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## THE HELTER SKELTER APPLICATION OF THE REVERSE PIERCING DOCTRINE

*Michael Richardson\**

### I. INTRODUCTION

The essence of the corporate form is that it offers financial protection to the parties involved. Individuals wishing to begin a business can do so without putting themselves at risk of substantial personal liability. Likewise, corporations can secure financing through outside shareholders without concern that the misdeeds and misfortunes of their equitable owners will create problems. This desire for protection reflects the reality that creditors, both voluntary and involuntary, will seek to attach any assets they are legally able to in order to satisfy the debts owed them.

This continuing conflict between debtors hiding behind the shield of the corporate form and their creditors has resulted in substantial case law on piercing the corporate veil. In the prototypical case, a creditor with a right to the assets of an undercapitalized corporation seeks to execute against the assets of the party who owns and controls the corporation.<sup>1</sup> If the owner has intentionally abused the corporate form to profit excessively and shield himself from loss while disregarding the possibility of harm to third parties, the theory holds that this creditor should collect from the owner as if he and the corporation were one. This practice, while tightly regulated, is widely accepted.

Less frequently, parties will try to pierce the corporate veil “in reverse.” “Outsider” reverse piercing occurs when a party with a claim against an individual or corporation attempts to be repaid with assets of a corporation owned or substantially controlled by the defendant.<sup>2</sup> In doing so, plaintiffs attempt to increase the ease of collecting on their

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1. See *infra* Part II.

2. In “insider” reverse piercing, by contrast, the controlling members will attempt to ignore the corporate fiction in order to take advantage of a benefit available to the corporation, such as an interest in a lawsuit or protection of personal assets. For a more complete analysis of the distinction between insider and outsider reverse piercing, see Gregory S. Crespi, *The Reverse Pierce Doctrine: Applying Appropriate Standards*, 16 J. CORP. L. 33 (1990). Outsider reverse piercing is the subject of the present analysis, and references to reverse piercing hereinafter will refer to the outsider form unless specified.

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judgment by skipping the intermediary step of seizing the defendant's interest in the corporation.<sup>3</sup> Outsider reverse piercing flips the traditional doctrine on its head by contemplating the seizure of corporate assets in a suit against an owner.

What remains unsettled is how courts should handle the reverse situation, where a corporation is held responsible for the debts and misdeeds of its shareholder. At first glance, reverse piercing of the corporate veil appears to require the same examination as traditional piercing.<sup>4</sup> As such, with the notable exception of the Tenth Circuit,<sup>5</sup> reverse piercing grew to become increasingly accepted by state and federal courts, often applying the same analysis.<sup>6</sup> On the other hand, this simplified application of a distinct concept may be what Cardozo warned of when he said “[m]etaphors in law are to be narrowly watched, for starting as devices to liberate thought, they end often by enslaving it.”<sup>7</sup> What do the two versions of piercing the corporate veil have in common, other than a metaphor? In what ways is applying liability to a corporation different than from an individual? How are the relevant parties affected? Is reverse piercing necessary, or are there alternative means of achieving the same end? If the doctrine is to have prospective application, its relation to traditional veil piercing must be more closely examined.

Outsider reverse piercing is supported by an analogy that breaks down under scrutiny due to the different set of affected parties and the strength of their interests. Other jurisdictions should follow the Tenth Circuit's lead and abandon it.<sup>8</sup> The purpose of this Comment is to examine judicial application of the reverse piercing doctrine, from its beginnings to the changes of the past few decades, as well as the underlying reasoning presented by the courts for or against its application. After providing a detailed analysis of traditional piercing of the corporate veil in Part II, Part III illustrates how reverse piercing is handled by the courts—from an identical analysis borrowed from traditional piercing to a refusal to apply it and every gradation in between. Part IV uses the

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3. See *infra* Part IV.A (discussing the traditional judgment collection methods).

4. See Kurtis A. Kemper, *Acceptance and Application of Reverse Veil Piercing*, 2 A.L.R. 6th 195 (2005) (“[R]everse piercing of the corporate veil . . . and traditional piercing . . . are viewed by the courts as opposite sides of the same coin. The same considerations are usually at issue regardless of which direction a third party attempts to reach through the veil.”).

5. See *infra* Part III.B (discussing the doctrine as it has developed within the Tenth Circuit).

6. See *infra* Part III.A.

7. *Berkey v. Third Ave. Ry. Co.*, 155 N.E. 58, 61 (N.Y. 1926).

8. This has occurred to some extent, as jurisdictions have adopted the reasoning of Tenth Circuit cases on reverse piercing. See, e.g., *Acree v. McMahan*, 585 S.E.2d 873 (Ga. 2003). As the following sections will show, however, this adoption is far from uniform.

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multiple factors enumerated by the courts to analyze the reverse piercing doctrine's appropriateness as an equitable remedy as well as its responsiveness to the rights of plaintiffs, defendants, shareholders, and third-party creditors. Part V concludes that reverse piercing is too dangerous to innocent parties to be preferred over existing judgment collection tools and should thus be abandoned by all jurisdictions.

## II. TRADITIONAL PIERCING OF THE CORPORATE VEIL—BACKGROUND

It is a basic concept of corporate law that corporations are legal entities separate from their shareholders. In fact, this distancing of individual from corporation has been referred to as the cornerstone of American business law under the common law, allowing for individuals to engage in business while limiting their personal liability should the corporation fail.<sup>9</sup> Given the importance of the fiction of the corporation, courts are understandably reluctant to pierce the corporate veil except in extreme circumstances. Nevertheless, it is widely accepted that piercing of the corporate veil is allowed where maintaining the corporate fiction would create an unjust result.<sup>10</sup> Where exactly this line should be drawn, however, is unclear and varies widely, making piercing of the corporate veil one of the most frequently litigated issues in corporate law.<sup>11</sup>

The relevant factors and typical scenarios are evident in an example where piercing was permitted. In *NetJets Aviation, Inc. v. LHC Communications, LLC*,<sup>12</sup> LHC Communications (LHC) and its primary investor Laurence Zimmerman were sued for breach of contract and unsettled accounts. LHC was one of many companies started and fully funded by Zimmerman, who used it to invest in various communications and internet technology companies.<sup>13</sup> NetJets contracted with Zimmerman, through LHC, to provide use of an airplane and related

9. See, e.g., *De Brececi v. Graf Bros. Leasing, Inc.*, 828 F.2d 877 (1st Cir. 1987).

10. Much criticism remains, however, about the consistency of its application, particularly when applied to limited liability entities. See, e.g., David Millon, *Piercing the Corporate Veil, Financial Responsibility, and the Limits of Limited Liability*, 56 EMORY L.J. 1305 (2007).

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

12. 537 F.3d 168 (2d Cir. 2008). This case dealt with collection against a limited liability company rather than a corporation. The court, however, found that LLCs have "limited liability akin to the corporate form" and analyzed piercing in a manner indistinguishable from its application to corporations, including citing authorities which referred only to corporations. *Id.* at 176 (quoting *Elf Atochem N. Am., Inc. v. Jaffari*, 727 A.2d 286, 287 (Del. 1999)); *id.* (citing *Geyer v. Ingersoll Publ'ns Co.*, 621 A.2d 784 (Del. Ch. 1992)).

13. *Id.* at 179.

services.<sup>14</sup> Zimmerman invested and withdrew money from LHC at will in informal transactions demarcated “loans” before LHC became undercapitalized and stopped doing business altogether.<sup>15</sup> At the time, over \$300,000 in costs incurred were still owed to NetJets.<sup>16</sup> After noting that Zimmerman used the company as his alter ego<sup>17</sup> by intermingling its funds with his own and not observing corporate formalities, the court stated there was sufficient evidence that LHC had become undercapitalized through unjustified withdrawals by and purchases on behalf of Zimmerman.<sup>18</sup> This fact pattern, and the legal analysis applied by the courts, is typical of veil piercing cases.

Courts determining the appropriateness of disregarding the corporate form do so based on a number of factors that can be divided roughly into two prongs: control and equity.<sup>19</sup> First, a plaintiff is required to demonstrate that the person from which relief is sought had domination of the corporation whose veil would be pierced. Sometimes termed instrumentality, this is a central factor in piercing and the reason why the “alter ego” doctrine is the label sometimes used interchangeably with piercing.<sup>20</sup> Determining control can involve a look at the corporation’s diversity of ownership, intermingling of corporate assets with those of another person, and the observance of corporate formalities.<sup>21</sup> This can readily apply both to the relationship between a parent corporation and its subsidiary or one or more owners of a close corporation. In *NetJets*, the corporation had a single shareholder, observed very few corporate formalities, and intermingled its profits with the funds of its owner, all evidencing Zimmerman’s control.

Secondly, the injury alleged must result from utilizing corporate control for a fraudulent, illegal, or otherwise inequitable purpose.<sup>22</sup> This

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14. *Id.* at 172.

15. *Id.* at 183.

16. *Id.* at 173.

17. The term “alter ego” applies in corporate law to a situation where the corporation is “a mere instrumentality” of a controlling party so that the acts of one may be imputed to the other. *XL Vision, LLC v. Holloway*, 856 So. 2d 1063, 1066 (Fla. Dist. Ct. App. 2003) (quoting *Bellairs v. Mohrmann*, 716 So.2d 320, 323 (Fla. Dist. Ct. App. 1998)). Determination of alter ego status is highly intertwined with the control prong and is sometimes treated as an independent test. See *infra* notes 81–91 and accompanying text.

18. *NetJets*, 537 F.3d at 184.

19. See, e.g., *Laborers’ Pension Fund v. Lay-Com, Inc.*, 580 F.3d 602, 610 (7th Cir. 2009). This of course is a great simplification of a complex, multi-factor analysis. Even wide ranging tests, however, such as the twelve-factor analysis employed by the Fifth Circuit in *United States v. Jon-T Chemicals, Inc.* can be broadly grouped and separated according to these prongs. 768 F.2d 686 (5th Cir. 1985).

20. See, e.g., *XL Vision*, 856 So. 2d at 1066.

21. See, e.g., *Zimmerman v. Puccio*, 613 F.3d 60 (1st Cir. 2010).

22. See, e.g., *NetJets*, 537 F.3d at 177.

may take the form of undercapitalization or fraudulent conveyance<sup>23</sup> in the most typical cases. *NetJets* is a typical case of fraudulent conveyance by the owner under the guise of personal loans, resulting in undercapitalization and refusal to pay established debts. After canceling his contract with NetJets, Zimmerman withdrew from the company an amount greater than that owed to NetJets, proving that the corporate assets were sufficient to pay the debt before Zimmerman's interference.<sup>24</sup>

While the common law determination for piercing the corporate veil is far from settled and uniform, the two-prong analysis provides an accurate paraphrase of the evaluation conducted by some jurisdictions,<sup>25</sup> and a summary of the factors used in others.<sup>26</sup> The standard has developed to examine the unique facets of a traditional piercing. The central question is whether the corporation has taken particular actions that amount to a waiver of the corporate veil's protection of shareholders. In developing a corresponding framework for dealing with reverse piercing, courts would be required to determine how to shift the focus to the actions of the individual as they affect the rights of the corporation, its shareholders, and its creditors. As Parts III and IV will show below, this altered focus has been slow to develop or ignored altogether.

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23. While "fraudulent conveyance" is used here to refer generally to secreting or misuse of assets, it should be noted that fraudulent conveyance is its own term of art describing a creditor's remedy for dishonest distribution of assets, particularly in the context of bankruptcy. See 11 U.S.C. § 548 (2006). For criticism of reverse piercing used as a shortcut to achieve the same end, see *infra* notes 141–146 and accompanying text.

24. *NetJets*, 537 F.3d at 184.

25. See, e.g., *Belvedere Condo. Unit Owners' Ass'n v. R.E. Roark Cos.*, 617 N.E.2d 1075, 1086 (Ohio 1993) ("[T]he corporate form may be disregarded and individual shareholders held liable for corporate misdeeds when (1) control over the corporation by those to be held liable was so complete that the corporation has no separate mind, will, or existence of its own, (2) control over the corporation by those to be held liable was exercised in such a manner as to commit fraud or an illegal act against the person seeking to disregard the corporate entity, and (3) injury or unjust loss resulted to the plaintiff from such control and wrong.").

26. See, e.g., *Hamilton v. Water Whole Int'l Corp.*, 302 F. App'x 789, 793 (10th Cir. 2008) (holding that the factors include "(1) whether the dominant corporation owns or subscribes to all the subservient corporation's stock, (2) whether the dominant and subservient corporations have common directors and officers, (3) whether the dominant corporation provides financing to the subservient corporation, (4) whether the subservient corporation is grossly undercapitalized, (5) whether the dominant corporation pays the salaries, expenses or losses of the subservient corporation, (6) whether most of the subservient corporation's business is with the dominant corporation or the subservient corporation's assets were conveyed from the dominant corporation, (7) whether the dominant corporation refers to the subservient corporation as a division or department, (8) whether the subservient corporation's officers or directors follow the dominant corporation's directions, and (9) whether the corporations observe the legal formalities for keeping the entities separate." (quoting *Gilbert v. Sec. Fin. Corp. of Okla.*, 152 P.3d 165, 175 (Okla. 2006)).

## III. REVERSE PIERCING—DEVELOPMENT AND DIVERGENCE IN CASE LAW

Reverse piercing claims are rooted in the 1929 case of *Kingston Dry Dock Co. v. Lake Champlain Transportation Co.*<sup>27</sup> Kingston, following repairs made by the request of the defendant, Lake Champlain Transportation, looked to collect debts owed by attaching the assets of a subsidiary of the defendant.<sup>28</sup>

The Second Circuit came out strongly against the application of the veil piercing doctrine in reverse. To begin, there was nothing beyond a shared set of directors to show that the subsidiary had participated sufficiently in the action giving rise to the debt to create liability, much less controlled the parent company.<sup>29</sup> The court went so far as to say that reverse piercing would be appropriate only in rare circumstances, if ever.<sup>30</sup> In dwelling upon the infrequency with which control by a subsidiary could be found, the court implicitly recognized that a traditional veil piercing analysis is inapplicable.<sup>31</sup>

While this would appear to signal a developing break in the common law between traditional and reverse piercing, the Second Circuit rooted its decision entirely in the traditional analysis, citing its decision in *Costan v. Manila Electric Co.*<sup>32</sup> to show that the central element was the issue of control.<sup>33</sup> Proceeding through this lens, the court looked at the level of control that the subsidiary had, particularly its influence on its parent company with regard to the specific action giving rise to the debt at issue.<sup>34</sup> As there was no evidence of the subsidiary intervening in the actions of its parent or attempting to make the parent an agent of the subsidiary, the court reasoned, there was no control exercised by the subsidiary, and reverse piercing would be inappropriate.<sup>35</sup>

The court failed to conduct a full analysis of how closely reverse piercing cases resembled their traditional counterparts, and to what extent the same interests were involved. In so doing, Judge Learned Hand provided muddled reasoning that presaged the reverse piercing debate that exists to this day. In the eighty years since *Kingston*, jurisdictions have distinguished themselves based on whether they apply old tests to unique facts (as in *Kingston*), look at reverse piercing as a

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27. 31 F.2d 265 (2d Cir. 1929).

28. *Id.* at 265.

29. *Id.* at 267.

30. *Id.*

31. *Id.*

32. 24 F.2d 383 (2d Cir. 1928).

33. *Kingston*, 31 F.2d at 267.

34. *Id.*

35. *Id.*

wholly distinct (and perhaps misguided) concept, or fall somewhere in between.

The remainder of this Part outlines the factors considered and tests applied in these cases. Subpart A will look at examples of courts strictly applying the traditional two-prong test. Subpart B will look at the opposite trend: courts ruling out any application of reverse piercing. Finally, Subpart C will explore the wide range of factors and considerations applied by other jurisdictions. This will set the stage for Part IV's analysis of the best approach to reverse piercing.

#### *A. The Two-Prong Test—The Emergence of Reverse Piercing*

One of the first jurisdictions to embrace the practice of reverse piercing was the State of Washington following its Supreme Court's decision in *W.G. Platts v. Platts*.<sup>36</sup> In *Platts*, Beatrice Platts obtained by attachment land owned by the plaintiff corporation according to a divorce settlement between Beatrice and Willard Platts.<sup>37</sup> The dispute arose when this lien was challenged by the corporation.<sup>38</sup> The court cited to the ruling precedent in the jurisdiction regarding traditional piercing of the corporate veil and applied its two-prong test without alteration.<sup>39</sup> The court found that Willard did "control and use the corporation as a tool or instrument for carrying out his own plans and purposes," justifying liability.<sup>40</sup> Unlike *Kingston*, the *Platts* court did not specifically require that the controlled corporation be somehow involved in the conduct that was the subject matter of the suit.<sup>41</sup> While the equity prong was applied, it had a unique application in this case because Willard had agreed to the attachment during negotiations over the divorce settlement, treating the corporation as a marital asset.<sup>42</sup> Therefore, the court reasoned, it would be unconscionable to use the corporate form as a shield relieving him of agreed to obligations.<sup>43</sup>

Strict adherence to the two-prong test is perhaps most clearly present

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36. 298 P.2d 1107 (Wash. 1956).

37. *Id.* at 1108.

38. *Id.*

39. *Id.* at 1110–11 (citing *Platt v. Bradner Co.*, 230 P. 633 (Wash. 1924)).

40. *Id.*

41. *But cf.* *Ackerman v. Sobol Family P'ship, LLP*, No. CV030826123, 2004 Conn. Super. LEXIS 1270 (Conn. Super. May 12, 2004) (dismissing a reverse piercing claim that failed to allege sufficiently that the corporation, acting under the control of the individual defendant, was the source of the inequity).

42. *Platts*, 298 P.2d at 1108. Willard refuted that he had actually agreed, but the court found otherwise based on documentation from the lower court. *Id.*

43. *Id.* at 1111.



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in New York, which routinely follows the precedent established in *State v. Easton*.<sup>44</sup> Following a \$7.5 million judgment against Karl Easton for Medicare fraud,<sup>45</sup> the State of New York attempted to attach the assets of two corporations, Cobble Hill Center Corp. and the 3 Lafayette Avenue Corp., allegedly controlled by Easton.<sup>46</sup> Although no New York precedent at that time had clearly established reverse piercing, the *Easton* court felt that “conceptually ‘reverse’ piercing is not inconsistent with nor antithetical to the salutary purposes of traditional piercing.”<sup>47</sup> Believing that the control and equity prongs, when properly applied, could produce equally just results in reverse piercing cases, the court held that the two-prong test should apply just as readily to reverse piercing.<sup>48</sup> Lest there be any doubt about nuances differentiating the two versions of piercing, the court provided one of the most definite statements yet written about the handling of reverse piercing: “[t]he direction of the piercing is immaterial where the general rule has been met.”<sup>49</sup>

The *Easton* standard was recognized as law in New York when it was adopted by the Second Circuit Court of Appeals in *American Fuel Corp. v. Utah Energy Development Co.*<sup>50</sup> American Fuel sought to use the reverse piercing doctrine not for a collection of damages, but to bind Utah Energy to an arbitration agreement signed by its president, Robert Nead, as part of an employment agreement with American Fuel.<sup>51</sup> Although the *American Fuel* court reversed the lower court and refused to pierce the corporate veil in reverse, it did so because it found that the two-prong test had not been satisfied.<sup>52</sup> Specifically, the presence of a co-founder with equal involvement negated allegations of Nead’s

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44. 169 Misc. 2d 282 (N.Y. Sup. Ct. 1995). While only a lower court decision, *Easton* was recognized by the Second Circuit as representing New York law, and has since been cited numerous times as the guiding precedent in reverse piercing cases. See *Am. Fuel Corp. v. Utah Energy Dev. Co.*, 122 F.3d 130 (2d Cir. 1997); see also, e.g., *Spinnell v. J.P. Morgan*, 59 A.D.3d 361 (N.Y. App. Div. 2009); *Sweeney, Cohn, Stahl & Vaccaro v. Kane*, 6 A.D.3d 72 (N.Y. App. Div. 2004).

45. *People v. Brooklyn Psychosocial Rehab. Inst.*, 585 N.Y.S.2d 776 (N.Y. App. Div. 1992).

46. *Easton*, 169 Misc. 2d at 283. While *Easton* did not personally own any portion of the corporations, the entirety of their stock was owned by his infant children, who graciously allowed him to act as president. *Id.* at 284.

47. *Id.* at 289.

48. *Id.* at 289–90.

49. *Id.* at 290.

50. *Am. Fuel*, 122 F.3d at 130. New York law was relied on in spite of the fact that the defendant was incorporated in Utah because “[a]t oral argument, both parties stressed that the law of New York and Utah is virtually identical regarding piercing of the corporate veil, and we follow their lead.” *Id.* at 134. This is slightly ironic given the interpretation of Utah law by the Tenth Circuit Court of Appeals.

51. *Id.* at 131.

52. *Id.* at 134–35.

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absolute control, and the specifics of the alleged breach of contract were not sufficiently fraudulent or wrongful.<sup>53</sup> The court unequivocally held that “New York law recognizes ‘reverse’ piercing,”<sup>54</sup> and has since been cited for that proposition.<sup>55</sup>

As exemplified by these cases, the simplest and most intuitive approach to reverse piercing cases is a straightforward application of the traditional veil piercing test that predated reverse piercing cases and is still widely accepted.<sup>56</sup> The result is an analysis that focuses exclusively on the conduct and status of the party sued to determine if the party has control over the corporation and if equity dictates relief beyond the assets of that party.

*B. The Tenth Circuit Doctrine—The Disposition of Reverse Piercing*

Far from the strict application of the traditional two-prong test preferred in New York, the Tenth Circuit Court of Appeals has been a leading proponent of severely limiting reverse piercing, or even eliminating it altogether. A seminal case arguing against reverse piercing of the corporate veil is *Cascade Energy & Metals Corp. v. Banks*,<sup>57</sup> which arose from a dispute between parties with partial interests in an underperforming gold mine in Eastern California.<sup>58</sup> The plaintiff, Cascade Energy & Metals Corporation (Cascade), was primarily owned by W. David Weston.<sup>59</sup> After purchasing the goldmine, Cascade entered into a joint venture with two other corporations partially owned and controlled by Weston and Cascade.<sup>60</sup> Working interests were then sold to thirty-five individual investors, who agreed to provide working costs and pay royalties for the product of the mine.<sup>61</sup> When production at the mine remained below expected levels and continued losing money, Cascade initiated the suit against individual investors who refused to pay further assessments that Weston had

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53. *Id.*

54. *Id.* at 134.

55. *See, e.g.,* *Ammirato v. Duraclean Int’l, Inc.*, 687 F. Supp. 2d 210, 220 n.5 (E.D.N.Y. 2010). Some New York courts continue to cite *Easton* rather than *American Fuel*. *See, e.g.,* *Spinnell v. J.P. Morgan*, 59 A.D.3d 361, 361 (N.Y. App. Div. 2009).

56. These are far from the only jurisdictions to, in at least some circumstances, apply the simple two-prong test. *See, e.g.,* *Sea-Land Servs., Inc. v. Pepper Source*, 941 F.2d 519, 520 (7th Cir. 1991) (citing *Van Dorn Co. v. Future Chem. & Oil Corp.*, 753 F.2d 565 (7th Cir. 1985)); *Emmons v. Hometown Builders*, No. CV-09-046, 2010 Me. Super. LEXIS 84 (Me. Super. Sep. 21, 2010).

57. 896 F.2d 1557 (10th Cir. 1990).

58. *Id.* at 1563.

59. *Id.* at 1561–62.

60. *Id.* at 1564.

61. *Id.*

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informed them were necessary to continue operating the mine.<sup>62</sup> The investors countered that Weston had fraudulently misdirected Cascade's funds for personal use and committed securities violations.<sup>63</sup> After a series of cross- and counter-claims, virtually all the parties with an interest in the mine became a party to the suit, as well as various companies partially or totally owned and controlled by Weston.<sup>64</sup>

The relevant portion of the district court's decision held that Weston and the Weston Companies were jointly and severally liable for the wrongful actions of Weston.<sup>65</sup> The basis of the holding was that the companies were mere alter egos of Weston, justifying a reverse veil-piercing to reach the assets of each controlled corporation.<sup>66</sup> The Tenth Circuit reversed the lower court, providing several reasons to reject the theory of reverse piercing altogether: (1) the presumption is that the corporate form should not be disregarded; (2) reverse piercing would unnecessarily bypass traditional judgment collection procedures; (3) innocent shareholders of the corporations would be harmed; and (4) there are traditional, well-established theories of law that accomplish the same goals without the need to recognize a duplicative new theory of reverse piercing.<sup>67</sup>

While these arguments presented clear reasons to abandon reverse piercing, the court fell short of plainly holding reverse piercing should never be recognized by also arguing that it should not apply to the specific facts in the case. Namely, the court held that the Weston Corporations were sufficiently distinct from their owner, that they could not be termed alter egos, that Weston's ownership of other companies was not instrumental in the fraud he perpetuated, and that reverse piercing was less appropriate in consensual relationships than in the context of torts.<sup>68</sup>

The Tenth Circuit again provided a clear condemnation of reverse piercing in *Floyd v. IRS*.<sup>69</sup> Thomas Bridges was the sole shareholder and director of two corporations, each of which paid Bridges's salary to

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62. *Id.* at 1566.

63. *Id.*

64. *Id.* These companies in which Weston had a controlling interest in shall hereafter be referred to as the "Weston Companies."

65. *Id.* at 1574.

66. While this exact phraseology was not used by the lower court, the *Cascade* court extrapolated this basis from the underdeveloped analysis of why joint and several liability was appropriate. *Id.* at 1575.

67. *Id.* at 1576–77.

68. *Id.* at 1577–78.

69. 151 F.3d 1295 (10th Cir. 1998).

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a third corporation he controlled.<sup>70</sup> The IRS, the State of Kansas, and a group of judgment creditors all asserted claims against Bridges and his companies, giving rise to a dispute over priority.<sup>71</sup> In particular, the parties asked the Court to determine if priority rights to the Bridges Companies' assets could be obtained through a tax lien against Bridges using a reverse piercing theory, as the lower court had determined.<sup>72</sup>

In reversing the lower court decision, the *Floyd* court began by referring back to the lines of reasoning set forth in *Cascade* before adding new arguments in opposition to reverse piercing.<sup>73</sup> The court noted that reverse piercing makes it possible (as occurred in the present case) for business creditors to have their rights subsumed by creditors of an individual shareholder.<sup>74</sup> In addition to being unfair to those creditors who could not predict losing priority in such a manner, the court also predicted that it could damage businesses ability to obtain credit as a result of the greater fear of losing assets.<sup>75</sup>

This doctrine can be identified as one unique to the Tenth Circuit, even more so than its constituent states individually. While both *Cascade* and *Floyd* were framed as interpretations of governing state law<sup>76</sup>—Utah and Kansas, respectively—a superficial analysis shows that little input from state courts was considered. In fact, the *Floyd* court acknowledged that the Kansas Supreme Court recognized reverse piercing, but reasoned that this holding was limited to a jurisdictional context.<sup>77</sup> Similarly, the court in *Cascade* referred to the Utah Supreme Court's decision in *Messick v. PHD Trucking Service, Inc.*<sup>78</sup> only to quote it calling reverse piercing "little-recognized."<sup>79</sup> The *Cascade* court chose not to mention that the *Messick* court went on to apply the traditional two-prong veil piercing test and deny the reverse piercing only because the alter ego test was not satisfied.<sup>80</sup>

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70. *Id.* at 1296. These companies shall hereafter be referred to as the "Bridges Companies."

71. *Id.*

72. *Id.* at 1297.

73. *Id.* at 1299.

74. *Id.* (citing *In re Hamilton*, 186 B.R. 991, 1000 (Bankr. D. Col. 1995)).

75. *Id.*

76. See *Cascade Energy & Metals Corp. v. Banks*, 896 F.2d 1557, 1577 (10th Cir. 1990); *Floyd*, 151 F.3d at 1299. Subsequent Tenth Circuit cases likewise refused to allow veil piercing claims "[i]n the absence of a clear statement" by state courts on the matter. See *In re Denton*, No. 99-6059, 2000 Colo. J. C.A.R. 524 (10th Cir. Jan. 31, 2000) (unpublished) (The court's decision is also referenced in a "Table of Decisions Without Reported Opinions" appearing at 203 F.3d 834 (10th Cir. 2000).).

77. *Floyd*, 151 F.3d at 1299 n.4 (citing *Fahra v. Signal Cos.*, 532 P.2d 1330 (Kan. 1975), *modified*, 535 P.2d 463 (Kan. 1975)).

78. 678 P.2d 791 (Utah 1984).

79. *Cascade*, 896 F.2d at 1575 n.17.

80. *Messick*, 678 P.2d at 794-95.

Whether it be termed the ruling law of Utah, Kansas, or the Tenth Circuit itself, the precedent established in *Cascade* and *Floyd* provides an even simpler framework for deciding on claims of reverse piercing: under all circumstances, deny. The Tenth Circuit clearly sees the ample legal alternatives to reverse piercing as superior to the risk of damage to third parties with an unprotected interest in the assets of a besieged corporation. Many of the same concerns voiced in *Cascade* and *Floyd* can be found (individually or in some combination) in the cases discussed in the following subpart.

*C. The State of the Law—Divergent Application of Reverse Piercing*

If the two-prong test and the Tenth Circuit doctrine can be seen as opposite ends of the spectrum, state courts and the federal courts applying their law have explored nearly every shade in between. Each jurisdiction attempting to find the proper rule of law—or at least proper resolution of the case at bar—has looked at different factors in determining where to draw the line between acceptable and unacceptable reverse piercing of the corporate veil. The result in some cases is not a clear test at all, but merely one or more factors deemed relevant in that particular case. In order to provide an overall picture of the legal landscape, it is necessary to look at the divergent circumstances that have swayed jurisdictions on whether reverse piercing is an acceptable practice.

In *McCall Stock Farms, Inc. v. United States*, the Court of Appeals for the Federal Circuit focused heavily on whether the entities involved were alter egos of each other.<sup>81</sup> John and Phyllis McCall were the sole proprietors of the McCall Stock Farms, Inc. (MSFI), in which they invested a loan made to them by the Small Business Administration (SBA).<sup>82</sup> When the McCalls defaulted, the SBA attempted to collect by offsetting payments made to MSFI by the Agricultural Stabilization and Conservation Service, a Department of Agriculture program.<sup>83</sup> The court's analysis consisted mainly of delineating the ways in which the McCalls had ignored proper corporate form.<sup>84</sup>

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81. 14 F.3d 1562 (Fed. Cir. 1993). The court intentionally declined to distinguish whether its ruling was made under Iowa or federal common law, viewing them as the same on the relevant issues. *Id.* at 1569 n.6.

82. *Id.* at 1564.

83. *Id.* at 1564–65.

84. *Id.* at 1569 (“It is undisputed that MSFI had no savings account, no financial reserves, no investments, and no assets apart from a few pick-up trucks. All the land subject to MSFI’s operations was casually leased to it without formal instruments, and all the farm equipment was owned personally by the McCalls and leased to MSFI. No capital was invested in the corporation. The individuals made

The *McCall* court did not analyze whether the corporation was being used to perpetuate a fraud or inequity or make an explicit finding on the equity prong. While the court explained that even traditional veil piercing required only constructive and not actual fraud, the court did not delineate how the facts of the case represented even constructive fraud.<sup>85</sup> The *McCall* decision simplifies the two-prong test to a single prong by relying solely on a finding that one party was the alter ego of another, even if the controlled entity was not used in a fraudulent manner.<sup>86</sup>

A similar but far more restrictive test has been recently applied by California courts. California courts have a broad policy prohibiting reverse piercing to reach corporate assets.<sup>87</sup> In *In re Schwarzkopf*,<sup>88</sup> the U.S. Ninth Circuit Court of Appeals showcased the narrow exception to California's general policy against reverse piercing of the corporate veil.<sup>89</sup> According to the court, trusts determined to be the alter ego of the debtor lose their status as independent legal entities.<sup>90</sup> As a result, the assets of an alter ego trust (and no other corporate entity) are vulnerable to reverse piercing under current California law.<sup>91</sup>

*McCall* may also be considered as an example of deference to the collection of debts by the government. Courts appear to be least resistant when the matter involves collecting taxes from a trust or other entity in which the delinquent taxpayer has a controlling interest.<sup>92</sup> In *United States v. Bigalk*, the government attempted to collect estate taxes it found owing from a farm the defendants allegedly transferred fraudulently to a trust prior to the owner's death.<sup>93</sup> The U.S. District Court for the District of Minnesota stated that it was to "look to state law when determining whether an entity is the alter ego of a taxpayer."<sup>94</sup>

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loans to the corporation that were never repaid. These loans to MSFI were not formally documented, had no terms of payment, and bore no interest. MSFI never paid its corporate officers any salary or other compensation. The corporation never declared any dividends. Mr. and Mrs. McCall made all the decisions regarding the corporation's farm business.").

85. *Id.* at 1568.

86. *See* Fed. Deposit Ins. Corp. v. Almodovar, 671 F. Supp. 851 (D.P.R. 1987).

87. *See, e.g.*, Postal Instant Press, Inc. v. Kaswa Corp., 162 Cal. App. 4th 1510, 1512-13 (Cal. Ct. App. 2008).

88. No. 08-56974, 2010 U.S. App. LEXIS 24046 (9th Cir. 2010).

89. *Id.* at \*12 (citing *Postal Instant Press*, 162 Cal. App. 4th at 1512).

90. *Id.* at \*12-\*13 (citing *Wood v. Elling Corp.*, 572 P.2d 755, 762 (Cal. 1977)).

91. *Id.* at \*13.

92. *See, e.g.*, *United States v. Boscaljon*, No. CIV.07-4111, 2010 U.S. Dist. LEXIS 26980 (D.S.D. Mar. 22, 2010); *Century Hotels v. United States*, 952 F.2d 107 (5th Cir. 1992) (disregarding that Louisiana precedents did not recognize reverse piercing claims).

93. 654 F. Supp. 2d 983 (D. Minn. 2009).

94. *Id.* at 994.

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Defendants cited Minnesota law that reverse piercing was not accepted.<sup>95</sup> The court did not dispute the validity of reverse piercing under Minnesota law, but rather held that “[r]everse piercing is a well-established theory in the federal tax realm.”<sup>96</sup>

The deference to the government in tax cases may also be explained by the reasoning that avoiding tax payments is itself sufficient to satisfy the equity prong.<sup>97</sup> This reasoning, however, is not as often applied to hiding assets when a government agency is not involved.<sup>98</sup> Compared to federal agencies, bankruptcy trustees have faced a much more mixed reception when trying to reach assets of a third party corporation owned by the debtor prior to filing for bankruptcy. *In re Schuster*<sup>99</sup> addressed a trustee attempting to reach assets of the North Scooter Inn. The debtor had given his wife his one-half interest in the corporation a year prior to filing for bankruptcy.<sup>100</sup> Similar to the reasoning in the tax evasion cases, the Bankruptcy Court for the District of Minnesota held that reverse piercing should be allowed—and the opposing motion to dismiss denied—because allowing the debtor to shield his assets by hiding them in a corporation until the debt was discharged would itself be inequitable.<sup>101</sup> This may explain why other districts have allowed reverse piercing in bankruptcy disputes even when it is undisputed that the debtor did not intend to defraud any creditors and when the formal elements of a fraudulent conveyance are not addressed.<sup>102</sup>

In *Daily v. Lilipuna Associates*,<sup>103</sup> the Ninth Circuit acknowledged this “prevailing trend” of bankruptcy courts permitting reverse piercing claims.<sup>104</sup> The court, however, dismissed the claim before it as the debtor was not a shareholder when he filed for bankruptcy, which the

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95. *Id.* at 995.

96. *Id.* (quoting *United States v. Scherping*, 187 F.3d 796, 803 (8th Cir. 1999); *cf. Century Hotels*, 952 F.2d at 110 (citing *Owens & Sons, Inc. v. Guastella East, Inc.*, 354 So. 2d 571 (La. Ct. App. 1977) (distinguishing state case law opposed to reverse piercing by saying it did not render a decision on the relevant issue, contrary to a plain reading of the case)).

97. *Brownfield Inv. Corp., Nev. v. United States*, 74 A.F.T.R. 2d (RIA) 5452 (9th Cir. 1994) (unpublished) (The court’s decision is also referenced in a “Table of Decisions Without Reported Opinions” appearing at 28 F.3d 105 (9th Cir. 1994)).

98. *See, e.g., Sea-Land Servs., Inc. v. Pepper Source*, 941 F.2d 519 (7th Cir. 1991) (holding that avoidance of a judicially imposed recovery was not on its own sufficient to satisfy the equity prong); *Thomsen Family Trust v. Peterson Family Enters.*, 989 S.W.2d 934 (Ark. Ct. App. 1999) (upholding transfer of stock in a family farm to a trust that the debtor owned 98% of on the basis that the corporation was not involved in any wrongdoing).

99. 132 B.R. 604 (Bankr. D. Minn. 1991).

100. *Id.* at 606.

101. *Id.* at 612.

102. *See In re Mass*, 178 B.R. 626, 630 (M.D. Pa. 1995).

103. No. 95-16370, 1996 U.S. App. LEXIS 8391 (9th Cir. Apr. 4, 1996).

104. *Id.* at \*10.

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court believed to be a controlling factor in similar cases.<sup>105</sup> The court was not moved by the fact that the debtor's shares had simply been transferred to his children for allegedly less than reasonable value.<sup>106</sup>

Government agencies and bankruptcy trustees are not the only class of plaintiffs held to a different standard in deciding reverse piercing issues. A Connecticut Superior Court in *Stotz v. Everson*<sup>107</sup> dismissed a reverse piercing claim arising from a lease. The corporation to be pierced occupied the space originally leased by one of its owners, John Everson, who had ceased making payments under the lease.<sup>108</sup> The court differentiated between tort claimants and those bringing an action such as breach of contract, stating that it had "serious reservations about granting equitable relief in what is essentially a breach of contract action."<sup>109</sup> Because the plaintiff's claim was a breach of a lease, a pure contract claim, the court held that exceptional circumstances would be required to find that an equitable remedy such as reverse piercing was warranted.<sup>110</sup>

In some jurisdictions, particular interest is paid to the potential for collateral damage to innocent third parties, stock holders in particular. The U.S. District Court for the District of South Dakota in *United States v. Boscaljon*, gave relatively wide approval to reverse piercing, but specified that it was appropriate only "when no innocent individual would be harmed thereby."<sup>111</sup> This requirement was supported, albeit in less strong terms, by the Supreme Court of Nevada in *LFC Marketing Group, Inc. v. Loomis*,<sup>112</sup> which upheld a lower court's decision to permit reverse piercing in reliance upon the finding that the innocent shareholder of the corporation would not be harmed by forfeiting its assets for the debt of a vice president with no direct ownership of the corporation.<sup>113</sup>

Some courts have attempted to determine reverse piercing claims solely through the application of agency law. In *Flight Services Group v. Patten Corp.*, Patten, a defendant in a suit over the sale of an airplane,

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105. *Id.* at \*10–\*12.

106. *Id.* at \*4. *Accord In re Hamilton*, 186 B.R. 991 (Bankr. D. Col. 1995).

107. No. CV94 06 29 06, 1994 Conn. Super. LEXIS 3106 (Conn. Super. Ct. Nov. 8, 1994).

108. *Id.* at \*1.

109. *Id.* at \*3.

110. *Id.*

111. *United States v. Boscaljon*, No. CIV.07-4111, 2010 U.S. Dist. LEXIS 26980, at \*12 (D.S.D. Mar. 22, 2010).

112. 8 P.3d 841 (Nev. 2000).

113. *Id.* at 847. The Nevada Supreme Court, while mentioning the need to protect innocent shareholders, did not further examine the district court's finding that attaching \$25,000 in accounts payable to a corporation solely owned by an innocent party would not harm that owner.



brought a counterclaim for breach of fiduciary duty based on actions in the operation of a third company, Berkshire.<sup>114</sup> Two of Flight Services Group's (FSG) owners had an ownership interest in Berkshire as well.<sup>115</sup> The U.S. District Court for the District of Connecticut dismissed the counterclaim on the basis of agency law, stating that "[i]t does not make sense to impose liability on an agent for the actions of the principal where the agent is not otherwise liable."<sup>116</sup> FSG, the agent, was not responsible for the actions of its principals to the extent they affected another entity.

Another factor of interest for some courts has been the number of steps in between the individual and the corporation alleged to be an alter ego. In *Zahra Spiritual Trust v. United States*, the government looked to collect taxes due from Fadhalla and Muneera Haeri out of the assets of Dar Al-Hikmah, incorporated in the Netherlands, and Mudin Inc., a domestic corporation.<sup>117</sup> Both corporations were controlled by the Haeris and owned by the Haeri Trust, and their sole function was to own property that was freely used by the Haeris without a lease or other formal agreement.<sup>118</sup> The U.S. Fifth Circuit Court of Appeals expressed a strong belief that a piercing was justified because the corporation's assets were freely used by and intermingled with the property of the Haeris, yet remanded the case without allowing a reverse piercing. The trial court had determined control of the corporations by the Haeri Trust, but had not made a direct finding regarding the Haeris' control of the trust.<sup>119</sup>

The *Zahra* court relied in part on a decision by a Texas Court of Civil Appeals, *George v. Houston Boxing Club, Inc.*<sup>120</sup> The dispute in *George* was an alleged breach of contract, for which George sought relief from K.S. Adams.<sup>121</sup> Adams advanced all the money used to start the Houston Boxing Club (HBC), was not repaid for this "loan," and received all of the remaining assets when HBC was dissolved.<sup>122</sup> While he was not technically the owner, Adams held all of HBC's stock in trust for his children.<sup>123</sup> The court, in stating that the alter-ego test had not been satisfied, noted that "we find no Texas cases applying the alter ego

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114. 963 F. Supp. 158 (D. Conn. 1997).

115. *Id.* at 159.

116. *Id.* at 160.

117. 910 F.2d 240 (5th Cir. 1990), *aff'd*, 38 F.3d 569 (5th Cir. 1994).

118. *Id.* at 241-42.

119. *Id.* at 246.

120. 423 S.W.2d 128 (Tex. App. 1967).

121. *Id.* at 129.

122. *Id.* at 131.

123. *Id.*

doctrine to a situation where the individual owned none of the outstanding stock.”<sup>124</sup> The *George* court simply held that the use of a trust nominally shifting ownership is sufficient to defeat the control test. The court declined to take the extra step of analyzing why Adams’s control over the trust was insufficient to establish control.

In *Hartford Fire Insurance Co. v. CMC Construction Co.*,<sup>125</sup> the determining factor was not the formalities of the trust, but the form of the relationship between the debtor and the party being pierced. Tara Asher, the debtor, had transferred \$400,000 into Asher Investments Partnership (AIP), which Hartford Fire Insurance Company wanted to reach.<sup>126</sup> The U.S. District Court for the Eastern District of Tennessee did not need to examine the relationship between Asher and AIP beyond determining that Asher was a natural person and shareholder in AIP.<sup>127</sup> Tennessee courts, the court explained, recognize reverse piercing only to reach a subsidiary’s assets based on the debts of a parent corporation.<sup>128</sup> An individual shareholder engaging in acts indistinguishable from those that would justify reverse piercing in a parent/subsidiary situations would thus have no liability under Tennessee law, and reverse piercing was not allowed in *Hartford*.<sup>129</sup>

*Sweeney, Cohn, Stahl & Vaccaro v. Kane*<sup>130</sup> added an additional element to the equity prong: the purpose of incorporation. One of the defendants, Amy Kane, had an outstanding debt to two law firms.<sup>131</sup> After incurring the first debt but before initial judgment was rendered on either, Kane and her husband incorporated Gin Properties, Inc., which they used to purchase a residence for themselves.<sup>132</sup> The Appellate Division of the New York Supreme Court made a point of noting that the corporation was formed knowing of the outstanding debts and seemingly in order to avoid satisfaction of any judgment on those debts by hiding the couple’s joint assets.<sup>133</sup> While the court did not treat this

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124. *Id.* at 132. As the court did not find a breach of contract, this finding falls under the category of dicta, but it has been no less relied on as the reference to it in *Zahra* shows.

125. No. 3:06-CV-11, 2010 U.S. Dist. LEXIS 86826 (E.D. Tenn. Aug. 24, 2010).

126. *Id.* at \*7–\*9. Hartford also brought a claim under the Tennessee Uniform Fraudulent Transfer Act regarding the same transaction, which the court did not render a decision on. *Id.* at \*65.

127. *Id.* at \*67–68.

128. *Id.* at \*67 (citing *Cont’l Bankers Life Ins. Co. v. Bank of Alamo*, 578 S.W.2d 625, 632–33 (Tenn. 1979)).

129. *Id.* at \*68.

130. 6 A.D.3d 72 (N.Y. App. Div. 2004).

131. The first law firm represented her in her duties as executrix of a will, and the second was retained to help her defend a suit against the first for unpaid fees. After a settlement of the first debt was negotiated, Kane refused to pay either party. *Id.* at 73–74.

132. *Id.* at 74.

133. *Id.* at 78.

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as mandatory, it is an easier analysis when the very formation of the corporation appears fraudulent.<sup>134</sup>

Some courts, without directly outlining a scenario under which reverse piercing is permissible, share the Tenth Circuit's preference for utilizing traditional judgment collection methods wherever possible.<sup>135</sup> In *Owens & Sons, Inc. v. Guastella East, Inc.*,<sup>136</sup> a creditor sued the Guastella East corporation on a promissory note signed only by its owners.<sup>137</sup> The Supreme Court of Louisiana found that if the owners were found to be titleholders to the assets sought, they could be levied directly.<sup>138</sup> Alternatively, the plaintiff could receive the benefits of the corporation's assets by selling the owners' shares and using the proceeds to pay the debt.<sup>139</sup> Therefore, the court reversed the decision of the trial court and found Guastella East not liable for the debt of its owners.<sup>140</sup>

While inconsistent, the approaches taken in the various jurisdictions all share a desire to find an equitable solution to the disputes before them. Of course, the courts are limited to the factual situation and arguments before them, which can detract from the development of a coherent doctrine. A consistent analysis of all the rights and interests involved in reverse piercing is lacking from the current case law. Without considering the precedential value of a particular test when applied to the variety of situations in which reverse piercing attempts may arise, later courts are left either to misapply the doctrine or rely on different reasoning in every instance where the claim arises. In order to encourage a comprehensive analysis of reverse piercing, Part IV will put the reasoning provided by various courts into a broader context to determine what the appropriate approach to reverse piercing should be.

#### IV. DISCUSSION

Assuming there is one overarching solution to handling this type of claim that can be evenly and fairly used, the analysis that leads to it must

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134. See also *Fed. Deposit Ins. Corp v. Almodovar*, 671 F. Supp. 851, 878 (D.P.R. 1987) ("Otherwise, manifest injustice would result from treating Vilmasor and Lumaral as separate entities when in fact they have merely been personal business conduits of the defendant used and designed for the only purpose of hindering, defrauding and delaying the creditors of Martinez and Amieiro.").

135. See, e.g., *Stoltz v. Emerson*, No. CV94 06 29 06, 1994 Conn. Super. LEXIS 3106, at \*4 (Conn. Super. Ct. Nov. 8, 1994).

136. 354 So. 2d 571 (La. 1977).

137. The plaintiff claimed the defendant corporation had signed the note, but this was erroneous. *Id.*

138. *Id.* at 572.

139. *Id.*

140. *Id.*

be found in drawing out the reasoning the above jurisdictions have given for the stance they take on reverse piercing. Broadly, these rationales can be grouped into two categories: an analysis of available alternatives in the law and a look at the impact various stances would have on the rights of all parties potentially affected. This Comment proceeds by looking at the reasoning within these categories and determining how well they apply to the unique situation of reverse piercing of the corporate veil.

*A. Misuse of an Equitable Doctrine—The Alternatives to Reverse Piercing*

Central to the holdings of *Cascade* and *Floyd* is that reverse piercing is not used because it is a necessary evil, but perhaps in spite of the fact that more clearly defined and traditionally accepted alternatives exist. This can be done either through measures after achieving judgment on the underlying complaint or adding the target corporation as a defendant under a different charge.

Plaintiffs who bring and win a suit against any defendant are able, even without reverse piercing, to take advantage of the assets of a wholly or partially owned and controlled corporation. Traditional judgment collection procedures allow for the creditor following judgment to levy the assets of the defendant, including shares in a corporation not named in the suit.<sup>141</sup> While there is certainly a danger that the corporation will attempt to shift its assets in order to avoid such a judgment, alternative methods of combating this secondary fraud already exist. In addition to seeking attachment of the interest prior to litigating the suit, judgment creditors can protect collection through applicable fraudulent transfer laws.<sup>142</sup> In the area of tax collection, these laws have been of particular interest to some courts in applying reverse piercing.<sup>143</sup> Treating transfers as constructive dividends allows some additional access to these assets of the corporation.<sup>144</sup>

Forcing collection to go through the traditional channels would be

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141. *But see* Litchfield Asset Mgmt. Corp. v. Howell, 799 A.2d 298, 312 n.14 (Conn. App. Ct. 2002) (finding that an attempt to attach distributions from the corporation would have been fruitless as the defendant simply used corporation assets to pay her debts, but not commenting on other judgment collection methods).

142. Fed. Deposit Ins. Corp. v. Almodovar, 671 F. Supp. 851, 881 (D.P.R. 1987) (finding the transfer rescindable as fraudulent after finding the same subject assets recoverable through reverse piercing).

143. *See* United States v. Bigalk, 654 F. Supp. 2d 983 (D. Minn. 2009).

144. *Floyd v. Internal Revenue Serv.*, 151 F.3d 1295, 1300 (10th Cir. 1998); *see also* 10 JACOB MERTENS, JR. ET AL., MERTENS LAW OF FEDERAL INCOME TAX § 38B:71 (2005).

advantageous to many parties involved in such a dispute directly or indirectly. Where there are other shareholders in the target corporation, traditional collection strikes the best balance for protecting their interests and rewarding the judgment creditor. Whether the creditor takes control of the shares or they are sold to a third party with the proceeds going to the creditor, the shares become an asset. The new holder would have an incentive to make economically rational decisions that benefit the corporation or resell the shares for value. Even if the new owner used majority ownership to force dissolution, other shareholders would be guaranteed their proportional share of the dissolved corporation. There would be no risk of innocent third parties losing their entire investment because essential assets were sold off to pay the debts of a majority owner.

Where creditors would be rightfully wary of relying on the sometimes arduous judgment collection process, there are alternative legal theories that would allow corporations to be joined as defendants without using an unpredictable reverse piercing approach. Namely, counts raised against the corporation for aiding and abetting or under general agency principals could succeed under similar circumstances to those present in many reverse piercing cases. While the burden of proof on these counts would make collection potentially more difficult than simple judgment collection, it would be similar to the extant control test. As this requires that plaintiffs establish a link between the conduct that is the subject matter of the suit and the corporation itself, voluntary creditors would be able to protect themselves through investigation of the corporation prior to entering into any contractual relationship.

Perhaps the most important advantage of these alternatives to reverse piercing is that they are more true to the purposes of equitable remedies in our legal system. As many courts have noted, reverse piercing is an equitable doctrine.<sup>145</sup> Therefore, it should be allowed exclusively where the requesting party is without an equivalent remedy at law.<sup>146</sup> As this Subpart has demonstrated, there are alternative methods of achieving similar results within the court, and each may have benefits as compared to reverse piercing of the corporate veil. In the absence of any compelling reason to continue allowing reverse piercing beyond the convenience of judgment creditors, reverse piercing should be set aside in favor of alternative, well-established legal remedies.

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145. See, e.g., *Schimmelpenninck v. Byrne*, 183 F.3d 347, 358 n.21 (5th Cir. 1999); *McKinney v. Gannett Co.*, 817 F.2d 659, 666 (10th Cir. 1987).

146. *Floyd*, 151 F.3d at 1300; see also 1 WILLIAM MEADE FLETCHER ET AL., *FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS* § 41.25, at 162–66 (perm. ed. rev. vol. 2006).

*B. The Rights of the Parties Under Reverse Piercing*

## 1. The Principal Actors—Judgment Creditors and Wrongdoing Defendants

As demonstrated above, the deceptive fiction beneath reverse piercing is that it is identical to the traditional situation and can thus be handled in the same manner, a fallacy fueled by a myopic focus on the principal parties. Indeed, both traditional and reverse piercing of the corporate veil act as mechanisms to transfer wealth from a dishonest defendant found liable for wrong doing to a valiant judgment creditor. There is no obvious public policy reason to prevent this transfer, and various equitable reasons that it should be facilitated in the face of a party's fraudulent attempt to avoid liability by shuffling assets. As the cast of characters with an interest in the transfer becomes more diverse, as will be shown below, this rationale becomes much more convoluted.

Even in a scenario where there are no third parties to be affected by the transaction, reverse piercing is still fundamentally an equitable doctrine.<sup>147</sup> As such, it should only be applied where legal remedies are unavailable or inadequate to protect the interests of creditors who are seeking to pierce the corporate veil.<sup>148</sup> As previously illustrated, a variety of state statutory and common law mechanisms are available to achieve the same ends, many of which are more widely recognized and have been for some time. To the extent that fraudulent transfer statutes or attachment of the defendant's shares would equally resolve the dispute, reverse piercing is therefore inappropriate even if the rights of third parties would not be affected.

## 2. Innocent Bystanders—The Uninvolved Shareholder

For traditional piercing, it is comparatively simple to protect the interests of innocent shareholders in a corporation used for fraudulent or illegal acts by a single controlling owner. In an ideal situation, placing liability on the owner rather than the corporation could make protection of shareholders a primary purpose rather than secondary effect.<sup>149</sup> The mechanism for ensuring that the liability is extended only to responsible parties is the control test, which examines the degree of control exercised over the corporation by a single shareholder.

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147. *Floyd*, 151 F.3d at 1300 (citing *McKinley*, 817 F.2d at 666).

148. *Id.* (citing WILLIAM MEADE FLETCHER ET AL., *supra* note 146, § 41.25, at 653).

149. *But see* *D'Ambrosi v. Bayly Martin & Fay Int'l, Inc.*, No. 86 Civ. 5368, 1987 U.S. Dist. LEXIS 7946 (S.D.N.Y. Sep. 2, 1987) (holding that New York law requires a corporation's assets to be exhausted before piercing the corporate veil to collect against shareholders or a parent corporation).

In the context of a reverse piercing, however, a direct application of the control test could lead to a grotesque misapplication of the law. Several courts considering traditional piercing have held that complete ownership is not a requirement; a mere significant interest and control of the corporation's operations suffice.<sup>150</sup> To apply this in the context of reverse piercing would not protect other shareholders, but expose them to an even greater degree to damages from the actions of another stakeholder.<sup>151</sup>

Long term, the investment patterns of individuals could come to reflect this danger. A primary advantage of the corporate form is the safety it provides from the overlap of individual and corporate debts. Traditional piercing is resisted except in exceptional cases in order to preserve this dichotomy, and the advantages of the separation flow both ways. Investors in a business expect it to be relatively safe. Any risk in the investment should ideally be ascertainable by due diligence into the individual business's practices as well as the industry overall. Reverse piercing would require investors to acknowledge risk in the form of unscrupulous owners. The result could be a retreat from small and mid-size enterprises in favor of investing in publicly traded companies with significantly lower risks of piercing.<sup>152</sup>

In order to prevent this misapplication, courts would, at a minimum, need to treat the existence of innocent shareholders as a separate and absolutely dispositive consideration when determining if reverse piercing is appropriate.<sup>153</sup> In *C.F. Trust*, the Virginia Supreme Court provided a precedent for this, holding that it is the burden of the party moving for reverse piercing to prove that innocent shareholders will not be affected and to do so by clear and convincing evidence.<sup>154</sup>

As explained above, an alternative to reverse piercing is to force parties to attach the shares or ownership interest in the corporation. Where there are minority shareholders, they would have an opportunity to purchase a greater interest or at least a guarantee that a new holder of

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150. *Telenor Mobile Commc'ns v. Storm LLC*, 587 F. Supp. 2d 594, 604 (S.D.N.Y. 2008), *aff'd*, 351 F. App'x 467 (2nd Cir. 2009) ("A company that owns a majority stake in another controls that company's operations, even if it does not have 100% ownership.")

151. *See United States v. Boscaljon*, No. CIV.07-4111, 2010 U.S. Dist. LEXIS 26980 (D.S.D. Mar. 22, 2010).

152. The lower risk is a result of diverse ownership, which makes satisfaction of the control prong much more difficult and allows for broader oversight that can check behaviors likely to be egregious enough to trigger the equity prong. This also follows with the trend in traditional piercing. *See Thompson, supra* note 11, at 1047-48 (finding no successful piercing of a public corporation in an empirical analysis of 1,583 cases involving an attempt to pierce the corporate veil).

153. *See, e.g., Boscaljon*, 2010 U.S. Dist. LEXIS 26980.

154. *C.F. Trust, Inc. v. First Flight Ltd. P'ship.*, 580 S.E.2d 806 (Va. 2003).

the shares will have an interest in making economically viable decisions about the corporation's assets. Even a corporation dissolved by a new majority owner would have its assets distributed in a predictable manner among shareholders. Minority shareholders would not find themselves with an interest in a corporation of significantly less value overnight due to a majority owner's decision not to pay taxes.

### 3. Undermined Contracts—The Usurped Creditor

Like innocent shareholders, legitimate creditors of a corporation may have an interest in its continued and successful operation that is left unprotected in a dispute over reverse piercing. These parties do not have a similar direct interest in the results of a traditional piercing of the corporate veil. Parties extending credit to a corporation are capable of examining the financial health of the corporation as well as its outstanding debts.<sup>155</sup> When owners of sole proprietorships or other small enterprises are asked to personally guarantee a business loan, the loaning institution goes into the transaction understanding that adverse actions of the individual could affect their interest and can modify the terms of any loan accordingly. Conversely, a loaning institution would not expect assets loaned to a corporation alone to be sold off to pay the debts of its owner.

Essentially, judgment creditors and victims of torts may be given preference over consensual creditors if reverse piercing is allowed with a simple two-prong test. Indeed, reverse piercing could allow tort victims to receive assets before the consensual creditors of either the individual or the corporation.<sup>156</sup> This is largely inconsistent with the common law treatment of traditional piercing, and precisely the reverse of many other legal areas, which are often more reserved when victims of torts attempt to gain the benefits of a corporation's assets before its consensual creditors.<sup>157</sup> Even in the case where the liability of the owner arises

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155. Whether the inquiry is actually made is a separate issue that must be analyzed on a case-by-case basis. For example, the court in *In re Mass* allowed reverse piercing over the objection that it hurt consensual creditors of the corporation because there was no proof an actual inquiry into the financial strength of the corporation was made or relied on. 178 B.R. 626, 631 n.5 (M.D. Pa. 1995).

156. See *supra* notes 107–110 and accompanying text.

157. See generally G. Michael Epperson and Joan M. Canny, *The Capital Shareholder's Ultimate Calamity: Pierced Corporate Veils and Shareholder Liability in the District of Columbia, Maryland, and Virginia*, 37 CATH. U. L. REV. 605, 632–33 (1988) (arguing that tort victims should be given preference in piercing of the corporate veil because they are unable to investigate and choose their judgment debtors, but noting that many courts have failed to make such a distinction); see also *Dombroski v. Wellpoint, Inc.* 895 N.E.2d 538, 545 (Ohio 2008) (“Insurer bad faith is a straightforward tort, a basic example of unjust conduct; it does not represent the type of exceptional wrong that piercing is designed to remedy.”); *Walkovszky v. Carlton*, 223 N.E.2d 6 (N.Y. 1966) (refusing to pierce the



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from exceptional circumstances, it is not clear that the rationale would extend to reverse piercing unless the creditors of the corporation knew that this threat to the corporation's assets was a possibility prior to initiating a contractual relationship.

The most important aspect of this from the perspective of creditors is the predictability of having the corporation's assets sold. If reverse piercing is allowed, there would be no rational way to investigate a business and determine the risk it presents. Reverse piercing is commonly invoked in purely personal cases, including satisfaction of tax debts<sup>158</sup> and settling marital assets in a divorce.<sup>159</sup>

There are multiple implications to this collateral attack on the rights of consensual creditors. First, attachment of the corporate assets raises due process concerns with regard to creditors who have an interest in the assets as collateral.<sup>160</sup> This is compounded by the fact that it could undermine state laws alerting creditors to the dissolution of a corporation.<sup>161</sup> If creditors take steps to shield themselves from this increased risk, the result could be a general chilling of the ability of small businesses with few owners to receive financing.<sup>162</sup> At the very least, lenders may begin through altered risk calculations to spread the cost of individual misdeeds across all small businesses.<sup>163</sup>

Conversely, forcing parties to use traditional remedies does not present the same risks. If shares in a corporation were sold rather than its assets, the purchaser would immediately obtain an interest in retaining the profitability of the corporation, protecting the investment of outside creditors. Even to the extent that fraudulent transfer statutes would still allow access directly to corporate assets, this would be limited to assets not relied on in extending credit or that reasonable investigation may show are obtained through inappropriate means. At the very least, it would provide creditors with a more settled body of law from which to calculate the risks inherent in lending.

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corporate veil of an undercapitalized taxi cab corporation for the victim of an accident); Robert B. Thompson, *Piercing the Corporate Veil: An Empirical Study*, 76 *CORNELL L. REV.* 1036, 1058–59 (1991).

158. See *United States v. Bigalk*, 654 F. Supp. 2d 983 (D. Minn. 2009).

159. See *W.G. Platts, Inc. v. Platts*, 298 P.2d 1107 (Wash. 1956); *Lyons v. Lyons*, 340 So. 2d 450 (Ala. Civ. App. 1976).

160. *In re Hamilton*, 186 B.R. 991, 1000 (D. Col. 1995).

161. *Id.*

162. *Floyd v. Internal Revenue Serv.*, 151 F.3d 1295, 1299 (10th Cir. 1998).

163. For a more thorough analysis in this vein in the context of Fourth Circuit decisions impacting Virginia's appeal to small businesses, see Wendy B. Davis, *The Failure of the Federal Courts to Support Virginia's Reluctance to Pierce the Corporate Veil*, 5 *J. SMALL & EMERGING BUS. L.* 203 (2001).

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## V. CONCLUSION

Attempts to make compensation for those victorious in lawsuits easier are laudable, but it must be acknowledged that these actions rarely take place in a vacuum. Any alteration to traditional judgment collections should be fully examined by courts to determine its impact not just on the parties to the case, but on other shareholders in or creditors of the company to be subject to reverse piercing. The complexity of a corporation's structure is exceeded in many cases only by the web of interactions it has. Furthermore, any expansion of methods for accessing the assets of a corporation carries with it the risk of decreasing loans and investments to small businesses and the chilling of economic expansion that can incur. This Comment suggests that the direct and indirect risks of reverse piercing are significant enough compared to the marginal benefits to judgment creditors to justify complete abandonment of the practice.

The Tenth Circuit's wary approach to piercing the corporate veil appears to be the correct one. At the very least, jurisdictions must take care when deciding reverse piercing claims to ensure that all interests are protected and all alternatives are considered.