

**DISREGARD OF THE CORPORATE
ENTITY: “PIERCING THE
CORPORATE VEIL”**

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I. GENERAL RULE: LIMITED LIABILITY

- ◆ Limitation of liability is the cornerstone of the law of corporations.
- ◆ The stockholders and officers of a corporation (or members and managers of an LLC) are not ordinarily personally liable for the acts and obligations of the corporation.
- ◆ Affiliated corporations (parents, subsidiaries, sister corporations) will not be responsible for others under doctrine of “corporate separatedness” (i.e., regarded as separate from each other and from their respective stockholders).

II. EXCEPTION TO GENERAL RULE: “PIERCING THE CORPORATE VEIL”

Although rarely done, courts will “pierce the corporate veil” in order to prevent gross inequity, injury or fraud. (These standards will generally apply to both civil suits and criminal prosecutions).

A. Factors Considered When Piercing the Corporate Veil.

1. In *My Bread Baking Co. v. Cumberland Farms, Inc.*, 353 Mass. 614 (1968) the SJC articulated the criteria that should be considered when deciding whether to pierce the corporate veil, identifying two sets of circumstances warranting disregard of the corporate status:

“(a) when there is active and direct participation by the representatives of one corporation, apparently exercising some form of pervasive control, in the

activities of another and there is some fraudulent or injurious consequences of the intercorporate relationship, or (b) when there is a confused intermingling of activity of two or more corporations engaged in a common enterprise with substantial disregard of the separate nature of the corporate entities, or serious ambiguity about the manner and capacity in which the various corporations and their respective representatives are acting.”

The SJC then summarized its reasoning as follows, “In such circumstances, in imposing liability upon one or more of a group of ‘closely identified’ corporations, a court ‘need not consider with nicety which of them’ ought to be held liable for the act of one corporation ‘for which the plaintiff deserves payment.’ ” (See, *My Bread Baking*, 353 Mass. at 619).

2. The federal courts then further broke down the *My Bread* criteria into twelve (12) specific factors. See, *Pepsi-Cola Metropolitan Bottling Co. v. Checkers, Inc.*, 754 F.2d 10, 14-16 (1st Cir. 1985). Massachusetts courts have since adopted a comparable list of factors. *Evans v. Multican Construction Corp.*, 30 Mass.App.Ct. 728, 733 (1991); *Attorney General v. M.C.K., Inc.*, 432 Mass. 546 (2000). These twelve factors listed by the SJC in *Attorney General v. M.C.K. Inc.*, *supra*, are still commonly referred to as the *My Bread Baking* factors:

- (1) common ownership;
- (2) pervasive control;

- (3) confused intermingling of business activity, assets, or management;
- (4) thin capitalization;
- (5) nonobservance of corporate formalities;
- (6) absence of corporate records;
- (7) no payment of dividends;
- (8) insolvency at the time of the litigated transaction;
- (9) siphoning away of corporate assets by the dominant shareholders; and
- (10) nonfunctioning of officers and directors;
- (11) use of the corporation for non-corporate transactions by the dominant shareholders;
- (12) use of the corporation in promoting fraud.

All of these factors are considered in determining whether the overall structure and operation misleads. The courts will weigh these factors in order to determine whether their cumulative effect favors piercing the corporate veil. However, there are several of these factors that are more frequently emphasized.

B. Common Ownership and Pervasive Control

- ◆ This factor is typically applied where looking to impute liability from one corporation to another based upon agency-type principles of control. *See, My Bread Baking*, 353 at 619 (“an agency or similar relationship exists between the parties”).
- ◆ Remember that even where common ownership and pervasive control is found the *My Bread Baking* test

also request causation: “... *and* there is some fraudulent or injurious consequence of the intercorporate relationship. *Id.* 353 Mass. at 619.

C. Nonobservance of Corporate Formalities

- ◆ Theory is that if the formalities of separate corporate existence are not observed, then the corporation was essentially used as an “alter ego” or “conduit” for the shareholders personal affairs. Examples are issuance of stock election of directors/officers, regular shareholders/director meetings, maintaining corporate notes and minutes, etc. Note, however, that a “closely held corporation” need not adhere to every corporate formality in order to maintain its shareholders’ immunity. *See, Crane v. Green & Freedman Baking Co., Inc.*, 134 F.3d 17, 25 (1st Cir. 1998).

D. Commingling of Assets and Affairs

- ◆ When corporate funds are used to meet the personal debts of shareholders, or the debts of affiliated corporations, corporate veil should be pierced on the theory that creditors relied on those funds to satisfy their claims. For example, where funds from one corporation were used to buy inventory of another. *See, Binder, Inc. v. Jewelers Mut. Ins. Co.*, 28 Mass.App.Ct. 459 (1990). But must distinguish from perfectly proper “loans” between affiliated corporations or with stockholders.
- ◆ Commingling of affairs has been found where two corporations had same officers, same stockholders, same place of business and same type of business. *W. W. Britton, Inc. v. S.M. Hill Co.*, 327 Mass. 335 (1951). Distinguish from situation where two corporations were part of a common enterprise bidding on the same project and pooling assets, but financing

individually – like a joint venture. *See, Westcott Construction Cop. v. Cumberland Construction Co.*, 3 Mass.App.Ct. 294 (1975).

E. Undercapitalization and Insolvency at the Time of the Liquidated transaction

- ◆ The concept is that creditors can expect that a business will be run profitably and that funds are available to meet corporate obligations as they become due and payable.
- ◆ This factor will apply with more force for involuntary creditors, such as tort victims, as opposed to voluntary creditors who chose to do business with the corporation and should be held to a certain level of due diligence. *See, Evans v. Multicon Construction Corp.*, 30 Mass.App.Ct. 728 (1991) (creditor knew of corporate financial situation at the time of contracting).

III. DISTINGUISH OTHER POTENTIAL LIABILITIES (IMPOSED WITHOUT PIERCING CORPORATION)

A. Statutory Liabilities

A corporate entity may also be disregarded when necessary to consummate the objectives of a statute or other overriding public policy which would be frustrated by observance of the entity. For example,

- ◆ G.L. c.149, §148 – Nonpayment of Wages. President, Treasurer and other managers liable.
- ◆ G.L. c.152, §66 – Failure to obtain mandatory worker’s compensation insurance coverage exposes corporate officers to liability.

B. Common Law Principles

Caselaw may impose liability on individual officers, directors and shareholders where they personally participated in the unlawful or tortious conduct. This concept has been extended to include violation of 93A and of the covenant of good faith and fair dealing. For a good article on common law theories see Golann, et als, *In Search of Deeper Pockets; Theories of Extended Liability*, 71 Mass.L.Rev. 114, 114-120 (Sept. 1986).

IV. THE LATEST WORD FROM THE SUPREME JUDICIAL COURT (*Scott v. NG U.S. 1*, 450 Mass. 760 (2008))

In March 2008, the SJC provided a comprehensive re-evaluation of the *My Bread Baking* factors in the context of environmental liabilities and the statutory scheme of Chapter 21E. The SJC reiterated the importance of the corporate form and the need for imposing the *My Bread Baking* test before piercing the corporate veil. In so doing, the SJC rejected the attempt by the Appeals Court to disregard the corporate form based on general policy goals.

A. Appeals Court Decision (67 Mass.App.Ct. 474 (2006) – Attachment A hereto)

The Appeals Court (Cyper, J.) reversed the Superior Court's (VanGestel, J.) entry of summary judgment for the defendant power company, New England Electric, finding that

there were sufficient genuine issues of material fact on the question of the power company's derivative liability as the shareholder (i.e., parent corporation) of Salem Gas and North Shore Gas for environmental releases caused by these two entities. Judge VanGestel had concluded that the corporate veil could not be pierced, as a matter of law, because the release occurred in the late 1800's – long before New England Electric had acquired these companies.

However, the Appeals Court, in an opinion by Justice Cypher, focused almost exclusively on the policies underlying G.L. c.21E so as to de-emphasize, or even ignore, the various *My Bread Baking* factors. The Court reversed and remanded for further evaluation of the evidence bearing on the piercing the corporate veil claim:

“We think both *equity and public policy* cut against a determination as a matter of law that corporate form and the passage of time protected [New England Electric] from the liabilities of Salem Gas, *especially when an innocent third party will be left with the expense of the present day cleanup.*” 676 Mass.App. at 485. (emphasis added)

B. Supreme Judicial Court Decision (450 Mass. 760 (2008) – Attachment B A hereto)

On appeal, the SJC (Marshall, J.) reversed the Appeals Court and held that the power company which acquired its interest in the subsidiary decades after the releases in question could not be

held liable under corporate veil piercing concepts. In so doing, the SJC reinforced the causation requirement that “the injured party... show some connection between its injury and the parent’s improper manner of doing business – without that connection, even when the parent exercises domination and control, over the subsidiary, corporate separateness will be recognized.” *Id.* at 767.

However, most significantly the SJC took the opportunity to reiterate the importance of the corporate form and the concept of limited liability:

“Neither Federal ... nor State environmental laws displace *bedrock principles* of corporate common law ... one of the *basic tenets* of that body of law is that corporations – notwithstanding relationships between or among them – ordinarily are regarded as distinct entities ... Indeed, the concept that a parent corporation ... is not liable for the acts of its subsidiaries, is *deeply ingrained* in our economic and legal systems.” (450 Mass. at 766) (citations omitted and emphasis added)

The SJC then went on to note the limited application of the corporate veil piercing doctrine, emphasizing the need for consideration of the twelve (12) *My Bread Baking* factors. (*See*, 450 Mass. at 769). (Chastising Appeals Court for “disregard of corporate form based on general statutory and policy goals, rather than evaluation of the factors in *My Bread Baking*”).

The SJC then concluded by acknowledging the important policy objectives of Chapter 21E, but cautioning that these policy objectives are not sufficient to pierce the corporate veil:

“We do not doubt that an important objective of G.L. c.21E is prompt ‘assessment, containment and removal’ of hazardous materials. Nor do we question that the party that caused the environmental contamination should be responsible for its cleanup ... But it does no injustice to G.L. c.21E to conclude that where the parent corporation lacked any interest in, and did not control, the subsidiary or its facility at the time of the acts giving rise to environmental liability, there is no occasion to disregard its corporate form.” (450 Mass. at 771-772)

In sum, the SJC decision in *Scott v. NG U.S. 1, Inc.* sends a strong message that the corporate form should be respected by the courts and, further, that the liability veil of protection may be pierced only after consideration of the twelve (12) *My Bread Baking* factors. In so doing, the SJC rejected the Appeals Court’s attempt to shift the analysis from the 12 determinative factors to “public policy and statutory purpose” focus. The implications of the Appeals Court’s *Scott* decision were potentially wide-reaching and apparently of grave concern to the SJC.