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Damages Pt. 8 – Ability to Recover by Piercing the Corporate Veil

In this week's installment in our series on damages, the attorneys at Pavlack Law discuss the doctrine of *piercing the corporate veil*. While this doctrine is not inherently one of damages, but rather of recoverability, it is a concept that makes the award of damages by a jury worth more than simply the paper it is written upon.

It is a well-understood reality that regardless of how much you may be awarded in a judgment, the only real value is the amount that can actually be recovered from a defendant. This is what is meant when someone is described as judgment proof – meaning that the person does not have sufficient assets or funds to satisfy the judgment. While this is obviously a problem associated most frequently with individuals it is also a problem that extends into the corporate realm. Typically a successful plaintiff is much more likely to satisfy a judgment against a corporation than an individual. However, there are many cases in which the corporation fails to have sufficient funds to satisfy the judgment. When this occurs it may still be possible to obtain additional funds under certain circumstances.

As a general rule the liabilities of a corporation do not extend beyond that corporate entity. This is the protective element of a corporation. It prevents

shareholders of companies from being liable for the debts and other liabilities of a company. In order to benefit from these protections the corporate form must be fully respected. Where the shareholders fail to respect the corporate formalities then that shareholder may be held personally liable by what is called *piercing the corporate veil*.

The origins of *piercing the corporate veil* date back to the 1809 Supreme Court of the United States (SCOTUS) decision in *Bank of United States v. DeVeaux*. The concept has become well established in Indiana. The Indiana Court of Appeals in *Fairfield Development, Inc. v. Georgetown Woods Senior Apartments Limited Partnership* gave a thorough discussion of the requirements to pierce the corporate veil.

> In general, the doctrine of "piercing the corporate veil" holds individuals liable for corporate actions based on the failure to observe corporate formalities. . . . The party seeking to pierce the corporate veil bears the burden of proving that the corporation is merely the instrumentality of another and that misuse of the corporate form constitutes a fraud or promotes injustice. . . . In exercising its equitable powers to pierce a corporate veil, the trial court engages in a highly fact-sensitive inquiry.
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> "While no one talismanic fact will justify with impunity piercing the corporate veil, a careful review of the entire relationship between various corporate entities, their directors and officers may reveal that such an equitable action is warranted." . . . Our supreme court has held that in deciding whether the plaintiff has met the burden of piercing the corporate veil, the court may consider evidence of the following factors:
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>> (1) undercapitalization; (2) absence of corporate records; (3) fraudulent representation by corporation shareholders or directors; (4) use of the corporation to promote fraud, injustice or illegal activities; (5) payment by the corporation of individual obligations; (6) commingling of assets and affairs; (7) failure to observe required corporate formalities; or (8) other shareholder acts or conduct ignoring, controlling, or manipulating the corporate form.
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> . . . This list of factors is not necessarily exhaustive, and all factors

need not be shown to support a decision to pierce the corporate veil.

To summarize, where a court finds that the owner of a company has rampantly failed to respect the corporate form by doing things such as using the corporation to pay his personal debts or failed to keep corporate records, then that owner may not avail himself of the protections of the corporate form.

The most frequent circumstances in which a corporate veil may be pierced is where one corporation is the subsidiary of another. In this type of case the typical issue leading a court to allow the veil to be pierced is that the parent company was using the subsidiary as nothing more than a name. This would be your prototypical shell company.

Another aspect of the doctrine is what is known as reverse piercing which seeks to attach the liabilities of an individual shareholder to the corporation. Reverse piercing is used much less frequently but is no less potent. The easiest example to conceptualize for reverse piercing is to imagine a guy named Bob who decides to start his own corporation called Bob Corp. Once Bob has incorporated Bob Corp. he transfers all of his personal assets to the corporation leaving him with no property to his individual name. Bob has created Bob Corp. with the sole purpose of shielding his assets from his own liability. Bob then goes out and savagely beats the new boyfriend of his ex-girlfriend. The new boyfriend sues Bob and obtains a $500,000 judgment. However, Bob has no assets at all. But, through the doctrine of reverse piercing, the new boyfriend can collect on his judgment against Bob Corp.

Real world examples of reverse piercing are certainly much more complex. Nevertheless, the purpose of reverse piercing is simple. A person cannot be allowed to shelter his or her assets in a corporation. Of course, like the regular piercing doctrine, the reverse piercing doctrine works for corporations as well. Where a parent company fails to observe the corporate form and has sheltered its assets in a subsidiary, a court may allow a plaintiff to attach to the assets of the subsidiary.

Whether a plaintiff seeks to pierce or reverse pierce a corporate veil, or even some combination of the two, it is very difficult legal maneuver to navigate. Nevertheless, pulling off that maneuver can be the difference between having a piece of paper that says that Bob owes you five million dollars and actually having five million dollars. Due to the difficulty and importance in succeeding in such a maneuver it is vitally important to have a guide who thoroughly understands the complexities of the law, is experienced, and can zealously advocate on your behalf.

Join us again next week for the next installment in our series on damages.

- Pt. 1 – Introduction to Damages and Loss of Consortium
- Pt. 2 – Duty to Mitigate Damages
- Pt. 3 – Diminished Value of Vehicle Due to Traffic Accident
- Pt. 4 – Damages for Negligently Inflicted Emotional Distress
- Pt. 5 – Assessing Damages When Injured Person is Partially at Fault
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- Pt. 9 – Damages for the Loss of Chance of Survival from Medical Malpractice
- Pt. 10 – Punitive Damages Under Indiana Law
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- Pt. 12 – Contract Damages

Sources

- *Bank of United States v. DeVeaux*, 9 U.S. 61 (1809).

- *Fairfield Development, Inc. v. Georgetown Woods Senior Apartments Limited Partnership*, 768 N.E.2d 463 (Ind. Ct. App. 2002).

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