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THE CAPITAL SHAREHOLDER'S ULTIMATE CALAMITY: PIERCED CORPORATE VEILS AND SHAREHOLDER LIABILITY IN THE DISTRICT OF COLUMBIA, MARYLAND, AND VIRGINIA

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Investors who elect to administer their investments through a corporation rather than some other form of organization do so in the belief that a corporation will stand as a buffer between the uncertainties of the business world and their personal assets. The use of a corporation to limit liability may be especially important where the activities of the business venture are likely to expose its promoters to liability in contract or in tort. But limited liability for corporate shareholders is neither automatic nor absolute; at best, the imperfectly maintained corporation constitutes an imperfect shield. While most investors acknowledge the liability risks for directors and officers,¹ many are likely to be surprised at the frequency with which courts "pierce the corporate veil" to hold shareholders personally liable for the acts and debts of the corporation.

This Article reviews the quite different circumstances in which the courts in the District of Columbia, Maryland, and Virginia have disregarded the corporate entity.² What Maryland views as only a theoretical remedy, rarely if ever used, the District of Columbia courts use frequently in a wide variety of cases. Virginia courts appear to steer a middle course, doling out the remedy where necessary, but doing so with a parsimonious hand.

Part I of this Article discusses the theory underlying the doctrine of limited liability and reviews the three primary scenarios in which that doctrine

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¹ This Article addresses only personal liability for shareholders, leaving the issues of personal liability for directors and officers to be treated elsewhere.

² The phrases "piercing the corporate veil" and "disregarding the corporate entity" are used interchangeably in the case law and in this Article.
may be disregarded: defective incorporation, charter revocation, and the piercing of the corporate veil. Part II focuses on the most common of these scenarios, the pierced corporate veil. After a comparative review of the case law applicable to corporations organized under the laws of the District of Columbia, Maryland, and Virginia, the Article also evaluates whether the source of liability (tort, contract, or evasion of statute) has affected the outcome of corporate veil cases in the three jurisdictions. Finally, Part III considers the counseling implications suggested by the case law for businesses incorporated in the capital region.

I. INTRODUCTION

A. The Doctrine of Limited Liability

The corporation is an artificial construct created by the state to facilitate business transactions. It is viewed as an independent entity, separate and distinct from its shareholders, and is endowed with attributes designed to make it a convenient and cost-effective form in which to operate a business.

Foremost among these corporate attributes is the express limitation of a shareholder's liability to an amount equal to his or her capital investment. According to this doctrine of "limited liability," a contributor to the corporation stands to lose only the amount he or she put at risk in the corporate venture; the debts of the corporation are its own and not those of its constituent members.

The purpose of limiting shareholder liability is to encourage investment and facilitate the accumulation of enterprise capital. The business incorpo-

3. A frequently quoted definition of the corporate entity was articulated by the United States Supreme Court in Trustees of Dartmouth College v. Woodward, 17 U.S. (4 Wheat.) 518 (1819):

A corporation is an artificial being, invisible, intangible, and existing only in contemplation of law. Being the mere creature of law, it possesses only those properties which the charter of its creation confers upon it, either expressly, or as incidental to its very existence. These are such as are supposed best calculated to effect the object for which it was created. Among the most important are immortality, and, if the expression may be allowed, individuality; properties, by which a perpetual succession of many persons are considered as the same, and may act as a single individual.


5. See Dodd, The Evolution of Limited Liability in American Industry: Massachusetts, 61 HARV. L. REV. 1351 (1948). Dodd considers limited liability to be one of the most important legal developments contributing to the growth of American industry during the nineteenth century. Id. at 1379. For a brief history of corporations, see McKim v. Odom, 3 Bland Ch. 407, 415-20 (Md. 1831).

6. The classic Virginia case, Beale v. Kappa Alpha Order, 192 Va. 382, 64 S.E.2d 789
rated solely and for the avowed purpose of limiting liability is not simply legitimate, but reflects the desired incentives of state corporation laws.\(^7\)

The success of the corporate form is reflected in the great concentration of the nation’s wealth it represents.\(^8\) From the investor’s perspective, limited liability allows for both diversification and limitation of risk; the investor will not lose more than his or her investment should the enterprise fail.\(^9\) For the corporation, limited shareholder liability reduces the cost of funds to the enterprise by making investment more attractive and, thereby, facilitates the aggregation of large amounts of capital.\(^10\) These social and economic policy

\(^7\) As a Maryland court explained, “[a] commercial corporation is a legal entity conceived by the mind of man and legitimated by statute for the avowed purpose of achieving a maximum profit with a minimum exposure to liability.” Dixon v. Process Corp., 38 Md. App. 644, 645, 382 A.2d 893, 894 (1978). Limited shareholder liability is consistent with the generally accepted public policy of creating and maintaining a social and economic environment attractive to business activity.

Whether limited liability is in fact either a necessary or moral attribute of the corporation is a subject of continuing debate, particularly in the realm of law and economics. Compare Easterbrook & Fischel, Limited Liability and the Corporation, 52 U. Chi. L. Rev. 89, 93-103 (1985) (economic analysis explains the legal treatment of limited liability) and Manne, Our Two Corporation Systems: Law and Economics, 53 Va. L. Rev. 259, 262-63 (1967) (examining various explanations for necessity of limited liability) with Meiners, Mofsky & Tollison, Piercing the Veil of Limited Liability, 4 Del. J. Corp. L. 351, 352 (1979) (generally questioning validity of limited liability doctrine) and Note, Should Shareholders Be Personally Liable for the Torts of Their Corporations?, 76 Yale L.J. 1190, 1196-98 (1967) (arguing for shareholders’ liability in tort cases).


10. Because of these perceived advantages to the corporate form, the states have codified the existence and qualities of the corporate entity, endowing it further with “individuality,” or an existence separate from the sum of its investors, and the “capacity to hold property, to contract, to sue and be sued, and to enjoy continued existence notwithstanding changes in its membership.” H. Henn, supra note 4, § 143. Although the corporation laws vary by jurisdiction, each state typically sets forth the attributes of the corporation in that state, the types of corporations that are recognized, and how the corporation may come into and maintain an independent existence. See, e.g., D.C. Code Ann. §§ 29-101 to -1148 (1981 & Supp. 1987); Md. Corps. & Ass’ns Code Ann. §§ 1-101 to 11-805 (1985 & Supp. 1987); Va. Code Ann. §§ 13.1-301 to -998 (1985 & Supp. 1987).

The perceived function of these corporation statutes and of the corporation itself is to advance business. Consequently, neither the laws nor the corporate form itself provide for the
interests in the corporation extend to common variations on the corporate form, namely closely held\textsuperscript{11} and affiliated corporations.\textsuperscript{12}

\textbf{B. Exceptions to the Doctrine of Limited Liability}

The corporate attribute of limited liability fails to protect the investor primarily\textsuperscript{13} in three circumstances: (i) when the corporate veil has not been properly established in the first instance; (ii) when the corporate charter has been revoked by operation of state corporation law; and (iii) when the corpo-

\textsuperscript{11} See Bradley, \textit{A Comparative Evaluation of the Delaware and Maryland Close Corporation Statutes}, 1968 \textit{Duke L.J.} 525:

The close corporation as it is found in the market place cannot be defined precisely, although corporations having very few stockholders all of whom are likely to be active in the operation of the business and whose shares are subject to transfer restrictions have been referred to as close corporations or incorporated partnerships. \textit{Id.} at 526 n.2. The one-person, family, or other close corporation will be recognized and accorded the benefits of the corporate form if, generally speaking, the business is conducted on a corporate rather than a personal basis and is established and operated according to the law. Ownership of all or nearly all of the shares by one individual or a handful of individuals will not ordinarily call into question the corporation's legitimacy. \textit{See} H. \textit{Henn, supra} note 4, § 144.

\textsuperscript{12} The separate corporate nature of subsidiaries and other affiliated corporations is similarly recognized, assuming legitimate purposes. Affiliated corporations are expected to operate separately and to maintain the requisite corporate formalities. H. \textit{Henn, supra} note 4, § 145.

\textsuperscript{13} On occasion a shareholder or shareholders will ask that the corporation be disregarded in order to avoid disadvantages of the corporate form. As a general rule the courts have been unwilling to acquiesce in the use of the law in such a manner. In Schenley Distillers Corp. v. United States, 326 U.S. 432 (1946), for example, the United States Supreme Court held that separate subsidiaries may not be treated as one single commercial enterprise under control of the parent when it is convenient for their purposes to do so:

While corporate entities may be disregarded where they are made the implement for avoiding a clear legislative purpose, they will not be disregarded where those in control have deliberately adopted the corporate form in order to secure its advantages and where no violence to the legislative purpose is done by treating the corporate entity as a separate legal person. One who has created a corporate arrangement, chosen as a means of carrying out his business purposes, does not have the choice of disregarding the corporate entity in order to avoid the obligations which the statute lays upon it for the protection of the public. \textit{Id.} at 437; \textit{see also} Terry v. Yancey, 344 F.2d 789, 790 (4th Cir. 1965) (where plaintiff sought to have corporation disregarded in order to increase damages for injuries to individual where corporation suffered no damage, court held that “where an individual creates a corporation as a means of carrying out his business purposes he may not ignore the existence of the corporation in order to avoid its disadvantages”); Picture Lake Campground, Inc. v. Holiday Inns, Inc., 497 F. Supp. 858, 863 (E.D. Va. 1980) (“[T]he officers and directors of First Management determined that two corporations were necessary, one to own and lease the Picture Lake property, and one to manage and operate the Trav-L-Park. . . . Once the decision was made, plaintiffs were bound by the disadvantages as well as the advantages of separate incorporation.”).
rate veil is "pierced" by a court to provide recourse to a tort victim, a creditor, or a litigant seeking damages for breach of contract.

1. Defective Incorporation

Investors in a new enterprise have been held personally liable for acts taken and debts incurred by the enterprise before it became a corporation. These defective incorporation cases typically involve faulty attempts to establish a corporation, as where the filing of the articles of incorporation was delayed for several months or where the organizational meeting of the incorporators was never held. Courts imposing personal liability on shareholders commonly have grounded such liability either in agency or in an "automatic partnership" theory, which holds that the principals of a defective corporation are partners carrying on as co-owners of a business for profit and, therefore, are jointly and severally liable for the debts of the partnership.

In the past, courts unwilling to mete out such a harsh result have invoked either of two doctrines to clothe an investor with the corporate attribute of limited liability. Where there has been a good faith effort to organize a corporation, courts have acknowledged de facto corporations, even where organizational efforts have been flawed. Alternatively, courts have estopped plaintiffs to deny the corporate existence where the plaintiff "has contracted or otherwise dealt with the association in such a manner as to recognize and in effect admit its existence as a corporate body." Modern corporation statutes, in an apparent effort to eliminate problems inherent in the de facto, de jure, and estoppel concepts, contain provisions declaring that the corporate existence shall begin only upon issuance of the certificate of incorporation, and that such certificate shall be conclusive evidence of incorporation. In the District of Columbia, such a provision has been held dispositive of the issue:

16. See generally Womack, 115 Wash. L. Rep. at 309 (recognizing the automatic partnership theory in other jurisdictions, but declining to adopt it in the District of Columbia).
17. The doctrine of de facto corporations has been applied where the promoters can show: (1) the existence of a law authorizing incorporation, (2) a good faith effort to incorporate under the existing law, and (3) the actual exercise of corporate powers. Cranson, 234 Md. at 480, 200 A.2d at 34.
18. Id. at 481, 200 A.2d at 34. The doctrine of estoppel can be invoked even where the elements of a de facto corporation have not been met. Id. at 487, 200 A.2d at 38.
No longer must the courts inquire into the equities of a case to determine whether there has been "colorable compliance" with the statute. The corporation comes into existence only when the certificate has been issued. Before the certificate issues, there is no corporation de jure, de facto or by estoppel.20

Similar provisions have been enacted in Virginia21 and in Maryland.22

2. Revocation of the Corporate Charter

Where the corporation has been formed in compliance with the state's

20. Robertson v. Levy, 197 A.2d 443, 446 (D.C. App. 1964); accord Womack, 115 Daily Wash. L. Rep. at 309. In Womack, the landlord leased commercial office space in September 1982 to a District of Columbia company, Capitol Technical Services Corp. (Capitol), upon the signature of its president, Stephens. Id. at 305. Unknown to the parties, however, Capitol's attorney failed to file the incorporation papers and the company was not actually incorporated until May 1983. Id. Before going out of business, Capitol occupied the landlord's premises for about a year. Id. The landlord sued to recover Capitol's unpaid rent from Capitol's stockholders, officers, and directors. Id.

The court awarded the landlord judgment against Hayes, who was one of Capitol's original organizers, directors, and stockholders, but not against Cooper, who joined the company after the lease had been executed (all other defendants had settled before trial). Id. The court considered Hayes' early involvement in the organization, capitalization, and management of the business, and specifically noted that Hayes had initiated contact with the landlord on Capitol's behalf for the purpose of securing the lease. Id. at 309. In his capacity as a director, Hayes also had voted to authorize Capitol's president to enter into the lease on Capitol's behalf. Id. Under these circumstances, the court had no hesitation in finding that Hayes, with respect to the lease obligation, had "assumed to act as the corporation." Id. Consequently, in the absence of a certificate of incorporation, he was personally liable for all "corporate" debts incurred by Capitol pursuant to that lease. Id.

Cooper, on the other hand, joined the company, and became a stockholder and a director two months after the lease was signed when Capitol was already on the premises. Id. Cooper never saw the lease, met with the landlord prior to its execution, or negotiated for the lease. Id. Nor did he in his capacity as director authorize the execution of the lease. Id. The court found that Cooper had never "assumed to act as a corporation" regarding the lease, and denied the landlord judgment against him. Id.

Notably, the landlord nevertheless argued that Cooper should be liable on the theory that a defective incorporation attempt results in a partnership, under which each partner would be fully liable even for acts he did not participate in or authorize. Id. The court considered the apparent applicability of the definition of a partnership under District of Columbia law, i.e., "an association of two or more persons to carry on as co-owners of a business for profit," and noted that other states have adopted the "automatic partnership" theory in cases of defective incorporation. Id. Because no District of Columbia court had adopted the theory, however, and because the court was persuaded that such a result is both inequitable and wrong, it refused to adopt the theory in the District of Columbia absent evidence that the parties intended to establish a partnership instead of a corporation. Id.


corporation statute, its charter nevertheless can be revoked by operation of law, as where the entity was organized under a statute granting a specific maximum duration,\textsuperscript{23} or where, as in most states, the corporation statute provides for automatic revocation of the corporate charter upon failure to pay required taxes or to file required reports for, in most cases, two years.\textsuperscript{24}

Where the corporation continues to do business in the corporate name after its charter has been revoked, the shareholders may be held liable for debts incurred or acts taken after the corporate form has been withdrawn. A Virginia court, for example, recently indicated that investors who sign a promissory note on behalf of a corporation dissolved for failure to file annual reports can be held personally liable on the note, even though the corporation is subsequently reinstated.\textsuperscript{25} District of Columbia courts also have imposed personal liability on the shareholders of a dissolved corporation. In 1979, for example, the District of Columbia Court of Appeals held the owner of a construction corporation personally liable for contract damages incurred during a temporary revocation of the corporate charter for failure to file reports.\textsuperscript{26}

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\textsuperscript{23} See, e.g., Supreme Lodge, Knights of Pythias v. Wheeler, 93 Va. 605, 611, 25 S.E. 891, 892 (Va. 1896) (corporation formed in 1870 under corporation law which limited life of all corporations to 20 years).
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\textsuperscript{25} McLean Bank v. Nelson, 232 Va. 420, 427-28, 350 S.E.2d 651, 657-58 (1986). The McLean court held that “[i]t is the corporate form that provides limited liability. Without the corporation . . . , personal liability exists.” Id. at 426, 350 S.E.2d at 656. Under the facts of that case, it was sufficient to hold that “officers, directors, or agents can be held personally liable for contracts entered into on behalf of the corporation,” id. at 428, 350 S.E.2d at 657, but the reasoning of the McLean decision would also apply to the shareholders of a dissolved corporation.
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\textsuperscript{26} Truitt v. Miller, 407 A.2d 1073, 1080 (D.C. 1979). The court said that reinstatement of the corporate charter would make the corporation liable for the debt incurred during the period of dissolution, but it would not relieve the shareholder of personal liability. Id.; see also National Paralegal Inst., Inc. v. Bernstein, 498 A.2d 560, 562 (D.C. 1985) (charter reinstatement given retroactive effect to enable dissolved corporation to be sued upon debt). Reinstatement does not allow the corporation to take advantage of contracts executed during the period of revocation. To allow the latter would “encourage a corporation to default on paying its taxes and fees and filing its annual reports [because it could later] completely erase the effects
3. "Piercing the Corporate Veil"

When a corporation has been properly organized and, in the eyes of the state corporation authorities, properly maintained, the only path to the investors’ personal assets is through the "corporate veil." Because to "pierce the corporate veil" is to undermine the very purposes of the corporation, courts addressing the issue often are caught between the conflicting goals of preserving the corporate entity and affording relief to the victim. The flexibility and discretionary nature of this remedy causes confusion in stating the doctrine and in applying it in any individual case. Furthermore, the strong policy rationales for maintaining the corporation have led courts to be reluctant, inconsistent, and unclear about whether and when the corporate entity will be disregarded. The doctrine has assumed very different forms even in the three neighboring jurisdictions of the capital region.

Most courts, applying a "two-pronged test," have disregarded the corporate form only when: (1) the shareholders have not maintained the separate identity of the corporation; and (2) the shareholders have misused the corporate form in such a way that, if the acts at issue are attributed to the corporation alone, an inequitable result will follow. The first prong of the test, known by many colorful labels, looks for "such unity of interest and ownership of the penalty." Truitt, 407 A.2d at 1081 (quoting Accurate Constr. Co. v. Washington, 378 A.2d 681, 685 (D.C. 1977)); see also Federal Express Servs. Corp. v. American Fed’n. of Community Credit Unions, 113 Daily Wash. L. Rep. 97, 100 (D.C. Super. Ct. Oct. 19, 1984) (corporation where charter is revoked is not legal entity capable of receiving title to real property and subsequent reinstatement cannot validate deed during period of revocation), aff’d, 116 Daily Wash. L. Rep. 81 (D.C. App. Ct. Jan. 14, 1988); American Elementary Elec. Co. v. Normandy, 46 App. D.C. 329, 340-42 (1917).

27. The Article focuses on disregard of the corporate entity in order to afford the meritorious plaintiff access to the personal assets of shareholders. Challenges are sometimes made to the corporate form for other purposes, however, including jurisdiction and res judicata. See generally Comment, The Alter Ego Doctrine: Alternative Challenges to the Corporate Form, 30 UCLA L. REV. 129 (1982).


29. Compare Hamilton, The Corporate Entity, 49 TEX. L. REV. 979, 979 (1971) ("A systematic analysis . . . is not readily discernible in the cases, and many courts continue to rely on metaphors to explain their results.") with Gillespie, The Thin Corporate Line: Loss of Limited Liability Protection, 45 N.D. L. REV. 363, 380 (1969) ("The doctrine’s continued vitality depends upon the very imprecision which might cause some legal critics to denounce it.").

30. See, e.g., Barber, supra note 9, at 376.

ership that the separate personalities of the corporation and the individual no longer exist." This "mere instrumentality" test is often met where there has been a failure to observe formalities and to maintain the proper "corporate housekeeping." The second prong of the test typically is met where a court finds fraud, undercapitalization, or bad faith on the part of shareholders. In theory, the doctrine of limited liability extends with equal force to all variations on the corporate form. In practice, however, the preponderance of corporate veils which have been pierced have been those of closely held or subsidiary corporations.

"snare," "subterfuge," and "tool." See E. Latty, Introduction to Business Associations: Cases and Materials 42 (1951). Justice Cardozo, in Berkley v. Third Ave. Ry., 244 N.Y. 84, 89, 155 N.E. 58, 61 (1926), addressed the problem of the metaphors frequently used in these cases:

Metaphors in law are to be narrowly watched, for starting as devices to liberate thought, they end often by enslaving it. We say at times that the corporate entity will be ignored when the parent corporation operates a business through a subsidiary which is characterized as an "alias" or a "dummy." All this is well enough if the picturesqueness of the epithets does not lead us to forget that the essential term to be defined is the act of operation.

Id., 155 N.E. at 61.

32. Labadie Coal Co. v. Black, 672 F.2d 92, 96 (D.C. Cir. 1982).
33. Barber, supra note 9, at 371.
34. See, e.g., Comment, supra note 27, at 137-38 (asserting that in every case in which courts have imposed shareholder liability, the shareholders arguably acted in bad faith). Undercapitalization is gaining strength in several jurisdictions, notably California, as grounds for disregarding the corporate form. See Barber, supra note 9, at 386-402; Gelb, Piercing the Corporate Veil—The Undercapitalization Factor, 59 Chi.[-]Kent L. Rev. 1, 14-15 (1982).
35. As a general rule, the law does not regard the parent-subsidiary relation as suspect, but rather presumes that the corporate entities are formally and functionally independent, and that each deserves the protections to which such corporations are legally entitled. Where, however, the parent so dominates or controls the subsidiary that the latter is a "mere instrumentality" of the parent, courts have pierced the subsidiary's veil to hold the controlling corporation responsible for its weaker affiliate's wrongdoing. As with the affiliated corporation, the general presumption for the one-person, family, or other closely held corporation is that it is an independent corporate entity apart from its shareholders or officers. Limited liability is enjoyed by a controlling shareholder where corporate formalities are observed, financing is adequate, and there is no evidence of fraud. See H. Henn, supra note 4, § 146. As one commentator has remarked, "[d]omination as such is not evidence of any impropriety which should contribute to a decision to pierce the corporate veil . . . far from discouraging domination of corporations by one person there are corporation statutes which expressly contemplate such a situation." Gelb, supra note 34, at 8-9. On the other hand, creditors dealing with close corporations are apt to require personal guarantees, thereby increasing the shareholders' liability without requiring the courts to look behind the corporate form. Id. at 9-10. Even so, in cases where there is a "unity of interests" between a corporation and its shareholders, and the latter attempts to use the corporate form for an improper or fraudulent purpose, a close corporation's veil can be pierced to afford a remedy to the victim of such conduct.

36. Henn states that the "principles for disregarding the corporation apply whether the corporation has one shareholder or many." H. Henn, supra note 4, § 143. Henn notes, however, that "the rule that corporateness will be sustained only so long as it is used for legitimate
Of the three primary exceptions to the doctrine of limited liability, shareholder liability most frequently results from attempts to pierce the corporate veil, and it is this third exception that is the focus of this Article.

II. DIVERGING APPROACHES IN THE DISTRICT OF COLUMBIA, MARYLAND, AND VIRGINIA

Although most courts, in deciding challenges to the corporate veil, pay homage to the traditional two-prong test, courts in different states have applied the test in such a manner as to develop widely divergent and sometimes contradictory standards across even neighboring jurisdictions. It must be emphasized at the outset, moreover, that this is an area of law where courts adopt differing approaches even within jurisdictions. Although the following discussion purports to discern patterns in the decisional law, generalizations about the law of any jurisdiction are advanced merely for purposes of comparison, and not as reliable restatements of coherent case law. Subject to those caveats, however, the following discussion dramatically demonstrates the differing standards for determining shareholder liability which, depending on their state of incorporation, may apply to corporations doing business in the capital region.37

A. Piercing the Corporate Veil in the District of Columbia

Of the three neighboring jurisdictions, the District of Columbia has been the most obliging to plaintiffs seeking to disregard the corporate form. While paying lip service to the traditional two-prong test,38 it can be argued that District of Columbia courts regard transacting business in a corporate

purposes has special significance when applied to the one-man, family or other close corporation.” Id. § 144. The scrutiny given close and affiliated corporations stems from their use of corporate formalities to obtain seemingly disproportionate benefits to their obligations and their level of business activity. The individual can incorporate and create a fiction whereby his personal assets are separated and protected from the liabilities engendered by his business activities; a parent corporation may seal off a new or risky venture in a subsidiary, preventing the liabilities incurred by such activity from inducing the hemorrhage of the parent corporation. Id. § 145.

37. For a discussion of choice of law issues, see infra text accompanying notes 186-92.

38. In Vuitch v. Furr, 482 A.2d 811 (D.C. 1984), for example, the court reported that “[t]hroughout the years this court has held that the acts and obligations of the corporate entity will not be recognized as those of a particular person until the party seeking to disregard the corporate entity has proved by affirmative evidence that there is (1) unity of ownership and interest, and (2) use of the corporate form to perpetrate fraud or wrong.” Id. at 815; see also McAuliffe v. C & K Builders, 142 A.2d 605, 607 (D.C. 1958); Burrows Motor Co. v. Davis, 76 A.2d 163, 165 (D.C. 1950). Two cases involving an attempt to pierce the corporate veil in a bankruptcy context are In re Washington Medical Center, 10 Bankr. 616 (D.C. 1981) and In re 1438 Meridian Place, N.W., Inc., 15 Bankr. 89 (D.C. 1981).
form as a privilege conferred on a deserving few. In the District of Columbia, unlike in Maryland or Virginia, a disregard of corporate formalities, without more, may constitute prima facie evidence of unfairness or inequity. Only in the District of Columbia has the corporate form been disregarded solely on the grounds that it was formed to avoid personal liability.

I. The Labadie Coal Case: Merging the Two-prong Test

Any consideration of the doctrine in the District of Columbia should begin with the federal appellate court decision in *Labadie Coal Co. v. Black*. In *Labadie*, a coal broker named Black had allegedly purchased hundreds of thousands of dollars worth of coal on credit from the plaintiff, resold it, and then failed to pay the plaintiff. The district court had dismissed plaintiff’s action seeking to hold Black personally liable for money owed by Black’s family-owned corporation, FAI Trading, Ltd. (FAI). The court of appeals reversed on the ground that the trial court had inadequately considered whether unfairness would result if the corporate veil was not pierced. The *Labadie* court articulated the considerations which it thought deserved emphasis on remand, and in doing so provided an unusually detailed picture of the analysis by which the corporate entity may be disregarded in the District of Columbia.

In line with the two-prong test, the *Labadie* court instructed the district court to examine first the “formalities,” and second, “the element of unfairness.” Beginning with “the nature of the corporate ownership and control,” the court of appeals reviewed six types of formalities which would indicate the separateness or unity of the corporation and its shareholders. The essence of the inquiry was “whether the corporation, rather than being a distinct, responsible entity, is in fact the alter ego or business conduit of the person in control.” Accordingly, the district court was instructed to evaluate the defendant’s failure to maintain corporate minutes or adequate corporate records:

> If FAI has been viewed as a separate and distinct entity, one would expect appropriate records to be kept. If it is merely a separately-named business conduit for defendant’s own activities, a “d/b/a”

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39. 672 F.2d 92 (D.C. Cir. 1982); see also Quinn v. Butz, 510 F.2d 743 (D.C. Cir. 1975) and cases cited therein.
40. *Labadie*, 672 F.2d at 95 n.15.
41. While FAI was incorporated under the laws of Virginia, the *Labadie* court did not address the choice-of-law issue. *Id.* at 93.
42. *Id.* at 100.
43. *Id.* at 96-100.
44. *Id.* at 97.
45. *Id.* (emphasis in original).
in all practicality, such records would not be as important and would not be carefully maintained.\textsuperscript{46} The court noted that defendant's failure to produce corporate records was compounded by the lack of "evidence that FAI's directors, whoever they are, have ever played a meaningful role in FAI's activities, or have even formally held a meeting."\textsuperscript{47} Under these circumstances, it appeared that Black alone controlled FAI and made all necessary decisions.\textsuperscript{48}

The court of appeals then turned to FAI's failure to maintain the formalities necessary for issuance or subscription to stock, citing the absence of any "formal approval of the stock issue by an independent board of directors."\textsuperscript{49} Black had produced for FAI only a "stock book" of blank certificates and stubs from which the certificates had been removed, which indicated that 130 shares had been issued to his wife and three children. Apparently, however, the certificates themselves did not exist, nor did minutes or resolutions authorizing the issuance of stock. Moreover, the certificate stubs did not reflect the stockholdings by his wife and children that Black had described to the court. The court, troubled by what it considered an excessive disregard for corporate formalities, even for a closely held corporation,\textsuperscript{50} indicated that the absence of stock subscription formalities should be considered by the lower court "in determining whether the corporation exists beyond the 'Ltd.' in FAI's name."\textsuperscript{51}

The \textit{Labadie} court next suggested that the commingling of Black's personal funds and the assets of the corporation, as evidenced by the checks and financial records of Black and FAI, would suggest a failure to treat the corporation as a separate and distinct entity.\textsuperscript{52} The court noted that the separateness of the corporation and its shareholders would be undermined by the use of corporate funds to cover unrelated personal or business expenses, or by the "disproportion between the salaries paid and the services actually rendered to the corporation."\textsuperscript{53} Similarly, the court warned that the use of the same office location by both the corporation and its shareholders illustrated the precise relationship between Black and FAI.\textsuperscript{54}

Turning from its analysis of the formalities to the element of unfairness, the \textit{Labadie} court indicated that the unfairness test might be satisfied on

\textsuperscript{46} Id. at 98.  
\textsuperscript{47} Id.  
\textsuperscript{48} Id.  
\textsuperscript{49} Id.  
\textsuperscript{50} Id.  
\textsuperscript{51} Id.  
\textsuperscript{52} Id.  
\textsuperscript{53} Id. at 99.  
\textsuperscript{54} Id.
remand if the lower court determined that Black had "adequately failed to capitalize the corporation for the reasonable risks of the undertaking." The court further reasoned:

[Undercapitalization] is only a single example of how the "unfairness" prong of the piercing test may be satisfied in this case, depending on the eventual findings on remand. There may be others. The "errant" party need not have willfully wronged the other party, nor need he have engaged in anything amounting to fraud in their relationship. The essence of the fairness test is simply that an individual businessman cannot hide from the normal consequences of carefree entrepreneuring by doing so through a corporate shell.

The Labadie court thus expanded the idea of unfairness beyond fraud and beyond injustice to encompass mere carelessness or callousness in business behavior.

Perhaps more importantly, the Labadie decision reflects the inclination of the District of Columbia courts to merge the two prongs of the traditional analysis and to find the unfairness element satisfied by a finding of a unity of interest between the corporation and its shareholders. Thus, a consideration such as undercapitalization, ordinarily considered an indicia of the corporate formalities or "instrumentality" requirement, was transposed in Labadie to represent unfairness as well. Indeed, the court in Labadie suggested that "[m]any of the factors listed in the formalities section of this discussion should . . . be considered in the court's evaluation" of unfairness.

2. A Pox on Carefree Entrepreneuring

The Labadie decision can be viewed as one manifestation of the flexibility demonstrated by District of Columbia courts in finding that the "unfairness" test has been met. That flexibility was again brought to bear in Vuitch v. Furr, a medical malpractice action against a physician, his wife, and the incorporated clinic and hospital owned by them. The plaintiff, Furr, brought suit for injuries she suffered from a second trimester abortion and post-operative treatment performed by Dr. Vuitch at the Laurel Clinic. Af-
After a detailed review of the Vuitchs' intermingling of the affairs of both corporations for their personal purposes over a period of years, the court concluded that evidence of the intermingling of both the identities and the property of the two corporations and the disregard for some corporate formalities supported the finding that the two corporations failed to maintain separate identities. The court further stated that the medical facilities served as the Vuitchs' alter ego for the purpose of personal gain.

The court disagreed with the Vuitchs' argument that Furr had failed to show that any unfairness or injustice would result from upholding the corporate form. By his own admission, Vuitch had kept Furr, after serious complications arose, overnight at the clinic in knowing violation of a District of Columbia licensing law which required that clinic patients with complica-

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59. Id. at 814-15.
60. Id. at 817.
61. Id. at 817 & n.10.
62. Id. at 817. The court analyzed the intermingling of affairs in the following manner: Laurel Hospital was incorporated, obtained a certificate to do business in the District of Columbia, and opened a clinic at 1712 Eye Street, N.W. in 1969. Thereafter, in 1973, the Vuitchs separately incorporated the Eye Street Clinic as Laurel Clinic, Inc. under District of Columbia law, and Laurel Hospital has existed only on paper since then. The corporate offices for the Hospital and Clinic are, and always have been, Dr. Vuitch's residence at 1225 Edgevale Road, Silver Spring, Maryland (the Annex), which Dr. and Mrs. Vuitch jointly own. For several years all Clinic bills were paid by Laurel Hospital, and the Clinic's employees were and are covered by the Hospital's Pension and Trust Plan. Laurel Hospital and Laurel Clinic file a consolidated tax return. Dr. Vuitch uses a Laurel Hospital car to transport patients from the Clinic to the Annex, which he uses to treat Clinic patients overnight. Yet the Annex, which is not licensed in Maryland to treat patients, is both Dr. Vuitch's personal residence and the business office of Laurel Hospital. Mrs. Vuitch pays all bills for the upkeep of the Edgevale Road property from "Dr. Vuitch's accounts."

Id. (footnotes and citations omitted).
63. Id. at 817 (emphasis added) (citing Valley Finance, Inc. v. United States, 629 F.2d 162, 172 (D.C. Cir. 1980), cert. denied, 451 U.S. 1018 (1981)).
tions be transferred to a hospital for overnight treatment.\textsuperscript{64} The court thus refused to "allow the interposition of a corporation to defeat a legislative policy."\textsuperscript{65}

Perhaps more surprising was the court's refusal to accept the Vuitchs' argument that absent a showing that the corporations were unable to pay the judgment against them, there was simply no unfairness to Furr which would justify disregarding the corporate form.\textsuperscript{66} That argument derived from the so-called exhaustion rule, which is based on the concern that, absent a rule requiring a court to find a subsidiary corporation incapable of satisfying a judgment against it, the stockholders of its parent corporation could be joined at the outset of every case against a subsidiary and forced to go through trial even though the subsidiary might be financially capable of satisfying the judgment. Without discussion, the \textit{Vuitch} court sidestepped the exhaustion rule, declaring it inapplicable in the case before it, because the corporations were closely held.\textsuperscript{67} Moreover, the court reasoned:

We are persuaded that because the privilege of transacting business in a corporate form granted by the legislature has been used contrary to law, and because the separate incorporation of the clinic appears to be consistent only with establishing a \textit{double layer of insulation} for Laurel Hospital and Dr. and Mrs. Vuitch, the total organization should not be allowed to be artificially subdivided for the sole purpose of limiting liability.\textsuperscript{68}

The \textit{Vuitch} decision reveals the District of Columbia courts' healthy suspicion of using the corporate form to limit shareholder liability, especially in the context of a parent-subsidiary relationship where the parent is closely held. Given an intermingling of personal and business assets, as well as an intermingling of the assets of the two corporations, the \textit{Vuitch} court held that the first prong of the test could be satisfied by the absence of "some" corporate formalities, even though other formalities had been respected.\textsuperscript{69} The second prong, that of unfairness, was satisfied either by the use of the corporate form to evade District of Columbia law, or by the Vuitchs' attempt to establish for themselves a "double layer" of limited liability.\textsuperscript{70}

This suggestion in \textit{Vuitch}, that the unfairness element of the two-pronged

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\textsuperscript{64} \textit{Id.} at 817-19.

\textsuperscript{65} \textit{Id.} at 819 (citing Anderson v. Abbott, 321 U.S. 349, 362-63 (1944)).

\textsuperscript{66} \textit{Id.}

\textsuperscript{67} The court found "no reason to force appellee to expend further time, effort and expense in attorney fees and court time; appellants can remedy any inequities between themselves when they determine how the judgment shall be paid." \textit{Id.} at 819-20.

\textsuperscript{68} \textit{Id.} 820 (emphasis added).

\textsuperscript{69} \textit{Id.} at 817.

\textsuperscript{70} \textit{Id.} at 820.
test would itself be satisfied by the conclusion that the corporation was formed solely to limit liability, had been foreshadowed by the decision in *Harris v. Wagshal*.\(^{71}\) Georgetown Chateaux, Inc. owned property which was subject to Wagshal’s deed of trust. Wagshal foreclosed on the property and secured a deficiency judgment against the corporation. Finding that Chateaux was insolvent, Wagshal sued to hold Mrs. Harris, its sole shareholder, personally liable alleging that Chateaux was a sham corporation. In upholding the trial court’s decision to disregard the corporate form of Chateaux, the court in *Wagshal* appeared to rely solely on its determination that the corporation was the alter ego of Harris and her husband:

> We recognize that formation of a corporation in order to avoid personal liability is not itself, standing alone, an abuse of the corporate form. Here, however, we have evidence supporting a number of findings, viz., that the corporation was formed to protect the Harrises’ business from the claims of Mr. Harris’ judgment creditors (a fact providing some evidence of fraudulent use of the corporation and of its use as a personal instrumentality), that Mrs. Harris extensively commingled corporate with personal funds, and that the formalities of the corporate form were in large part disregarded. Taken together, the findings support the conclusion that the corporation had no independent existence, but was used as the personal instrumentality of the Harrises.\(^{72}\)

The court went on to reject the Harrises’ contention that the plaintiff must prove fraud directly tainting the obligation sued upon for the court to pierce the corporate veil.\(^{73}\) Citing the decision of the United States Court of Appeals for the District of Columbia Circuit in *Francis O. Day Co. v. Shapiro*,\(^{74}\) the court noted that “it is not always necessary to allege fraud; other considerations of equity and justice can justify piercing the corporate veil.”\(^{75}\) In *Francis O. Day*, an action to recover an unpaid judgment for breach of contract, defendant Shapiro had owned and operated several corporations from his place of business. The court pierced the corporate veil, finding Shapiro had used the corporate form to evade liability on the contract. In so holding, the court concluded that equitable considerations and plain justice may lead a court to pierce the corporate veil in some cases even in the absence of fraud. The court noted that this is especially true of those situations involving “one-man” or family corporations.\(^{76}\)

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72. Id. at 287.
73. Id.
74. 267 F.2d 669 (D.C. Cir. 1959).
76. *Francis O. Day*, 267 F.2d at 673 n.11.
B. Piercing the Corporate Veil in Maryland

At the other end of the spectrum from the District of Columbia courts, Maryland courts accord the corporate entity an extraordinary measure of deference, apparently relaxed only in instances of proven common law fraud. The rule in Maryland is that the corporate form "will be disregarded only when necessary to prevent fraud or to enforce a paramount equity."77 In practice, however, the courts simply have not found an equitable interest more important than the state's interest in limited shareholder liability.78

1. A Bright-Line Test

The Maryland cases suggest that neither an utter disregard for corporate formalities nor the use of the corporate form by an individual as a shield from liability will lead to piercing the corporate veil unless accompanied by actual common law fraud. This bright-line test, which Maryland courts consistently have followed in recent years,79 imposes a substantially more rigorous standard for meeting the second prong than the amorphous "unfairness" test applied in the District of Columbia and in Virginia. Consequently, in applying the ostensibly equitable remedy of piercing the corporate veil, Maryland courts admit little of the discretion invoked by the courts of the neighboring jurisdictions.

In Bart Arconti & Sons, Inc. v. Ames-Ennis, Inc.,80 for example, general contractor Ames-Ennis, Inc., after contracting to construct three public buildings in Baltimore, subcontracted with Bart Arconti & Sons, Inc. (Arconti) for the performance of the masonry and related work on each of the projects.81 When a contract dispute between Ames-Ennis, Inc. and Arconti resulted in protracted litigation, the Board of Directors of Bart Arconti & Sons resolved that the company would cease to operate until the litigation

78. Refusing to pierce the corporate veil of a subsidiary of a savings and loan association in Starfish Condominium v. Yorkridge Serv. Corp., 295 Md. 693, 458 A.2d 805 (1983), the court stated:
   The fundamental difficulty with the trial court's analysis of the liability of S & L is that there is no finding of fraud nor is there identification of an equity which requires enforcement, and which is paramount to the ordinary expectation of limited liability on the part of the shareholder of Service Co.
   Id. at 714, 458 A.2d at 816; see also Carozza v. Federal Fin. & Credit Co., 131 A. 332, 338 (Md. App. 1925) (referring to a "paramount and superior equity").
79. For three older Maryland cases, see Crocker v. Pitti, 179 Md. 52, 56, 16 A.2d 875, 877 (1940); William Danzer & Co. v. Western Md. Ry., 164 Md. 448, 457, 165 A. 463, 467 (1933); Bethlehem Steel Co. v. Raymond Concrete Pile Co., 141 Md. 67, 82, 118 A. 279, 284 (1922).
81. Id. at 297, 340 A.2d at 227.
with Ames-Ennis was resolved.82 Prior to the litigation, Arconti had been the most prominent of three corporations owned by Bart and George Arconti.83 While Arconti lay dormant, the other two corporations, which operated at the same place of business and employed the same workmen, used Arconti's equipment and assets without compensation.84

The trial court found the purpose of these activities had been to "evade legal obligations devolving upon [Arconti] during the pendency of the present action," and resulted in rendering Arconti all but insolvent.85 In the view of the trial court, Bart and George, as the dominant directors and sole shareholders of all three corporations, had directed their corporate operations for the sole purpose of keeping Arconti's subcontracting business while rendering that corporation insolvent through the shifting of assets and business to the other corporations.86 The trial court found that these actions justified piercing the corporate veil.87

The Court of Appeals of Maryland reversed stating that it was unaware of any Maryland case where the court had disregarded the corporate entity, absent evidence of fraud or similar conduct, merely to prevent the evasion of legal obligations.88 In so holding, the court of appeals rejected the analysis advanced by Herbert Brune in his frequently cited treatise, Maryland Corporate Law and Practice,89 which was relied upon by the lower

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82. Id. at 304, 340 A.2d at 231.
83. Id., 340 A.2d at 231.
84. Id. at 304-05, 340 A.2d at 231. These activities also included loans to Bart and George Arconti from Arconti, and the transfer of insurance policies on Bart and George Arconti to them from the corporation. Id. at 305, 340 A.2d at 231.
85. Id., 340 A.2d at 231.
86. Id., 340 A.2d at 231.
87. Id., 340 A.2d at 231.
88. Id. at 311-12, 340 A.2d at 235.
89. Id. at 309-11, 340 A.2d at 234-35. Brune advances three occasions in which the courts under Maryland law will pierce the corporate veil:

The general rule is that the corporation will be regarded as an independent person, distinct from its shareholders and having rights not limited by disabilities or liabilities which would be imposed on its shareholders; and, conversely, that the shareholders are not liable for the debts or obligations of the corporation. This rule is subject to exception when necessary to prevent fraud or to enforce a paramount equity; and a number of cases have arisen which set a pattern as to the circumstances under which the corporate entity will be disregarded.

First. Where the corporation is used as a mere shield for the perpetration of a fraud, the courts will disregard the fiction of separate corporate entity.

Second. The courts may consider a corporation as unencumbered by the fiction of corporate entity and deal with substance rather than form as though the corporation did not exist, in order to prevent evasion of legal obligations.

Third. Where the shareholders themselves, or a parent corporation owning the stock of a subsidiary corporation, fail to observe the corporate entity, operating the
The court stated Brune's grounds for piercing under Maryland law had an "appealing quality about them, but . . . [found] no authoritative support permitting their applicability to the facts" before it. Instead, reaffirming the narrow nature of the inquiry in Maryland, the court announced that "[t]he common thread 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."92

In Dixon v. Process Corporation,93 two investors, Dixon and Litty, sued to pierce the veil of the Process Corporation (Process), one of eleven wholly owned subsidiaries of Process Incorporated of Maryland (PIM), against whom Dixon and Litty had obtained judgments. Dixon and Litty had purchased a tract of land to be developed by Process, entering into a contract whereby PIM was to repurchase the tract within one year.94 When the repurchase never materialized, and PIM lacked the assets to satisfy the judgments obtained against it, Dixon and Litty argued that the separate corporate identities of PIM and Process should be disregarded, claiming that Process and PIM were simply the alter ego of Garland, president of both.95 Dixon and Litty argued that Garland's domination of both corporations for his personal ends, without maintaining a separate identity for each corporation, should expose Process to liability in equity for the actions of PIM.96

After reviewing the nearly complete absence of corporate housekeeping,97 the court explicitly found that there was "legally sufficient evidence to cast business or dealing with the corporation's property as if it were their own, the courts will also disregard the corporate entity for the protection of third persons."


91. Arconti, 275 Md. at 312, 340 A.2d at 235.
92. Id., 340 A.2d at 235.
94. Id. at 648, 382 A.2d at 896.
95. Id. at 651, 382 A.2d at 897-98.
96. Id., 382 A.2d at 898.
97. Id. at 647, 382 A.2d at 895. The court concluded that:
Garland, the president and a director of both PIM and [Process], testified that the directors for both 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 employees, rented their offices, operated their payrolls and unemployment matters, and managed their affairs. At meetings of the boards of directors, inferentially of PIM, the business matters of the various corporations were discussed. Separate board meetings were not held.

Id. at 654, 382 A.2d at 899. However, the court noted that the stock was not issued "because of the neglect of the secretary" and that articles of incorporation for both PIM and Process
doubt as to the separate corporate identities of PIM and Process." The court nonetheless found such flaunting of corporate formalities insufficient grounds for piercing the corporate veil and refused to disregard the separate corporate entities, noting that the lower court "expressly found that there was no fraud and that no paramount equity was present in the case sub judice which required the intervention of equity's awesome powers." Citing its earlier decision in Bart Arconti, the Dixon court concluded in strong language that "we make clear that the rule of law in this state 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."

2. Focus on Common Law Fraud

In Colandrea v. Colandrea, the court did pierce the corporate veil, but only upon proof of actual fraud. In Colandrea, Dominic and Carmen Colandrea, husband and wife, incorporated Cortland Realty Ltd. When the couple divorced, a stock redemption agreement was executed whereby Mr. Colandrea sold to Cortland Realty all of his stock in the corporation for $100,000, to be paid by Cortland Realty through seven promissory notes. Mrs. Colandrea remained as the sole shareholder, director, and president. Quickly following the redemption agreement, Mrs. Colandrea incorporated Cortland Ltd., which then assumed Cortland Realty's assets and operations, but none of its liabilities. Cortland Realty's name was changed to Carmen Management Co., which existed without assets until annulled by the

had been filed with the state, a uniform set of bylaws was adopted, and minutes kept. Id. at 647, 382 A.2d at 895.
98. Id. at 654, 382 A.2d at 899.
99. Id. at 655, 382 A.2d at 900.
100. Id., 382 A.2d at 900.
104. Id. at 433, 401 A.2d at 487. 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":
Other cases suggest that, even when both prongs of the test are met, the corporate veil should be pierced only on a "showing of actual fraud." The use of the term fraud, however, probably should not be interpreted in its full legal sense. The cases indicate that this additional prong is satisfied if there is evidence of fraud, intent to defraud, bad faith, or a showing that injustice may result if the veil is not pierced. This actually is nothing more than satisfaction of the "unfairness" prong of the test.
Barber, supra note 9, at 377 (footnotes omitted).
105. Colandrea, 42 Md. App. at 422-23, 401 A.2d at 482.
106. Id. at 424, 401 A.2d at 483.
The seven promissory notes held by Mr. Colandrea were never honored. As the appeals court concluded, "[t]he effect of all these corporate machinations is obvious. By [them] Mrs. Colandrea was able to continue the profitable business of Cortland Realty, Ltd. without its attendant obligations to Mr. Colandrea." In order to establish fraud, however, the court required that the elements of fraud be demonstrated by Mr. Colandrea with "clear and convincing proof." In her deposition, Mrs. Colandrea had admitted that at the time she executed the stock redemption agreement for the corporation, she never intended to repay the notes. The court accordingly pierced the corporate veil and imposed liability on Mrs. Colandrea.

3. A Herculean Task

Maryland courts are explicit in their encouragement of the corporation as a liability shield, protecting even the "flimsily woven" corporation and denying relief absent actual fraud on victims of corporate activities. Nor do

107. Id. at 423-24, 401 A.2d at 482-83.
108. Id. at 423, 401 A.2d at 482.
109. Id. at 425, 401 A.2d at 483.
110. Id. at 428, 401 A.2d at 484. To prove fraud, the court required Mr. Colandrea to show five elements:
   (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.
111. Id., 401 A.2d at 484.
112. Id. at 430, 401 A.2d at 485-86.
   It may well be true that Bankers Trust placed the corporate body of Melba between itself and any liability arising from the operation of Antigua Condominium. It is apparently true that Melba acted under the control and direction of Bankers Trust. None of this is impermissible, however. It is for the very purpose of limiting liability that corporations are created in the first place. Moreover, it is common for one corporation to distance itself from potential liability arising from various transactions by creating and directing another corporation to manage them. The pleadings in the instant case show no more than an arrangement which is common-place and accepted in the commercial world.
114. Id. at 734-35, 501 A.2d at 1364.
Maryland courts consider closely held or affiliated corporations as suspect, or as sham attempts to limit liability. These forms apparently receive no greater scrutiny, even when corporate formalities have been disregarded. In particular, Maryland departs from its neighboring jurisdictions in the high level of protection afforded the parent-subsidiary relationship. In Dixon, for example, where the parent corporation had set up no fewer than eleven subsidiaries, and had flouted corporate formalities, the court stated:

A commercial corporation is a legal entity conceived by the mind of man and legitimated by statute for the avowed purpose of achieving a maximum profit with a minimum exposure to liability. When such an entity is the parent of multiple offspring in the form of subsidiary corporations, woe unto the creditor who seeks to rip away the corporate facade 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.

C. Piercing the Corporate Veil in Virginia

Virginia courts, in deciding whether to disregard the corporate entity, have commonly resorted to a more fluid analysis which endeavors to take into account the "totality of the circumstances" surrounding a case. In recent cases, Virginia courts consistently have relied on the Fourth Circuit's review of a South Carolina decision in DeWitt Truck Brokers, Inc. v. W. Ray Flemming Fruit Co., in which the court of appeals, after a federal com-
mon law analysis, held that disregard of the corporate entity was justified where there was a complete disregard of corporate formalities in the operation of the corporation (which functioned only for the financial advantage of its president),118 where the corporation was undercapitalized,119 where the president withdrew funds from the corporation which he had collected as due the plaintiff (a creditor),120 and where the president had stated to the plaintiff that he would take care of payment of plaintiff's charges if the corporation failed to do so.121 While in DeWitt the Fourth Circuit reviewed precedent from many jurisdictions, Virginia cases subsequent to DeWitt122 have cited that decision for at least two important propositions: (1) that "proof of plain fraud is not a necessary element in a finding to disregard the corporate entity,"123 and (2) that "[t]he conclusion to disregard the corporate entity may not . . . rest on a single factor . . . but must involve a number of such factors."124

I. West v. Costen

The 1983 federal court decision in West v. Costen125 exemplifies the DeWitt Trucking approach. Costen involved a class action of consumers brought against a debt collector under the Fair Debt Collection Practices Act (FDCPA), which had been enacted "to protect consumers from a host of unfair, harassing, and deceptive debt collection practices without imposing unnecessary restrictions on ethical debt collectors."126 The plaintiffs all owed or previously owed debts, which the primary defendant, Multi Service Factors, Inc. (MSF), attempted to collect on behalf of various creditors.127 MSF was in the business of collecting dishonored checks, for which it would

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118. Id. at 688.
119. Id.
120. Id. at 689.
121. Id.
123. DeWitt, 540 F.2d at 684. That actual fraud is neither necessary, nor alone sufficient, to pierce the corporate veil has long been the law in the Fourth Circuit, and in Virginia. See, e.g., Cunningham v. Rendezvous, Inc., 699 F.2d 676, 680 (4th Cir. 1983); Hamilton Ridge Lumber Sales Corp. v. Wilson, 25 F.2d 592, 595 (4th Cir. 1928); Puamier v. Barge BT 1793, 395 F. Supp. 1019, 1039 n.10 (E.D. Va. 1974).
124. DeWitt, 540 F.2d at 687.
127. Id. at 571.
receive between thirty and fifty percent of the amount of the check collected for its client.\textsuperscript{128}

The consumer plaintiffs named as defendants not only MSF, but also William C. Costen, its president and primary shareholder, and several of its officers and employees.\textsuperscript{129} The plaintiffs alleged that the defendants engaged in a series of practices which violated the FDCPA.\textsuperscript{130} The court found virtually all of plaintiffs' claims to be meritorious, but had some trouble sorting out the liability of the individual defendants. The court imposed personal liability for statutory violations on the individual debt collectors (other than Costen, who didn't have direct contact with consumers) and, under a vicarious liability theory, on MSF.\textsuperscript{131} Because there was no allegation that Costen violated any provisions of the Act himself, the court held that Costen could be held personally liable only by piercing the corporate veil of MSF.\textsuperscript{132}

In considering whether to disregard the corporate entity of MSF, the Costen court cited DeWitt as establishing the law on piercing the corporate veil in the Fourth Circuit.\textsuperscript{133} The court declared that "[a] corporate entity generally will be recognized as a separate entity, functioning through its officers and directors, to which its creditors must look for satisfaction of debts and obligations incurred in the corporate name."\textsuperscript{134} The court cautioned, however, that the corporate structure was not "a shield for dominant shareholders to hide behind while defrauding or injuring creditors, or conducting illegal operations."\textsuperscript{135} Citing DeWitt, the court concluded that "when substantial ownership of all the stock of a corporation in a single individual is combined with other factors clearly supporting disregard of the corporate fiction on grounds of fundamental equity and fairness . . . , the corporate entity will be disregarded and liability fastened on the individual

\textsuperscript{128} Id. at 571-72.
\textsuperscript{129} Id. at 569.
\textsuperscript{130} Id. at 572. Specifically, the plaintiffs alleged that the MSF group violated the FDCPA by:

(1) communicating with third parties concerning the collection of debts . . . ;
(2) threatening that criminal prosecution was pending or that warrants were to be issued when such was not intended and could not be done legally . . . ; (3) failing to comply with the notice and validation of debt procedures required [by the FDCPA];
(4) collecting service charges not expressly authorized by the agreement creating the debt or permitted by law . . . ; and (5) misrepresenting the amount of the debt owed and the legality of receiving service charges as compensation for collecting debts.

\textsuperscript{129} Id. at 572.
\textsuperscript{131} Id. at 573.
\textsuperscript{132} Id. at 585.
\textsuperscript{133} Id.
\textsuperscript{134} Id.
\textsuperscript{135} Id.
Capital Shareholder’s Ultimate Calamity

Turning to the facts before it, the court noted that MSF was formed as a Pennsylvania corporation in 1974 with only 500 shares of common stock at $2.00 par value, for a total authorized capital of $1,000.00.137 Aside from its $1,000.00 capital base, MSF had few assets beyond office equipment and furniture.138 MSF maintained no reserves for contingencies, and a $15,000.00 loan from a bank was obtained on the personal signatures of Costen and another officer rather than on the credit of MSF.139 The court observed that “MSF, like any debt collection agency, faced prospective liabilities under the FDCPA because claims thereunder are a predictable risk of a collection business, even for an agency that attempts to comply” with the FDCPA.140 Moreover, MSF’s potential loss for even a single claim was statutory damages of up to $1,000.00 plus actual damages and attorney’s fees. “Patently,” the court concluded, “MSF’s woefully inadequate capitalization would barely cover even a single individual statutory penalty at the maximum level, much less a number of claims or a class claim. Thus, the uncontested facts show that MSF was grossly undercapitalized to operate as a collection agency.”141

The court noted that in addition to being undercapitalized, MSF had never paid a shareholder’s dividend, despite the fact that MSF paid Costen substantial sums of money in the form of commissions for obtaining new accounts for collection.142 It was unclear from the Costen opinion whether MSF had properly authorized the distribution of earnings to Costen in the form of salary.

The court conceded that MSF had apparently maintained “at least a semblance of corporate records, including minutes of shareholders’ and direc-

136. Id. (footnotes omitted).
137. Id.
138. Id. at 586.
139. Id.
140. Id.
141. Id. The court held that undercapitalization was a proper ground for piercing the corporate veil because it is “the policy of the law that shareholders should in good faith put at the risk of the business unencumbered capital reasonably adequate for its prospective liabilities.” Id. (citing H. BALLANTINE, supra note 4, at 302-03).
142. Id. The court reasoned as follows:

That Costen was siphoning the funds of the corporation is illustrated by putting Costen’s compensation in perspective with MSF earnings during the same period. MSF suffered a net loss during 1976-1978 and its net gain in 1979 was only $282. By comparison, Costen’s remuneration during these years amounted to $2,567 in 1976, $6,184 in 1977, $15,428 in 1978, and $17,325 in 1979.

Id. (citation omitted); see also Leventhal v. Army-Navy Realty, Inc., Chancery No. 20,364 (Cir. Ct. of Arl. County) (June 18, 1971).
tors' meetings.' Despite the presence of corporate housekeeping, however, the court found that Costen considered MSF to be his own personal business vehicle. The court considered it significant that Costen's mother ran MSF's office in Norfolk, Virginia, and when asked her job description, answered that "she helps her son." Costen secured personal loans from MSF without the approval or vote of the MSF Board of Directors. Nor did MSF ever obtain a business license from the city of Roanoke, Virginia. The court concluded that Costen's disregard for the interests of MSF also was demonstrated by his failure to comply with the record keeping requirements of state law.

The court went on to hold, however, that perhaps the most important reason to disregard MSF's corporate form and impose personal liability on Costen was that "it would be unfair to the plaintiffs and contrary to the purpose of the FDCPA to uphold MSF's corporate facade." The court reasoned that MSF was liable to the plaintiffs for "blatantly illegal collection practices." The undisputed facts, the court found, compelled the conclusion that Costen himself knew or should have known of the MSF violations of FDCPA. He was, after all, at all times MSF's president and maintained his office on the corporate premises. The court concluded, therefore, that Costen had "misused the corporate form" and that justice required that MSF's corporate form be disregarded and that personal liability be imposed upon Costen.

2. Differential Treatment

Virginia courts appear to afford a greater deference to affiliated corporations than to close corporations, perhaps reflecting the result in *DeWitt*,

144. Id. at 587 (footnote omitted).
145. Id.
146. Id.
147. Id.
148. Id.
149. Id.
150. Id.
151. Id. En route to this holding, the court considered the argument that the consumers at all times knew that MSF was incorporated. The court handled the issue as follows:

Although the consumers from whom MSF attempted to collect debts cannot claim that they have been unduly influenced by the corporate front, a judgment creditor, including a victim of a statutory illegality, can be as effectively defrauded as a contractual creditor and is equally allowed to pierce the corporate veil in the appropriate situation. Indeed, a victim of a statutory illegality or tort may be more entitled to pierce an undercapitalized corporation because, unlike a contractual creditor, the former's dealings with the corporation are involuntary and uninformed.

Id. at 586 (citations omitted).
where the veil of a closely held corporation was pierced. Similarly, the Costen court imposed liability on the majority shareholder of a closely held corporation in part because the undisputed facts revealed that Costen considered MSF to be "his own personal business vehicle." Indeed, the Virginia case law is replete with suggestions that the courts should look somewhat suspiciously on the close or one-person corporation. In Puamier v. Barge BT 1793, for example, the court stated:

[W]hile there is no law against it, we are suspicious of the fact that Zapetis was the sole or primary stockholder in numerous corporations. It appears that, while each corporation may have had some legitimate business dealings, Zapetis brought them into play as shields for his personal dealings. This is clearly improper.

A Virginia court's strongest language directed at the closely held corporation appeared in a 1966 decision in Lewis Trucking Corp. v. Commonwealth:

In the case of the one-man corporation or the corporation in which all stock is owned by a single individual except a few shares necessary to qualify directors, courts have shown great liberality in lifting the veil of the corporate entity and holding the sole shareholder and the corporation to be one and the same.

Despite their strict scrutiny of close corporations, Virginia courts have proven more protective in the parent-subsidiary context. Brown v. Margrande Compania Navierta involved an attempt to hold the parent corporation liable for salvage services in towing and saving a tanker chartered by one subsidiary carrying another subsidiary's cargo. Texaco, the parent, owned all the stock of the two subsidiaries and the corporations had interlocking directors and officers.

Noting that "[i]ndiscriminate application [of the piercing doctrine] would destroy the purpose of the corporate law," the court refused to pierce the

152. Id.
154. Id. at 1039 (citations omitted).
155. 207 Va. 23, 147 S.E.2d 747 (1966) (Delaware corporation was sham corporation set up by Virginia resident for purpose of avoiding payment of Virginia license taxes.).
156. Id. at 32, 147 S.E.2d at 753-54 (quoting 4 Mich. Jur. Corporations § 5, at 559 (1983)).
158. Id.
159. Id. at 1006. The court further stated:

The extent of stock ownership and potential control possessed by a holding company is not the determining factor when its liability for acts and obligations of the subsidiary is in question. Something more is needed, such as fraud, illegality, or wrongdo-
veil of the subsidiaries on the ground that no unfairness would result.\textsuperscript{160} In order to disregard the corporate facade, the court stated, “[i]t must appear it was organized for a fraudulent purpose or that some injury has resulted to someone from the transaction, something of fraud, something of illegality or wrongdoing, or something where the moving party has cause for complaint in connection with the transaction.”\textsuperscript{161} Clearly the court placed greater importance on preserving Texaco’s carefully constructed shields to liability, choosing to regard the lack of compensation for salvage services as no cause for complaint.\textsuperscript{162}

The court was equally protective of the parent-subsidiary relationship in \textit{In re Nova Real Estate Investment Trust} \textsuperscript{163} despite seemingly damning facts. The court found common officers and directors and common offices between parent and subsidiary.\textsuperscript{164} The corporations transacted business for each other, and the parent had controlling influence over the subsidiary.\textsuperscript{165} Yet these facts were, in the view of the court, insufficient to find the subsidiary the instrumentality of the parent.\textsuperscript{166} “More must be shown, e.g., that one corporation is a mere agency, instrumentality, tool or adjunct of the other,” the court remarked.\textsuperscript{167} The same general guidelines of \textit{DeWitt} and other cases provide for little consistency in outcome. It is clearly more difficult in Virginia than in its neighboring jurisdictions to grasp the state’s piercing doctrine.

\subsection*{D. The Source of Liability: Tort, Contract, and Evasion of Statute}

A final means of comparing the three jurisdictions discussed above proceeds along thematic lines; namely, the importance of the source of liability in determining whether the corporate entity should be disregarded.

\subsubsection*{1. Tort Versus Contract}

For several decades, legal scholars and commentators have argued that the corporate veil should be pierced more readily in tort than in contract cases. Because a contract is consensual in nature, a party has a prior oppor-
portunity to investigate its contracting partner before it enters into the agreement. It is therefore argued that a party assumes the risks of contracting with an undercapitalized or otherwise improper corporation, and should not be entitled to pierce the corporate veil if the corporation is later unable to meet its obligations. In the case of closely held corporations, the party contracting has a prior opportunity to ask for personal guarantees from the shareholder or shareholders. Disregard of the corporation in contract cases, these commentators argue, should therefore be limited to situations in which the injured party relied to its detriment on misrepresentations or efforts to mislead on the part of the contracting corporation.\footnote{168}

In tort cases, on the other hand, the corporation and the injured party are typically strangers, such that the victim has had no prior opportunity to investigate. In such instances, the two-prong test often appears unjustly harsh. The tort victim's likelihood of piercing the corporate veil is dependent on whether the corporation had observed corporate formalities, a fortuitous circumstance ordinarily unrelated to the tort itself.\footnote{169} Despite the general trend in tort law towards compensating the victim, the victim of a tort committed by an insolvent corporation is often unlikely to be compensated for the wrong suffered. Instead, the victim involuntarily absorbs the loss, becoming an unwitting subsidizer for the corporation's activities.\footnote{170}

Despite extensive scholarship on the issue, however, most courts have failed to distinguish between tort and contract in deciding whether to disregard the corporate entity. Typically, shareholders are not held liable for a

\footnote{168} Arguably, contract creditors who were reasonably able to protect themselves should be denied access to shareholders' personal assets since the interest of preserving the corporate form and the expectation of limited shareholder liability can be said to outweigh any unfairness to an injured party that freely contracted. The focal point, in many commentators' views, should be the ability of the contracting party to protect itself:

Arguably, the court should assume that the parties to the transaction voluntarily distributed the risks between themselves in negotiating the contract terms. In effect, this approach modifies the two prong test for contract cases, requiring plaintiffs to show not only unfairness and disregard of corporate formalities but also that plaintiffs did not assume the risk by going ahead with the transaction.

Barber, \textit{supra} note 9, at 384-85; see also Gelb, \textit{supra} note 34, at 10-13; Gillespie, \textit{supra} note 29, at 390.

\footnote{169} See, e.g., Barber, \textit{supra} note 9, at 381-83.

\footnote{170} See Comment, \textit{supra} note 27, at 136-37 (discussing limited liability as a subsidy to insolvent corporate tortfeasors). Argues one commentator, "[i]t is difficult to see how mere commingling of affairs and failure to observe corporate formalities prejudice a third party, especially a tort creditor who is totally unaware of the situation at the time the cause of action arises." Note, \textit{ Liability of a Corporation for Acts of a Subsidiary or Affiliate.} 71 \textit{Harv. L. Rev.} 1122, 1126 (1958); see also Note, \textit{supra} note 7, at 1190 (advocating a separate test for torts). Singled out as particularly unjust by some commentators are tort cases in which the defendant corporation was closely held, and shareholders were actively involved in the corporation's policies and operations.
corporation's torts, nor for its contract obligations, except where corporate formalities have not been observed and where grave injustice would result.\(^{171}\)

The Virginia courts have been the only courts of the three contiguous jurisdictions to consider the long-argued position of commentators that a distinction between tort and contract is warranted in piercing cases. In Costen, the court in dicta explicitly discussed such a distinction, stating "a victim of a statutory illegality or tort may be more entitled to pierce an undercapitalized corporation because, unlike a contractual creditor, the former's dealings with the corporation are involuntary and uninformed."\(^{172}\)

Courts in the jurisdictions adjoining Virginia, however, have stood the tort/contract distinction on its head: the consistent outcome of decisions both in Maryland\(^{173}\) and the District of Col-

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\(^{171}\) See H. HENN, supra note 4, §§ 143, 146.

\(^{172}\) West v. Costen, 558 F. Supp. 564, 586 (W.D. Va. 1983) (emphasis added). Since the 1983 decision, however, no piercing case has relied upon this suggested distinction. Nor have courts in the state discussed such a distinction in contract cases. Costen, by combining a tort, the evasion of statute, and a closely held corporation, may have simply presented an isolated and compelling case to disregard the corporate entity. *Id.* at 584-87.

In contrast to the Maryland position, Virginia courts have looked into the contractual relationship and have demonstrated a willingness to interfere when misrepresentations have been made. In Puamier, the court found that misrepresentations made to the contracting party by Zapetis, the sole stockholder, justified piercing the corporate veil and imposing personal liability. Neither the existence of a binding contract, nor the assertion that any misrepresentations were made in good faith dissuaded the court from disregarding the corporation. Puamier v. Barge BT 1793, 395 F. Supp. 1019, 1038-39 (E.D. Va. 1974). This approach sharply conflicted with that of the Maryland court in Colandrea, which permitted piercing the veil only after being satisfied that the necessary element of scienter had been proven by the plaintiff. Colandrea v. Colandrea, 42 Md. App. 426-27, 401 A.2d 480, 484 (1979). The Puamier court stated:

If good faith were to become a defense in actions of this type, every defendant would claim good faith of some sort even though he did exactly what he intended to do in misrepresenting certain facts to an innocent party. This is not an action for common law misrepresentation in which scienter must be proven. That distinction must be made. The corporate identity can be pierced to prevent not only fraud, but any injustice.

*Puamier*, 395 F. Supp. at 1039.

\(^{173}\) The court's decision in Dixon suggests that Maryland law is consistent with legal commentary concerning piercing the corporate veil in contract cases. In actuality, Dixon is simply indicative of the general protectiveness exhibited by Maryland courts toward the corporate entity. The Dixon court distinguished the case of Bethlehem Steel v. Raymond Concrete Pile Co., 141 Md. 67, 118 A. 279 (1922), relying on the "instrumentality" rule rather than the tortious conduct at issue in *Bethlehem Steel*. Dixon v. Process Corp., 38 Md. App. 644, 652, 382 A.2d 893, 898 (1978). Moreover, the Bethlehem Steel court, in suggesting that a tort case may be less likely to result in piercing the corporate veil in Maryland than a contract case, took a position diametrically opposed to the views of commentators. *Bethlehem Steel*, 141 Md. at 81-82, 118 A. at 284. In *Bethlehem Steel*, the court refused to pierce the veil of the subsidiary to recover from Bethlehem Steel because no fraud or paramount equity was demonstrated, although the separate existence of the subsidiary was suspect. *Id.* at 81, 118 A. at 284. Be-
umbia\(^{174}\) has been to prefer the contract plaintiff to the tort plaintiff in disregarding the corporate form.

2. **Evasion of Statute**

Courts in all three capital region jurisdictions have shown less reluctance to disregard the corporate form where a corporation has been used to evade a statute or to circumvent legislative policy. The state's interest in upholding its law is generally a concern paramount to the preservation of the corporation in an isolated case.\(^{175}\) Although the Maryland law concerning evasion of a statute in piercing cases is sparse, it suggests that the courts do not require a showing of fraud in such cases to disregard the corporation.\(^{176}\)

In cases involving evasion of statute or legislative intent, Virginia courts have readily pierced the corporate veil,\(^{177}\) often to prevent the corporate

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174. In *Labadie*, the court blatantly flaunted the position espoused by most commentators that "a person dealing with a corporation in a contract setting is expected to have had the opportunity to investigate the corporation with which it deals, and essentially to have assumed the risk that the corporation may prove unable to meet its financial obligations." *Labadie Coal Co. v. Black*, 672 F.2d 92, 100 (D.C. Cir. 1982). Noting that most courts have failed to adopt this view, the *Labadie* court quoted another commentator in stating that "[i]f the prior opportunity to investigate is a consideration, then the plaintiff's lack of sophistication is equally tenable against the presumption that they knowingly assumed the risk of the corporation's undercapitalization." *Id.* (quoting Barber, *supra* note 9, at 386). In *Labadie*, however, the plaintiff was another corporation, presumably endowed with sophistication sufficient to operate its business.

Similarly, in *Schattner v. Girard*, 668 F.2d 1366, 1370 (D.C. Cir. 1981), the court pierced the corporate veil and allowed recovery on the contract, although no fraud or wrongdoing was alleged "with the requisite particularity." The court noted that "Schattner is not to be rescued from a poor bargain, of course, but it may not be presumed on this record that Schattner bargained with a clear understanding of the distinction between [the individual] and [the corporation]." *Id.* at 1370 n.4.

The District of Columbia courts do not single out tort cases for separate treatment, perhaps due to the courts' general willingness to pierce the corporate veil. In *Vuitch*, however, a medical malpractice case, the court chose to emphasize the equitable nature of the piercing doctrine rather than the tort context in disregarding the corporate entity. *Vuitch v. Furr*, 482 A.2d 811, 816 (D.C. 1984) (quoting W. FLETCHER, *supra* note 4, § 41.30).

175. *See* Comment, *supra* note 28, at 1245.


177. *See*, e.g., *West v. Costen*, 558 F. Supp. 564, 584-85 (W.D. Va. 1983), discussed *supra* notes 125-51 and accompanying text. In *United States v. Hudgins-Dize*, 83 F. Supp. 593, 597-98 (E.D. Va. 1949), the court held that an individual who attempted to use the corporate entity to evade the requirements of the Walsh-Healey Act may be held personally responsible for violating them. The court remarked that "[t]he interposition of corporate form has never been
form from denying relief to creditors of a bankrupt.178 Similarly, District of Columbia courts have demonstrated a readiness to disregard the corporation not only for evasion of statute, but also for the evasion of legislative intent.179

III. COUNSELING CONSIDERATIONS

A. Doctrinal Summary

As noted at the outset, the decisions of any state bearing on the issue of piercing the corporate veil are neither coherent nor susceptible of pat generalizations. Based on the cases discussed above, however, it may be permissible to advance the following conclusions.

1. District of Columbia

The law of the District of Columbia can be characterized as recognizing only a qualified doctrine of limited liability. In the District of Columbia, unlike in Maryland or Virginia, a disregard of corporate formalities, without more, may constitute prima facie evidence of unfairness or inequity. The permitted to thwart the action of law upon a wrongdoer. The courts will tear away the corporate veil whenever it is used 'to evade a statute or modify its intent.' " Id. at 598 (quoting Nettles v. Rhett, 94 F.2d 42, 48 (4th Cir. 1938)). Similarly, in Lewis Trucking Corp. v. Commonwealth, 207 Va. 23, 147 S.E.2d 747 (1966), the court, finding that Lewis created the corporation in order to avoid Virginia license plate fees, stated "[i]t is well settled that such a corporate transfer cannot be used as a method of nullifying established policies of law." Id. at 31, 147 S.E.2d at 753.

178. The threshold in Virginia for piercing the corporate veil in bankruptcy cases appears to be lower than for most other circumstances. See, e.g., Stone v. Eacho, 127 F.2d 284, 288-89 (4th Cir. 1942) (where Virginia store incorporated separately from Delaware parent, but all corporate activity performed by parent, the Virginia corporation would be disregarded and creditors of bankrupt parent allowed to reach assets of the subsidiary); Hamilton Ridge Lumber Sales Corp. v. Wilson, 25 F.2d 592, 595-96 (4th Cir. 1928) (corporation set up by creditor bank and bankrupt lumber corporation to secure debt to bank was not bona fide and would be pierced). But see In re County Green Ltd. Partnership, 604 F.2d 290, 294 (4th Cir. 1979) (refusing to pierce corporate veil).

179. "Courts have not hesitated to ignore the fiction of separateness and approve a piercing of the corporate veil when the corporate device frustrates the clear intendment of the law," the court remarked in Valley Finance Inc. v. United States, 629 F.2d 162, 171-73 (D.C. Cir. 1980). "The government's inability otherwise to satisfy legitimate tax debts clearly may form a sound basis for such disregard of corporate form." Id. Similarly, in Vuitch, the court commented that "[c]ourts will not allow the interposition of a corporation to defeat a legislative policy." Vuitch v. Furr, 482 A.2d 811, 818 (D.C. 1984); see also Quinn v. Butz, 510 F.2d 743, 759 (D.C. Cir. 1975) (quoting Capital Tel. Co. v. FCC, 498 F.2d 734, 738 n.11 (D.C. Cir. 1974) ("[w]e have admonished that 'the fiction of a corporate entity cannot stand athwart sound regulatory practice '"); Capital Tel. Co. v. FCC, 498 F.2d 734, 738 (D.C. Cir. 1974) (FCC validly exercised its discretion in piercing veil of corporate applicant for high-band radio-paging channel and treating the corporate applicant and its individual owner as one applicant).
practical effect of this merging of the two prongs of the traditional test is to lower the showing a plaintiff must make in order to pierce the corporate veil. Even if disregard of corporate formalities is not enough to satisfy the unfairness test in the District of Columbia, something less than fraud will suffice, perhaps a finding that the corporation was formed solely to limit liability. Finally, in the District of Columbia, as in its neighboring jurisdictions, a corporation quickly will be stripped of its limited liability where doing otherwise would evade a statute or circumvent legislative policy.

Consequently, any entity incorporated under the laws of the District of Columbia which disregards corporate formalities exposes its shareholders to a substantial risk of personal liability. To neglect the proper corporate housekeeping in the District of Columbia is to gamble with the very limited liability one sought to obtain by incorporating.\footnote{By lowering the threshold to piercing the corporate veil, the District of Columbia courts presumably seek to protect consumers and improve their bargaining position with corporations. From an economic standpoint, however, increasing the frequency with which the corporate veil is pierced in the District of Columbia creates incentives to the corporation, some of which work against the desired goal.}

2. Maryland

The law of Maryland with respect to disregarding the corporate entity can be characterized as inordinately protective of limited liability for shareholders. The Maryland courts have offered investors and their counsel a bright-line test: even in the absence of corporate formalities, the corporate veil will be pierced only in instances of proven common law fraud or evasion of a statute. One court aptly described piercing the corporate veil of a Maryland corporation as an unfair and improper act, leading to potential personal liability for shareholders.

\footnote{The current standard discourages businesses from either incorporating or doing business in the District of Columbia. Sloppy record keeping or complaints from creditors seem sufficient grounds for disregarding a corporation, despite good faith efforts on its part to comply. Although the stringent standards might screen out "shady" or marginal corporations, it seems likely that the net effect will be to reduce economic activity in the area. On the other hand, the clear standard in the District of Columbia facilitates business by reducing uncertainty. Uncertainty raises the cost of business by forcing parties to estimate their obligations and act on expected probabilities. Under a clear standard, as in the District of Columbia, parties know their legal obligations with a high degree of certainty and are free to shift the burdens of liability and risk by contract, like imposing insurance costs, for example, on the noncorporate party. See Coase, The Problem of Social Cost, 3 J.L. & ECON. 1 (1960). However, at least one complication arises. Individuals seeking to start a corporation will face extra costs in contractually altering the assignment of liability and risk. The negotiations cost time and money and there may be some uncertainty over the ability of the parties to limit the shareholders' liability by contract. These costs will deter investors from starting the business in the first place. The increased exposure to personal liability will reduce the return on capital in the District of Columbia. Individual consumers will benefit from the greater likelihood that they will be able to collect damages for any liability incurred by corporations. They will suffer, however, from a general decline in economic activity.}


corporation as "a herculean task." While counsel should never advise his or her client to disregard corporate formalities, the crux of a challenge to the corporate veil in Maryland is proof of fraud or evasion of a statute.

The strict Maryland policy of protecting the corporate entity may appear attractive to a business wishing to incorporate, and with some justification. Shareholders of a Maryland corporation can reasonably rely on the expectation that their limited liability will be upheld, even in a situation that would be borderline in another state. The overall effect is to spur substantial investment and long term planning on the basis of such a relatively secure and certain business environment.

From a practical standpoint, however, investors considering organization of their business under Maryland law should recognize that Maryland's fierce protection of limited liability also may be appealing to corporations that operate in a marginal or suspicious manner, perhaps borderline bankrupt, undercapitalized, or mismanaged companies. A situation of moral hazard may result: precisely the kinds of businesses that are likely to incur liability may incorporate in Maryland to escape legal obligations.

3. Virginia

Virginia, through its "totality of the circumstances" approach, perhaps best utilizes the doctrine of piercing the corporate veil as its equity roots intended: as a discretionary device employed in highly exceptional circumstances. While something less than actual fraud must be shown, under DeWitt the determination in any particular matter will turn on a number of factors. As a consequence of this approach, however, in Virginia it is harder to predict the outcome of a challenge to the corporate veil than in


182. See Comment, supra note 28, at 1264-65. From an economic standpoint, the relative lack of concern shown by the Maryland courts for corporate formalities further increases the uncertainties of doing business with Maryland corporations. To the extent that corporate formalities serve a notice function by facilitating identification of a legitimate corporate entity, Maryland corporations and businesses may provide less information than their counterparts in other states. Because a failure to comply with corporate formalities does not increase a corporation's likelihood of being pierced by a court in Maryland, corporations arguably are given little incentive to invest the efforts necessary to meet formality requirements.

The Maryland courts' failure to concern themselves with corporate formalities avoids the inequities of some jurisdictions where adherence to such formalities allows a corporation to protect itself from tort liability, although the formalities are likely irrelevant in an accident occurring between strangers.

either Maryland or the District of Columbia.\textsuperscript{184}

Nonetheless, it can be argued that, of the three jurisdictions, Virginia alone may be more likely to disregard the corporate form to compensate a tort victim. Like their neighbors, Virginia courts are unlikely to permit an entity to evade a statute by use of the corporate form. On the other hand, the Virginia courts consistently have protected subsidiary activities, even in the face of injustice. A corporation in Virginia, as in Maryland, may find it safer to undertake a new and potentially risky activity by engaging in it through a subsidiary. The opposite appears to hold true in the District of Columbia.\textsuperscript{185}

\textbf{B. Choice of Law}

The foregoing discussion suggests that the outcome of a challenge to the corporate entity may vary considerably depending on what state's laws are brought to bear on that challenge. Predicting what state's law will apply to any given corporation, however, may not always be a simple matter. Just because a corporation has been organized under the laws of a particular state does not mean that all courts will apply the laws of that state to a challenge to the corporate entity.

\textsuperscript{184} From an economic standpoint, the greatest disadvantage to incorporating in Virginia is uncertainty. Corporations have little understanding as to where the line is drawn between appropriate and inappropriate conduct; similar facts have produced different results before Virginia courts, and how much joint activity between affiliated corporations, for example, is considered "unity of interest" varies from case to case.

The risk of such uncertainty is that corporations will behave in a conservative manner in order to minimize the risk that a court would disregard their corporate form. This in turn may result in a less than optimal level of corporate activity, possibly leading to an unnecessarily poor economic and social climate.

\textsuperscript{185} This suggests a court-fashioned policy preference in Virginia for larger, established corporations and their subsidiaries over smaller, newer businesses. Arguably, those attracted to incorporate in Virginia will likely be one of two types. The first type will be large corporate subsidiaries with a greater disdain for safety and honest conduct, knowing Virginia courts will generally protect their limited liability. This amounts to a judgment call in Virginia that the economic benefits from such activity will outweigh the loss to individual members of the community or other corporations doing business with these subsidiaries. Yet in such a case one would expect the victims of that activity to be compensated for having borne a disproportionate loss in order to encourage a general economic and social gain.

The second type of business attracted to incorporate in Virginia is one that feels it has nothing to fear from a doctrine of ensuring justice in the individual case. Such a business should be well managed and should operate in accordance with the law. This is precisely the type of corporation that offers the greatest social benefit to the community. The cost of attracting these kinds of businesses is simply that they will not be risk-takers, technology-seekers, or venture firms. Apparently, Virginia has decided that a less than optimal level of economic activity due to its uncertainty in piercing decisions is a sacrifice it is willing to make for the corresponding gains in social welfare.
In *Labadie*, for example, the defendant FAI was incorporated under the laws of Virginia, but was sued in the District of Columbia.\(^{186}\) The District of Columbia circuit, without addressing the choice of law issue, reviewed precedent from both jurisdictions but declined to follow the approach in *DeWitt* in favor of the approach traditionally adopted by District of Columbia courts.\(^{187}\) Similarly, the corporate defendant in *Costen* was a Pennsylvania corporation licensed to do business in Virginia.\(^{188}\) The Virginia court applied Virginia law and the *DeWitt* approach in disregarding MSF's corporate form.\(^{189}\)

The promoters of a new venture may not, therefore, assume that they need only comply with the level of corporate formalities required by the state of incorporation. Unless an entity conducts a business which is so localized so as to subject it to suit only within its state of incorporation, it may be required to meet the standards of a neighboring jurisdiction. State courts may or may not apply their conflict of laws principles to determine whether the law of the forum state or of some other state should apply. Where a corporation has registered to do business in the state where suit is brought, the courts of that state, rightly or wrongly, may assume that the entity intended to subject itself to the laws of that state.

While federal courts sitting in diversity jurisdiction are more likely to address the choice of law issue, they may either apply the law of the forum or follow other federal cases.\(^{190}\) Similarly, courts asserting federal question jurisdiction may, like the Fourth Circuit in *DeWitt*,\(^{191}\) elect to fashion a federal common law by picking and choosing precedents from a number of jurisdictions.

This unpredictability provides little comfort to the venturers who seek to influence the strength of their corporate form through the selection of a jurisdiction in which to incorporate. Some solace may be found in the tendency of venue provisions to protect defendants from suits in jurisdictions other than where they reside, do business, or where the cause of action arose. Moreover, a defendant corporation may move for a transfer of venue on grounds of forum non conveniens or, in federal court, under 28 U.S.C. § 1404(a). Still, investors and their counsel are best served by a working assumption that their corporate veil may be judged by the standards of any

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186. 672 F.2d 92, 95 (D.C. Cir. 1982).
187. Id. at 96-99.
189. Id. at 584-87.
191. 540 F.2d 681, 683-87 (4th Cir. 1976).
jurisdiction in which personal jurisdiction may properly be asserted over the corporation and its shareholders.192

C. Corporate Formalities

Thus, regardless of the state of incorporation, investors and their counsel would be well advised to observe routine corporate formalities. It is a small price to pay for limited liability, yet, to varying degrees, it may well determine the outcome of a challenge to the corporate form. Especially in the District of Columbia, where the absence of corporate formalities is itself sometimes viewed as indicative of corporate fraud or wrongdoing, the shareholders of corporations who choose not to maintain proper corporate housekeeping are, simply put, at risk. Even in Maryland, which stands at the other end of the three-jurisdiction spectrum, and where the absence of corporate formalities will not lead to disregard of the corporate entity absent actual fraud or evasion of statute, no court appears to have addressed the issue whether fraud alone will justify shareholder liability where corporate formalities were assiduously maintained.

Those courts that have engaged in a detailed review of the corporate formalities maintained by a corporate defendant have proceeded along the lines of traditional corporate law. Regarding the initial organization of the venture, courts have expected to see articles of incorporation, bylaws, organizational meeting minutes, stock certificates, and proper capitalization.

Once the venture has been established, courts have looked for minutes of annual shareholder meetings to elect directors, followed each year by a meeting of the directors to elect officers and to transact other business. Special attention has been paid to the extent to which the corporation has acted through its board of directors, as evidenced by resolutions passed and recorded in minutes, and the extent to which principals of the company signed checks, notes, and documents on behalf of the corporation in their capacities as president, treasurer, and the like.

In addition to records of shareholder and director action, courts have focused on the records reflecting the revenues and expenses of the corporation. Personal and corporate funds must not be commingled. Earnings must be taken out of the corporation in the form of dividends or through salaries properly authorized by the directors. Indeed, the Labadie court looked suspiciously on the fact that the defendant corporation never declared a dividend, despite substantial earnings.

It deserves noting that the courts have not fastened upon the occasional

192. For a discussion of conflict-of-laws and jurisdictional questions, see Note, supra note 8, at 853.
deficiency in corporate formalities as grounds for disregarding the corporate veil. Yet there does appear to be an expectation that corporations will endeavor to observe the proper formalities on an ongoing basis, and a certain level of consistency appears to be required in order to avoid judicial suspicion.

D. Choice of Forum

As noted above, the promoters of any venture cannot be assured that the integrity of their corporate form will be measured against the law of the state in which they elect to incorporate. The unpredictability of the courts in this regard undermines any justification for selecting a home state based on that state's law with respect to piercing the corporate veil. At most, the extent of any jurisdiction's protection of limited liability should be but one of many factors considered in selecting a home state.193

In fact, the three-jurisdiction comparison set forth herein may be of greater use to a plaintiff than to a corporate defendant. That is, while a corporation may not be able to predict under which law its corporate form may be challenged, advance knowledge of a jurisdictional attitude toward piercing the corporate veil (to the extent a coherent attitude can be discerned) will probably influence the choice of forum by any plaintiff who is considering the need to disregard the defendant's corporate form. A plaintiff's ability to select his or her forum only underscores the importance of maintaining corporate formalities sufficient to pass muster in any jurisdiction that may assert personal jurisdiction over the corporation and its shareholders.

IV. CONCLUSION

De Tocqueville portrayed American business as thriving on the thrill of risk and chance:

Those who live in the midst of democratic fluctuations have always before their eyes the image of chance; and they end by liking all undertakings in which chance plays a part. They are therefore all led to engage in commerce, not only for the sake of the profit it holds out to them, but for the love of the constant excitement occasioned by that pursuit.194

193. Other factors include tax bases and rates, minimum capitalization requirements, limitations on the numbers of directors, provisions relating to the personal liability of directors and officers, restrictions on the payment of dividends, restrictions on the location of meetings of shareholders or directors, costs of organization, and annual filing fees. See generally G. Seward & W. Nauss, Basic Corporate Practice (2d ed. 1977).

Yet business activity more accurately thrives, and encourages investment from a variety of sources, where the associated risk is carefully controlled. Limited liability serves such a purpose for the American corporate enterprise. Well counseled investors will understand that, especially in closely held corporations, it is incumbent upon them to safeguard their limited liability by maintaining the fiction, and thereby the integrity, of the corporate form.

The doctrine of piercing the corporate veil serves as a safety valve—an important exception to limited liability in particularly egregious circumstances. As the discussion herein has demonstrated, how egregious the circumstances must be varies significantly among the three jurisdictions in the capital region. Prudent corporate shareholders will know how the doctrine is applied and will run their businesses accordingly.