The Real Reasons Courts Pierce the Corporate Veil – How to Avoid Putting Your Personal Assets at Risk

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This is the third article in a series on protecting a business's identity and avoiding personal liability for business actions. The ***first article*** *in this series generally explained how piercing the corporate veil can result in personal liability for business actions.* The **second article** discussed the importance of record retention policies.

As discussed previously in this series, the general rule in Michigan is that an individual's personal assets are shielded from business liabilities unless:

1. The business is a mere instrumentality of another entity or individual;
2. The business was used to commit a fraud or wrong; and
3. The business caused an unjust loss or injury to a plaintiff.

Two studies conducted recently resulted in data-driven articles that shed greater light on the issue of when, and why, courts accept veil piercing arguments. In "Why Courts Pierce: An Empirical Study of Piercing the Corporate Veil," John H. Mathewson discusses an extensive empirical study that examines when and why courts pierce the corporate veil. The author describes the results of his study as "startling" and identifies a number of statistically significant findings, including:

1. Courts pierce twice as often to hold individual persons liable than they do to hold entities, such as corporations and limited liability companies (parent-subsidiary piercing), liable.
2. Entity plaintiffs are almost twice as likely as individual plaintiffs to successfully pierce the corporate veil.
3. Courts are more likely to pierce to enforce a contract claim than to award recovery to a tort claimant.
4. The 'kitchen-sink' approach to piercing litigation (adding as many possible substantive claims as possible) is not as effective as bringing a single claim.

The author's most interesting and useful findings include:

1. Fraud, owner domination of management and operations, and commingling of funds have the strongest and most predictive relationship with piercing the corporate veil. **Indeed, the presence or absence of these factors alone is usually dispositive of the piercing decision.**
2. Conversely, factors reflecting the lack of operational formalities, such as non-existence or non-functioning of corporate directors or officers, are not significantly related to piercing.

In “Finding Order in the Morass: The Three Real Justifications for Piercing the Corporate Veil," Jonathan Maxey and Joshua Mitts identify several public policy goals that veil piercing is intended to further. For example, preventing shareholders of a business from obtaining credit by misrepresentation or other fraudulent misconduct is an objective commonly furthered by veil piercing. Piercing the veil is also used to preserve a business's value in bankruptcy.

The article's focus on public policy goals reinforces that veil piercing is often seen as an act of fairness by judges when the defendant appears to have acted unfairly.

These data-driven studies demonstrate that veil piercing is most likely to occur when businesses' actions are viewed as unfairly harming others. Courts punish business owners by putting their personal assets at risk when businesses commit fraud, misrepresent, and take actions that put assets out of reach of creditors.

In opposition to commonly held beliefs held by legal professionals, the data suggest that running a business with a lack of corporate and operational formality is *less* important when it comes to veil piercing. But there’s no doubt that in a close case, a business owner that runs a business like a business is less likely to put his or her assets at risk of veil piercing. Formality still matters. Formation documents should be accurate. Operating and shareholder agreements should be clear, and complied with. If a company has a board of directors, meetings should be held and minutes taken. Corporate funds should be used for corporate purposes and not commingled with an owner’s personal assets. Relationships with customers and vendors should be documented and dictated by contract.

Corporate law grants business owners the right to operate a business free of personal liability. But that right is not unfettered. Business owners must operate in accordance with certain principles and procedures. It is important that business owners consult with experienced legal counsel to ensure that they are following the procedures in order to avoid veil piercing and personal liability. It’s one thing to incur a large business debt. It’s another, far more harmful consequence, if that business liability becomes a personal one.