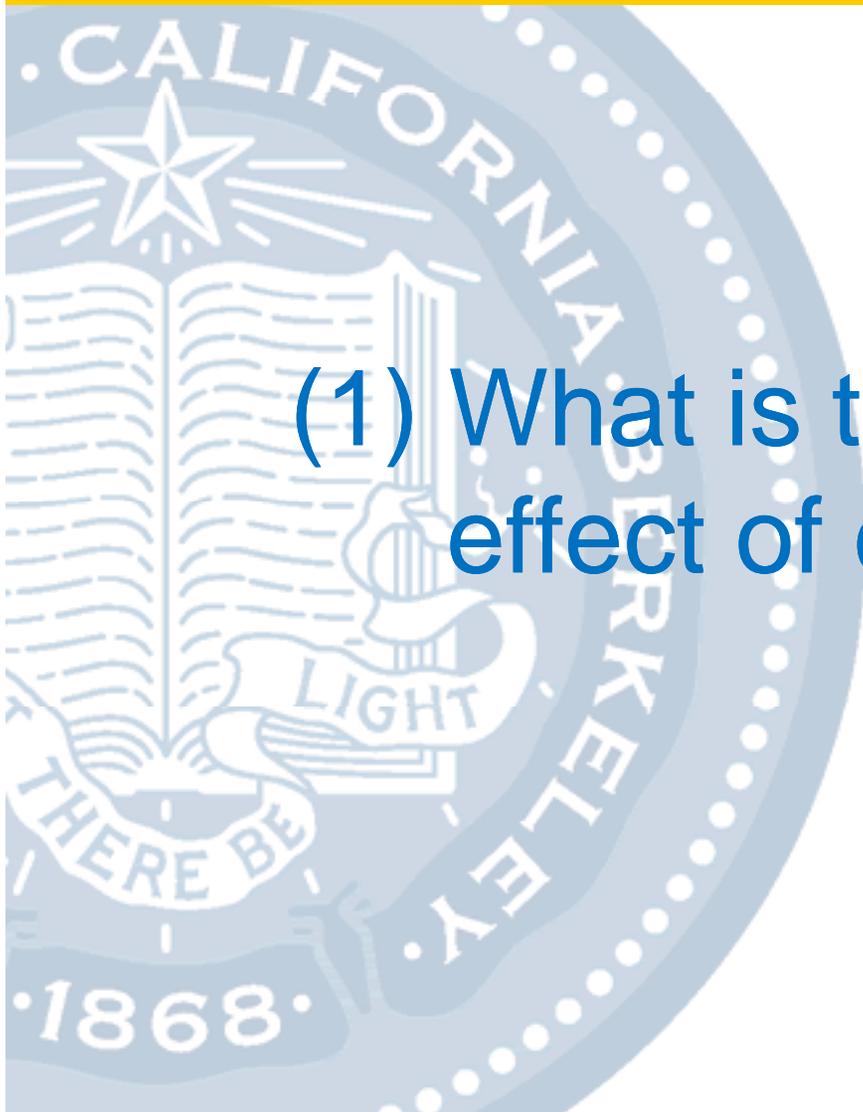
1. What is the purpose and effect of corporate law?
2. In what situations do veil-piercing considerations usually come into play?
3. What is the basic legal test for piercing the veil, and how is it decided?
4. How frequently do courts pierce the veil in practice?



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(1) What is the purpose and effect of corporate law?

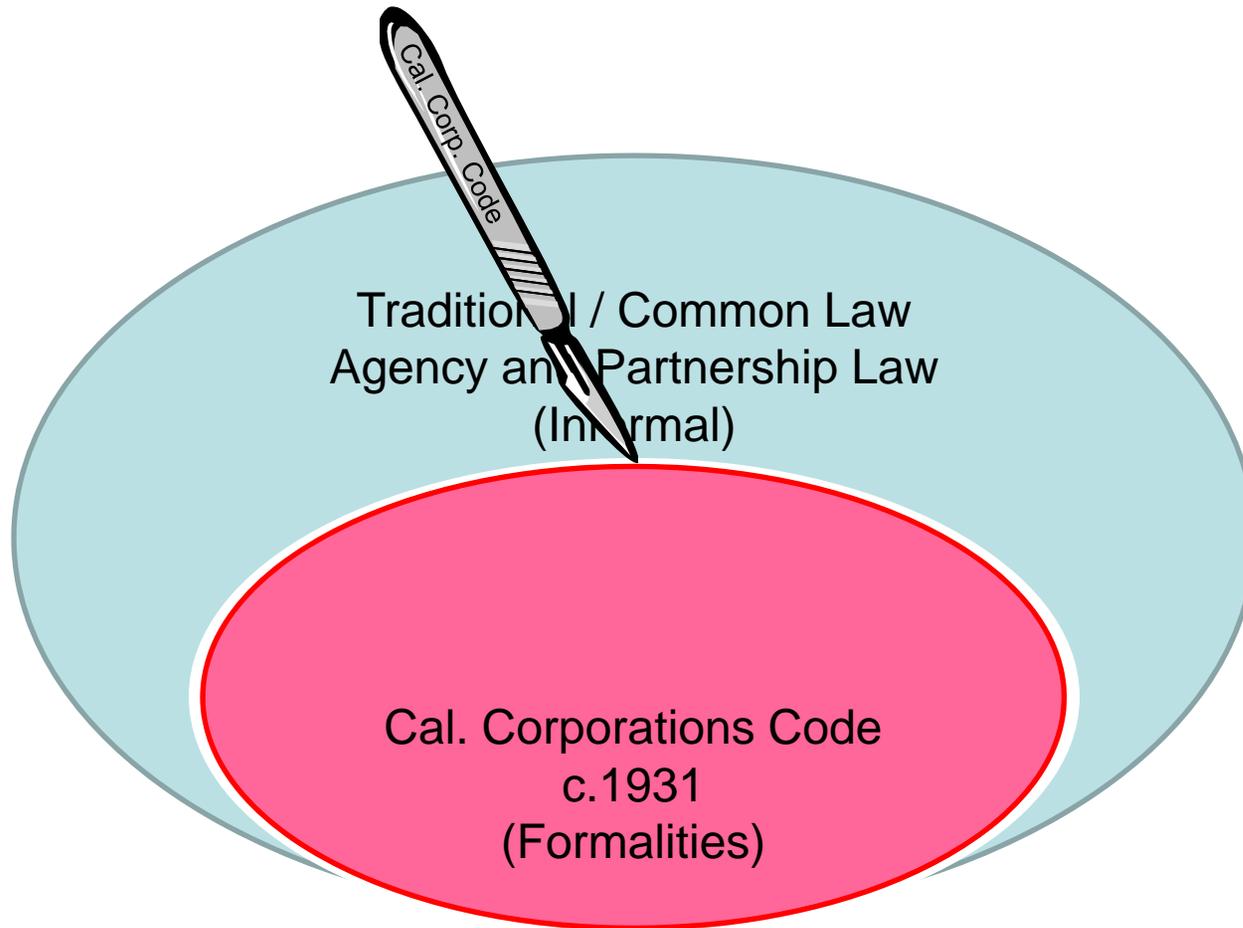




# Purpose & effect of corporate law I: A statutory “Carve Out” from common law



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*“An association formed under a statute other than [California’s Uniform Partnership Act] ... or a comparable statute of another jurisdiction is not a partnership under this chapter.” Cal. Corp. Code § 16202(b)*



# Purpose & effect of corporate law II: Legal Significance

- Distinct from common law agency / partnership
  - “[C]onsiderable doubt exists that the obligations that flow from a partnership...may be imposed on the shareholders of a corporation duly formed and operated under California statutes.”  
Persson v. Smart Inventions, Inc. (2005)
- Independent “Personhood”
  - Property/Contract Rights (Dartmouth College v. Woodward (1819)); Potentially other rights (Citizens United v. FEC (2010); FCC v. AT&T (2011))
- Limited Liability
  - Owners are generally liable only up to the amount they have invested in the corporation (absent other contractual obligations)
- Asset Partitioning: Boundaries between ownership rights / legal obligations of owners and companies:
  - Hansmann & Kraakman (2000); Palazzolo v. Rhode Island (2001)



## *Dole Food Co. v. Patrickson* (2003)

“A basic tenet of American corporate law is that the corporation and its shareholders are distinct entities. An individual shareholder, by virtue of his ownership of shares, does not own the corporation's assets and, as a result, does not own subsidiary corporations in which the corporation holds an interest.”



# Purpose & effect of corporate law III: Policy Significance

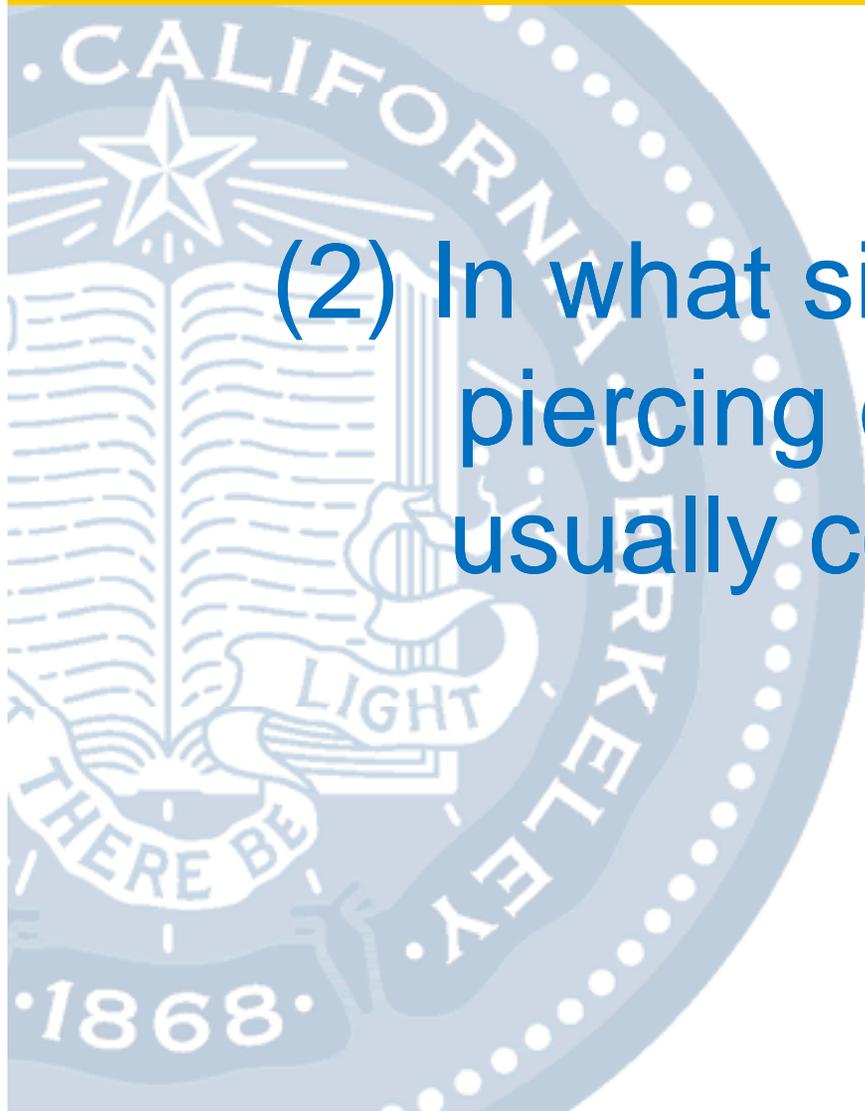
- Increases clarity / certainty of inv. expectations
- Permits tradability/marketability of ownership
- Enables efficient risk-spreading / diversification
- Facilitates continuity of purpose
- Encourages coordination among parties
- Catalyzes entrepreneurship & economic growth



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(2) In what situations do veil-piercing considerations usually come into play?

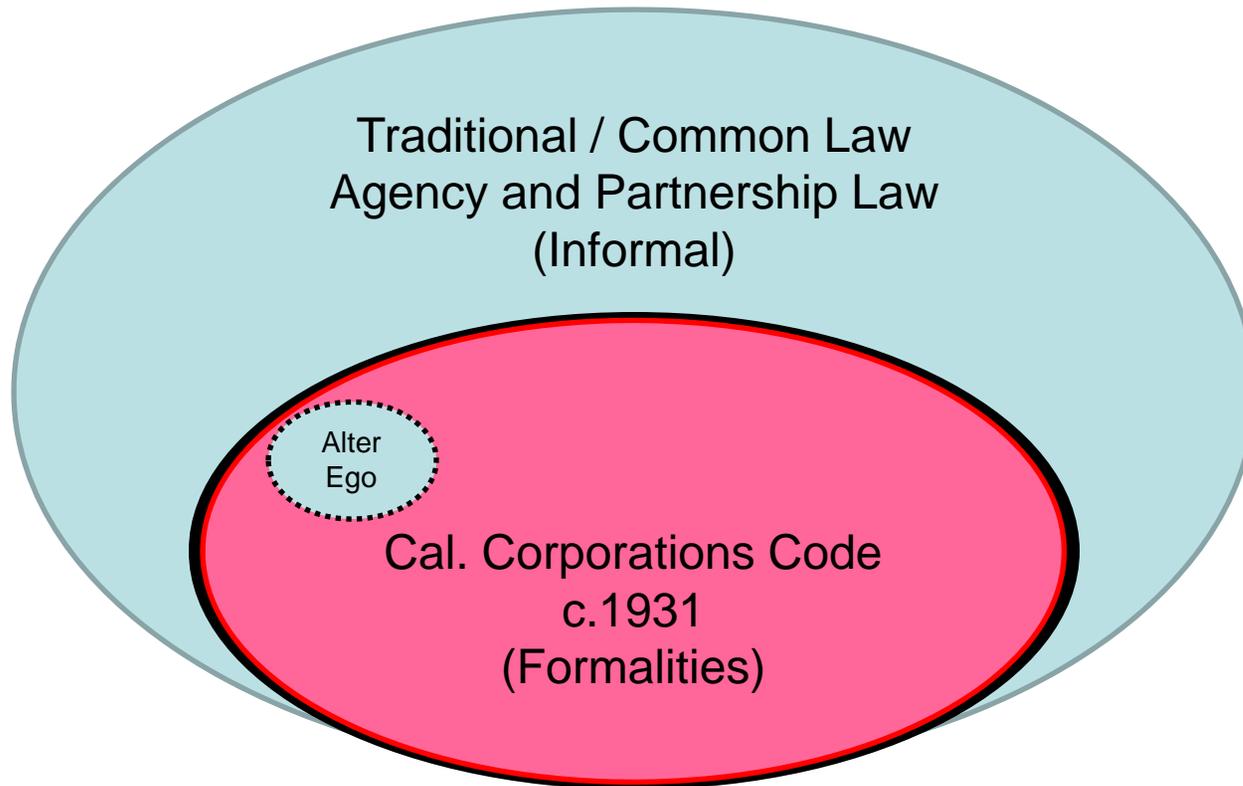




# Domain of Veil-Piercing I: Conceptually: A “Carve Out of the Carve Out”



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Basic Idea: In specific situations, courts retain limited “equitable” discretion to disallow the statutory benefits of corporate form, when such status is used improperly or abusively.



# Domain of Veil-Piercing II:

Typical contexts where piercing sometimes comes up

- Civil Liability
  - Contract claims (voluntary creditors)
  - Tort claims (involuntary creditors)
- Legal Process
  - Personal Jurisdiction & Venue
  - Choice of Law/Forum
- Criminal Liability Attribution
- Statutory/Regulatory Issues
  - E.g., the Cal. Coastal Act





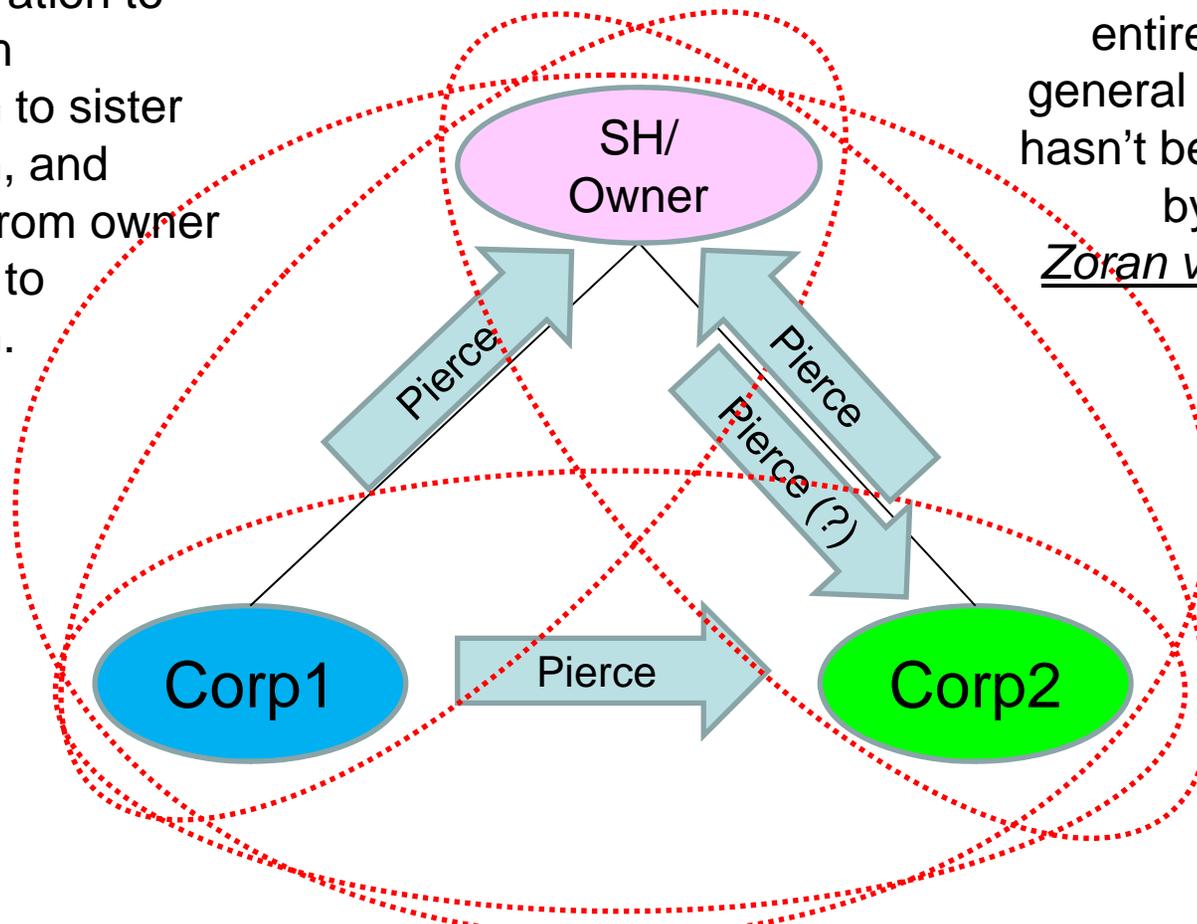
# Statutory/regulatory examples where alter ego analysis has been employed

- Vexatious litigant laws
  - Say & Say, Inc. v. Ebershoff (1993)
- Tax Law
  - H.A.S. Loan Service, Inc. v. McColgan (1943)
- Environmental Law
  - US v. Bestfoods (1998) (CERCLA ‘operator’ liability)
- Wage & Hours Law
  - Brennan v. Arnheim & Neely, Inc. (1973) (FLSA ‘enterprise’ definition).

# Domain of Veil-Piercing III: Piercing “from” what and “to” what?

Has been used (subject to certain caveats) to pierce from corporation to owner, from corporation to sister corporation, and (possibly) from owner back down to corporation.

Dyads can be “daisy chained”

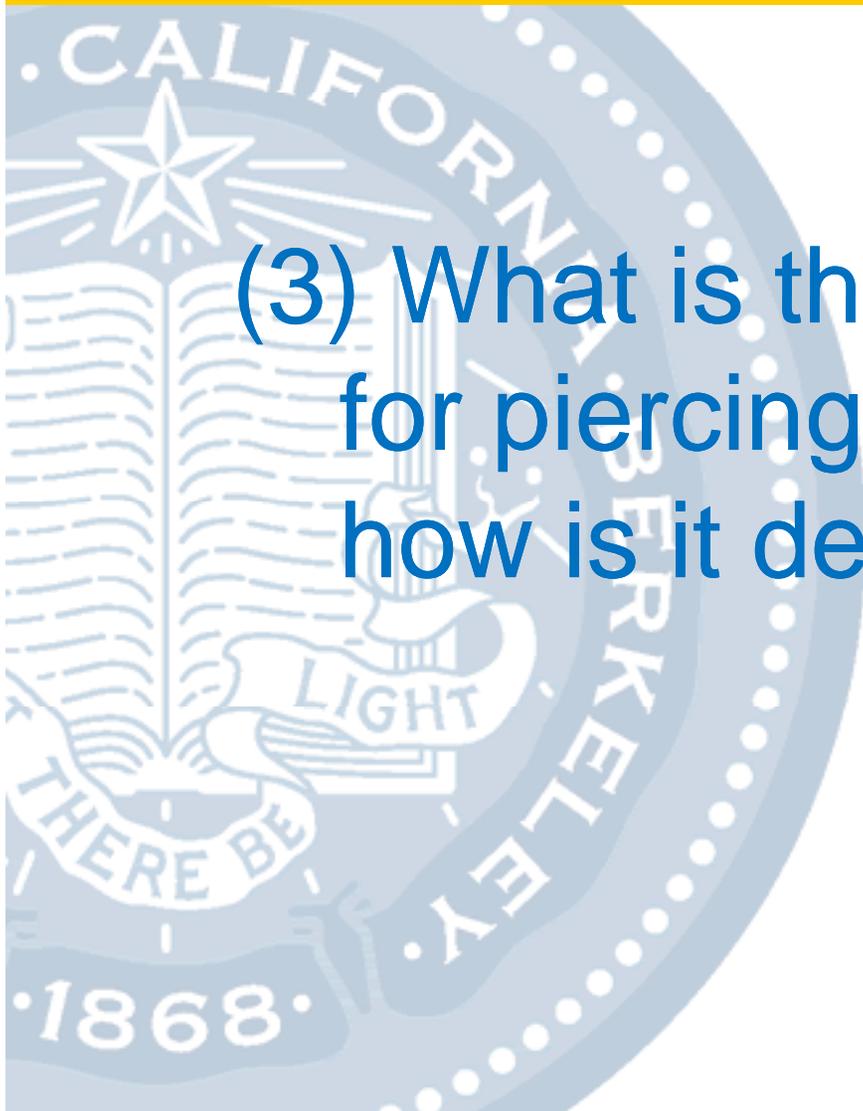


Piercing analysis is usually applied to each dyad separately; and not “holistically” to an entire group (i.e., a general “entity theory” hasn’t been embraced by U.S. courts). Zoran v. Chen (2010)

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(3) What is the basic legal test for piercing the veil, and how is it decided?





# Basic Legal Test I: A Conservative Approach Overall

- Piercing = A judge deciding to set aside statutory protections articulated in the Cal. Corp. Code
  - Statutes: usually “Compelling” authority (e.g., § 16202(b))
- Consequently, courts are reluctant to pierce absent sufficient evidence in favor:
  - “Only in narrowly defined circumstances and only when the ends of justice so require’ ” (Mesler v. Bragg (1985)).
  - Burden rests on the party alleging alter ego (Mid-Century Ins. Co. v. Gardner (1992); Zoran v. Chen (2010))
  - Frequently, party alleging alter ego must demonstrate case by clear and convincing evidence. Fashion Valley Mall, LLC v. Cty. of San Diego (2009) (Cal. Evidence Code § 662).
- When invoked, alter ego follows a 2-part conjunctive test...

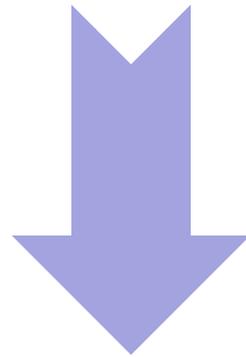


## Basic Legal Test II: A two-prong, conjunctive test

Unity of Ownership  
/ Interest

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Failure to pierce  
will “sanction a  
fraud” or “promote  
injustice”



# Pierce Corporate Veil



# Basic Legal Test II: A two-prong, conjunctive test

Unity of Ownership  
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injustice”

## Relevant Factors\* (*Associated Vendors v. Oakland Meats* (1962)):

1. Commingling of funds and other assets,
2. Failure to segregate funds of the separate entities,
3. Unauthorized diversion of corporate funds or assets to other than corporate uses
4. Treatment by an individual of the assets of the corporation as his own
5. Failure to obtain authority to issue stock or to subscribe to or issue the same
6. Holding out by an individual that he is personally liable for the debts of the corporation
7. Failure to maintain minutes or adequate corporate records,
8. Confusion of the records of the separate entities
9. Identical equitable ownership in the two entities;
10. Identification of the equitable owners thereof with the domination and control of the two entities;
11. Identification of the directors and officers of the two entities in the responsible supervision and management;
12. Sole ownership of all of the stock in a corporation by one individual or the members of a family
13. Use of the same office or business location;
14. Employment of the same employees and/or attorney
15. Failure to adequately capitalize a corporation;
16. Total absence of corporate assets, and undercapitalization
17. Use of corporation as mere shell, instrumentality conduit for single venture/business of an individual or another corporation
18. Concealment & misrepresentation of identity of responsible ownership, mgmt, financial interest, or personal business activities
19. Disregard of legal formalities and the failure to maintain arm's length relationships among related entities
20. Use of the corporate entity to procure labor, services or merchandise for another person or entity
21. Diversion to stockholder to detriment of creditors, or manipulation of assets/liabilities between entities so as to concentrate the assets in one and the liabilities in another
22. Contracting with intent to avoid performance by corporate entity shield against liability, or as subterfuge of illegal transactions
23. Formation and use of a corporation to transfer to it the existing liability of another person or entity

\* *No single factor determinative; factors are neither mutually exclusive nor exhaustive*



## Basic Legal Test II: A two-prong, conjunctive test

Unity of Ownership  
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Basic Question: Would piercing be “equitable”? A *thorough-going policy question*; no cookbook factors / conditions to guide outcome  
But, a few rules of thumb / framing inquiries:

- Mere inconvenience/inability in enforcing a judgment or asserting regulatory dominion is insufficient.
- Mere ownership of majority interest (and consequent control) of corporation is also insufficient.
- Involuntary creditors tend to be treated more generously than voluntary creditors (who can “price out” the risk)
- Horizontal Equity: Will piercing enhance or reduce from extent to which similarly situated parties are treated similarly?
- Fidelity to Statutory Goals: Pierce to ensure fulfillment & harmony of statutory goals (e.g., balancing goals of Cal. Coastal Act against goals of Cal. Corp. Code against goals of Cal/US Takings Clause)



## Basic Legal Test III: Who gets to decide?

- Veil piercing is an equitable doctrine (*Stark v. Coker* (1942)). Consequently, the judge is presumed most competent to balance policy interests at stake & make the final holding.



- For the same reason, appellate courts may revisit the piercing issue *de novo* (without deference to factual findings of trial court).



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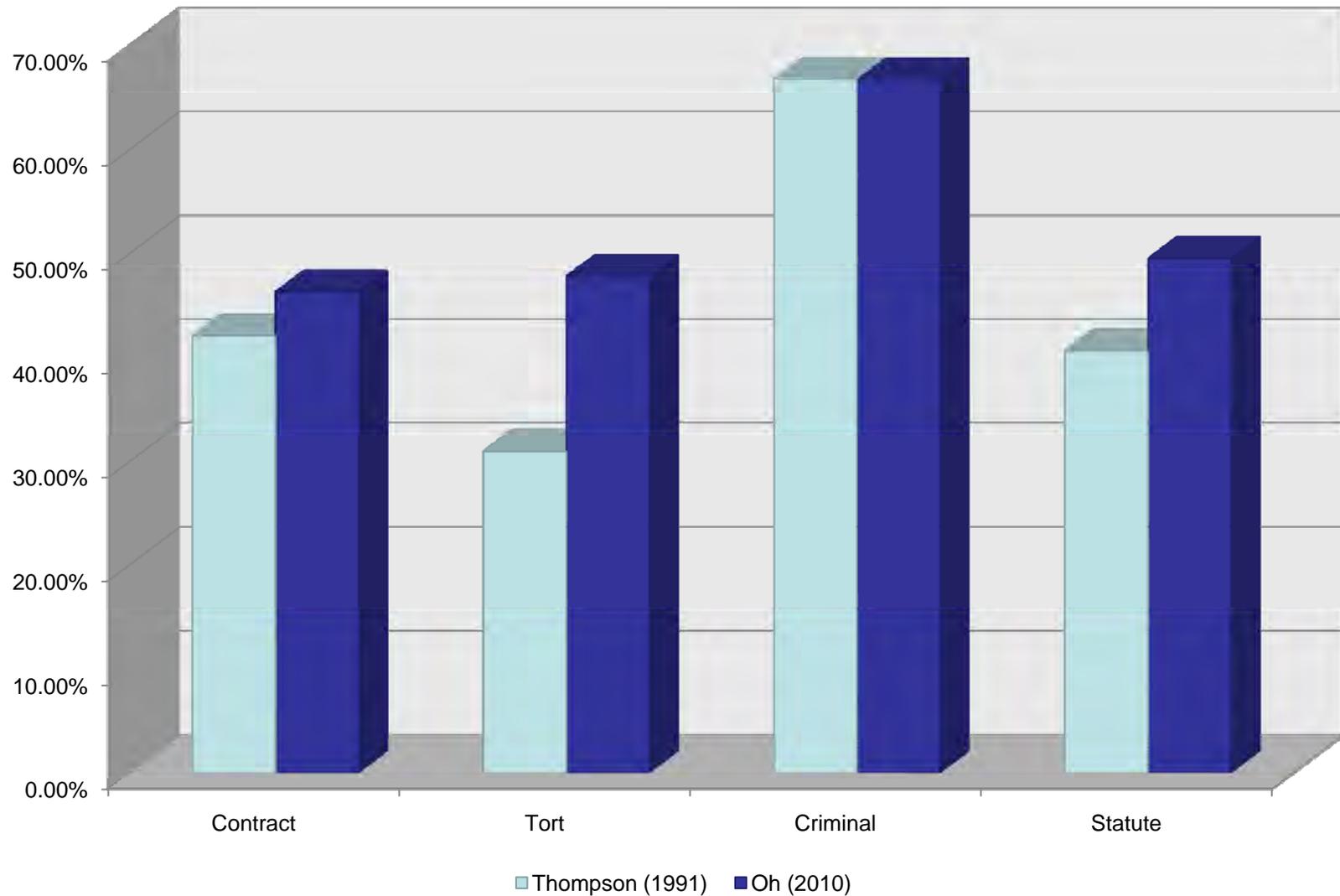
(4) How frequently do courts pierce the veil in practice?





# How often do courts pierce?

Percent of published opinions where veil pierced, by area

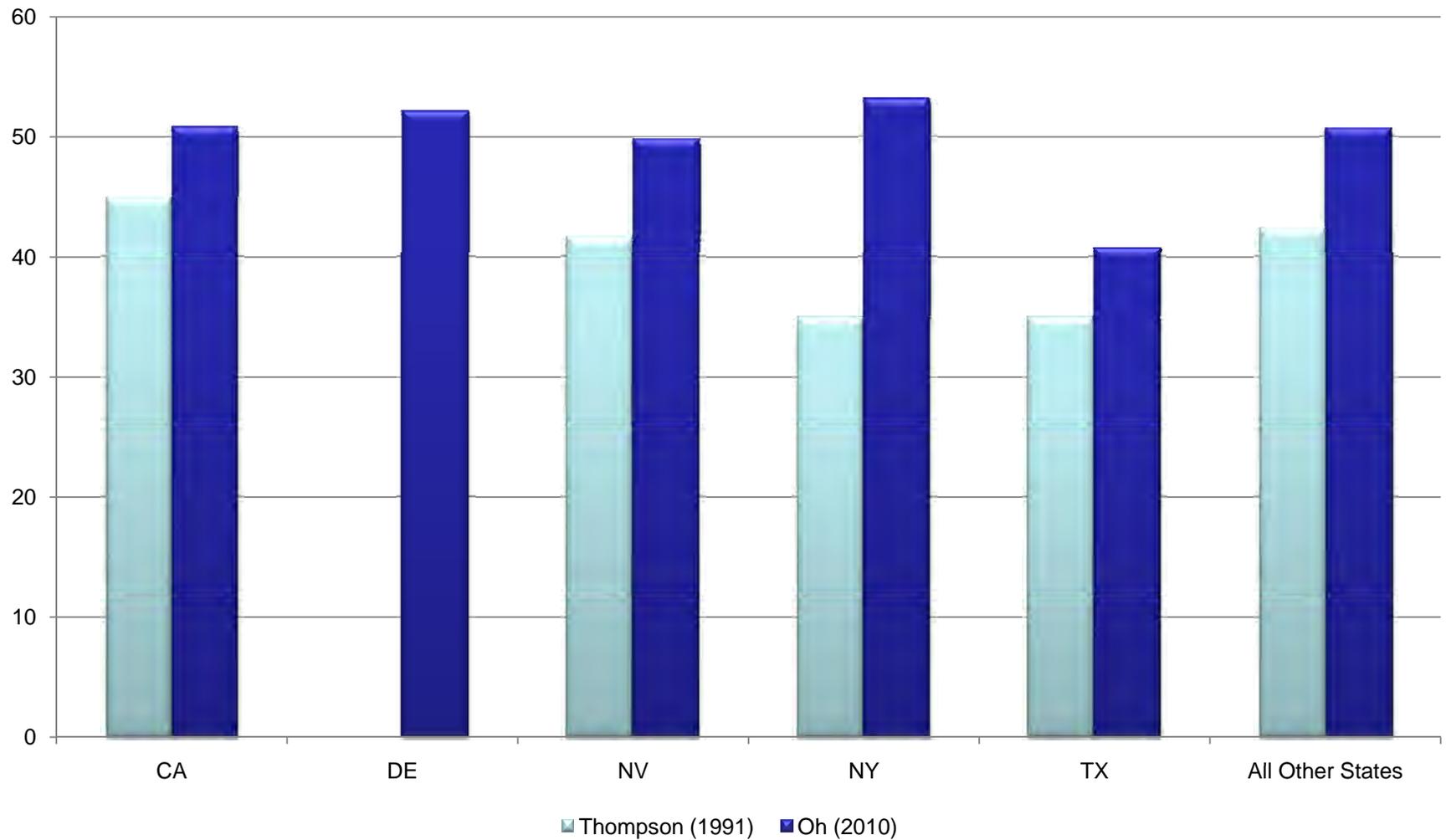


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# How often do courts pierce?

Percent of published opinions where veil pierced, by state



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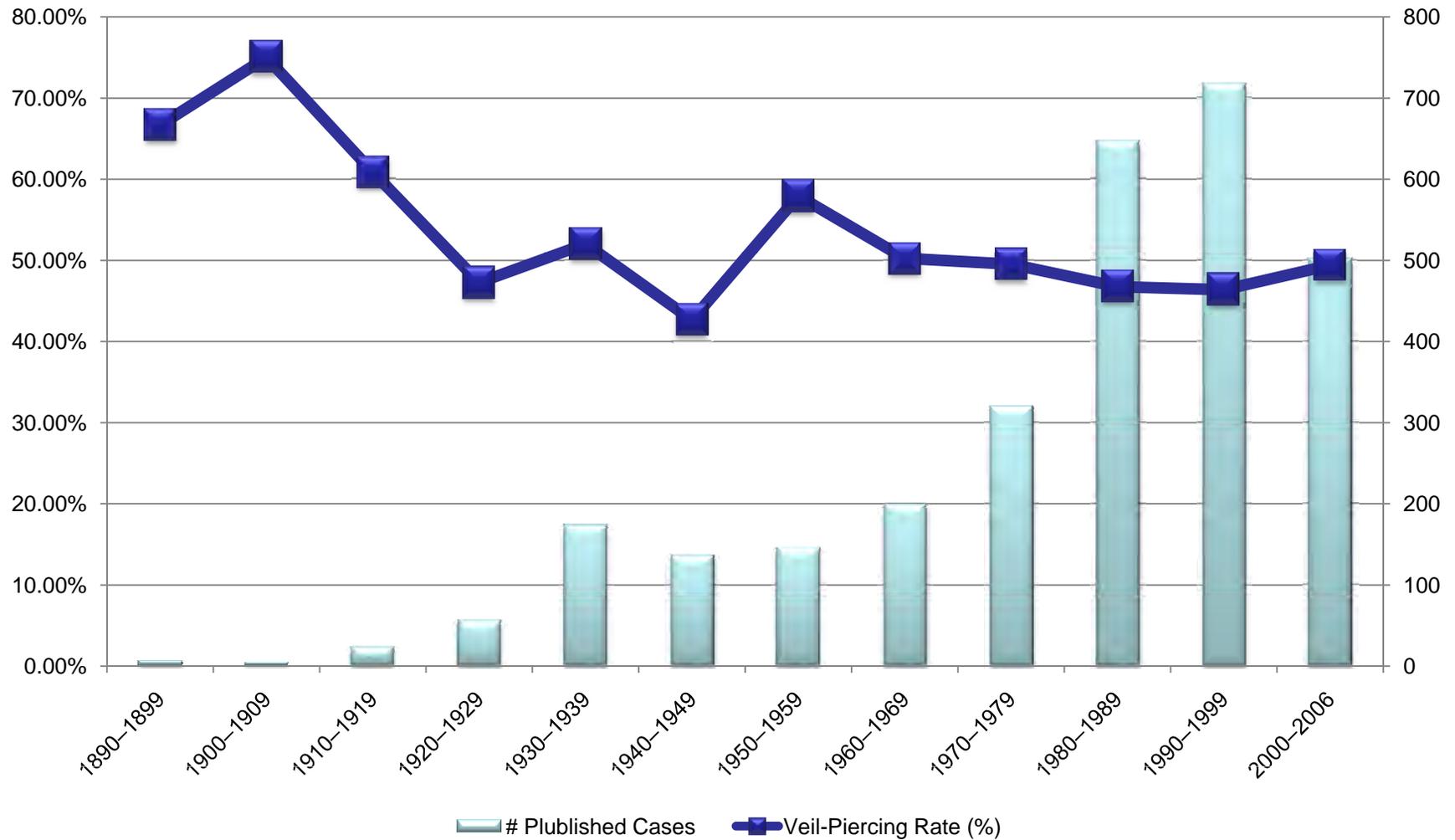


# How often do courts pierce?

## Litigation volume and piercing rate over time



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Source: Oh (2010)



# Warning: Do not over-interpret these data Huge Selection Bias Issues

- Easy Cases Settle
  - Outcomes are predictable; little reason to waste resources litigating them
- Hard Cases Litigate
  - Thus, hard cases comprise *all* of the previous slides' data.
  - In what fraction of these cases would we predict piercing by a court?
    - Priest & Klein (1984): 50%
    - Shavell (1996): *Anything!*





# Conclusions

- Cal. Corporate Law creates a statutory carve-out from agency/partnership law, which courts honor.
- Two-part alter ego test dictates the circumstances where courts may be willing to look past the formal separateness of corporations and owners
- In 2<sup>nd</sup> part of test, judge (not jury) may consider fulfillment of / balance between statutory goals
- Doctrine applied conservatively: Burden on party attempting to pierce



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# How often do courts pierce?

## Percent of litigated cases where veil pierced, by state



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