1978

Disregard of the Corporate Entity

Follow this and additional works at: http://open.mitchellhamline.edu/wmlr

Recommended Citation
Available at: http://open.mitchellhamline.edu/wmlr/vol4/iss2/3
NOTES

DISREGARD OF THE CORPORATE ENTITY

The characteristic of corporations which gives shareholders limited liability has profoundly affected American economic growth. Unfortunately, economic growth has not been the sole result of limited liability, for the corporate device can be used to achieve unjust ends. Disregard of the corporate entity, which eliminates limited shareholder liability, is an equitable remedy invoked when the benefits of incorporation are outweighed by equities in favor of unpaid creditors of the corporation. Judicial evolvement of the corporate disregard doctrine, however, has been equivocal and confusing; few standards exist to guide understanding. This Note evaluates the doctrine as it has evolved in Minnesota and other jurisdictions. In addition, this Note offers a suggested approach which attempts to identify the relevant policies and facts that should be considered when a court disregards a corporate entity.

I. INTRODUCTION ........................................................................................................ 334

II. MINNESOTA LAW ...................................................................................................... 336
   A. Traditional Concepts ................................................................................................. 336
      1. Fraud .................................................................................................................. 338
      2. Corporate Formalities ......................................................................................... 339
      3. Inadequate Capitalization .................................................................................... 340
      4. Shareholder Dominance ....................................................................................... 342
      5. Parent-Subsidiary and Affiliated Corporations .................................................. 342
   B. In re Will of Clarke—A Conceptual Modification ................................................. 344
   C. Related Theories ...................................................................................................... 346
      1. Agency ................................................................................................................ 347
      2. Estoppel .............................................................................................................. 348
      3. Fraudulent Conveyances ..................................................................................... 349
   D. Shortcomings of Minnesota Corporate Disregard Law ........................................ 350

III. ALTERNATIVE THEORIES .................................................................................... 351
   A. The Metaphor Approach ......................................................................................... 351
   B. The California Approach ....................................................................................... 351
   C. The Enterprise Entity Theory ................................................................................ 354

IV. SUGGESTED APPROACH ....................................................................................... 355
   A. Contract or Consensual Creditors .......................................................................... 356
   B. Tort or Nonconsensual Creditors .......................................................................... 358
   C. Allocation of Liability ............................................................................................. 364
   D. Summary ................................................................................................................ 364

V. EXCEPTIONAL APPLICATIONS OF THE CORPORATE DISREGARD THEORY . 365
   A. Probate Administration ........................................................................................... 365
B. Avoidance of Statutory Obligations 366
C. The Internal-Dealings Rule 368

VI. CONCLUSION 369

I. INTRODUCTION

The benefits derived from combination of resources and talents for common enterprise are exemplified nowhere better than by the private business corporation. The advantages of incorporation are evidenced by the overwhelming acceptance of the corporate device in American business; it has been a major factor contributing to this nation's phenomenal industrial growth. Through the use of corporations, investors can combine capital and participate in the profits of large and small business enterprises with the advantages of perpetual existence, free transferability of interest, and centralized management. For these reasons, the corporation is accorded a favored status in the law. The Minnesota Supreme Court has recognized this status, stating: "The corporation is of the utmost importance to the industrial and commercial world. It is essential to the welfare of our business interests."

Legislatures have endowed corporations with certain characteristics. Although limited liability has not always been one of these characteristics, it is clear now that the attribute of limited shareholder liability

2. See, e.g., H. Ballentine, Corporations § 1 (rev. ed. 1946); Oleck, Remedies for Abuses of Corporate Status, 9 Wake Forest L. Rev. 463, 466 (1973) (corporation invaluable in the economic development of the United States); cf. I. Wormser, Disregard of the Corporate Fiction and Allied Corporation Problems 2-3 (1927) (corporation allows trade on a scale commensurate with modern needs).
3. See, e.g., H. Ballantine, supra note 2, § 1; H. Henn, supra note 1, §§ 73-75.
5. The early legislatures were unwilling to grant limited liability to shareholders of industrial corporations. See Dodd, The Evolution of Limited Liability in American Industry: Massachusetts, 61 Harv. L. Rev. 1351, 1352 (1948).

Minnesota was among those states reluctant to free stockholders from liability for the debt of the corporations in which they owned stock. The Minnesota Constitution as adopted in 1857 provided: "Each stockholder in any corporation shall be liable to the amount of stock held or owned by him." Minn. Const. art. 10, § 3 (1857) (amended 1872, 1930, and 1954; repealed 1974). An 1872 amendment inserted an exception for corporations "organized for the purpose of carrying on any kind of manufacturing or mechanical business . . . ." Id. (1872). The most significant development occurred in 1930 when the section was rewritten to vest in the legislature the power to "limit or otherwise regulate the liability of stockholders or members of corporations . . . ." Id. (1930). Only one exception
DISREGARD OF THE CORPORATE ENTITY

has played a major role in increasing the popularity of incorporation. Without limited liability the amount of capital needed for modern business probably could not have been assembled. The courts recognize this advantage, holding that incorporation even for the sole purpose of achieving limited liability is legally permissible. Yet the limited liability attribute is not absolute; the courts have retained the power to ignore the corporate entity and impose shareholder liability in appropriate cases. This judicial power, labelled the doctrine of "disregard of the corporate entity" or "piercing the corporate veil," developed to correct the inevitable injustices that were not intended to be sanctioned by incorporation.

The doctrine of corporate disregard is an equitable remedy. As with any equitable remedy, the doctrine involves the balancing of competing policies. The policies favoring incorporation therefore must be bal-

to the legislative power remained: shareholders of banking or trust corporations were still liable for the debts of the corporation "contracted prior to any transfer of such stock and such individual liability shall continue for one year after any transfer of such stock . . . ." Pursuant to the 1930 amendment, the legislature passed Act of Apr. 18, 1933, ch. 300, § 18, 1933 Minn. Laws 406 (current version at MINN. STAT. § 301.19 (1976)), which effectively limited the liability of shareholders for the debts of the corporation once the shareholder had complied with the contract for subscription. The 1954 amendment removed the banking exception. The current version of the Minnesota Constitution, following its restructuring in 1974, see Act of Apr. 10, 1974, ch. 409, § 1, 1974 Minn. Laws 787, eliminated this provision entirely.


7. See H. BALLANTINE, supra note 2, § 1; cf. W. COOK, THE PRINCIPLES OF CORPORATION LAW 19 (1925) ("limited liability is the 'open sesame' to the accumulated wealth of the world"); Radin, The Endless Problem of Corporate Personality, 32 COLUM. L. REV. 643, 654 (1932) (in medieval Europe men would often decline to enter into business transactions unless they could limit their liability).


9. In re Will of Clarke, 204 Minn. 574, 579, 284 N.W. 876, 879 (1939).

10. Id.

11. See, e.g., Erickson-Hellekson-Vye Co. v. A. Wells Co., 217 Minn. 361, 381-82, 15 N.W.2d 162, 173 (1944); 1 W. FLETCHER, supra note 8, § 41.2.

12. See United Paperworkers Int'l Union v. Pentech Papers, Inc., 439 F. Supp. 610, 617 n.7 (N.D. Me. 1977). The disregard remedy must be evaluated in terms of the two strong competing policies involved in the cases: the necessity to foster the growth of the
anced against the public policies supporting performance of contracts, repayment of debt, and compensation for personal injury. Normally this evaluation occurs in cases involving close, parent-subsidiary, or affiliated corporations because the doctrine is rarely invoked against large publicly held corporations having many shareholders. The more liberal use of the corporate disregard remedy over the last half-century reflects the frequently superior equities of the wronged creditor vis-à-vis the somewhat more abstract benefits to the national economy flowing from corporateness. This Note will examine the doctrine of corporate disregard as it has developed in Minnesota. Moreover, alternative theories and a suggested approach will be set forth. Finally, exceptional applications of the doctrine involving policies not normally relevant to most disregard actions will be evaluated.

II. MINNESOTA LAW
A. Traditional Concepts

The Minnesota Supreme Court has a long history of struggling with the scope of the corporate disregard doctrine. As in most jurisdictions, however, the Minnesota court has yet to elucidate standards concerning the doctrine, although the court in a recent decision has taken some corporate style of doing business and the need to compensate or pay corporate creditors. See Dobbyn, A Practical Approach to Consistency in Veil-Piercing Cases, 19 U. KAN. L. REV. 185, 185 (1971). A triangle of interests is presented: a plaintiff seeking to enforce an obligation, a corporation being held directly liable to the plaintiff, and a shareholder on whom the plaintiff is seeking to shift the liability. Id.


15. See McCaskill Co. v. United States, 216 U.S. 504, 515 (1910) (growing tendency to pierce corporate veil); Metropolitan Holding Co. v. Snyder, 79 F.2d 263, 266 (6th Cir. 1935); Note, The Bodies Behind the Veil, 76 S. AFR. L.J. 89, 90 (1959) (judges in America are more willing to pierce the veil than judges in South Africa or Great Britain).

16. See notes 19-120 infra and accompanying text.

17. See notes 121-97 infra and accompanying text.

18. See notes 198-223 infra and accompanying text.

19. See Note, Corporations—Disclosing the Actual Identity of Related Corporations for the Purpose of Ignoring the Corporate Fiction When One is Insolvent, 4 MINN. L. REV. 219, 221 (1920) (no disregard rule has been established which might furnish accurate test of disregard). See generally Wang, The Corporate Entity Concept (Or Fiction Theory) and the Modern Business Organization, 28 MINN. L. REV. 341 (1944).

A federal court in 1905 formulated what has been described as a “landmark” disregard rule: “[W]hen the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime, the law will regard the corporation as an association of persons.” United States v. Milwaukee Refrigerator Transit Co., 142 F. 247, 255 (E.D. Wis. 1905). A leading commentator apparently embraced the formulation. See Wormser, Piercing the Veil of Corporate Entity, 12 COLUM. L. REV. 496, 517 (1912). The Minnesota Federal District Court apparently adopted the Milwaukee formulation in the decision of In re O'Brien, 40 F.2d 554, 555 (D. Minn. 1930). The rule’s weakness is its inutility as an
steps in that direction. In the latter part of the last century and the early part of the present one the Minnesota Supreme Court was reluctant to apply the doctrine of corporate disregard. The court’s attitude was based primarily on its great respect for the independence of the corporate entity, perhaps as a consequence of the Industrial Revolution. For example, in *Gallagher v. Germania Brewing Co.*, decided in 1893, the court stated that “it has been found absolutely essential, for the administration of justice, to treat a corporation as a collective entity, without regard to its individual shareholders. In no other way can title to corporate property be kept free from complication and uncertainty.” Similarly, in *Moe v. Harris*, the court denied corporate creditors a remedy against shareholders of a corporation that had subscribed no stock, kept no books, adopted no bylaws, held no meetings, and elected no officers. Thus the court established early a firm respect for the corporate entity.

Despite the court’s initial reluctance to invoke the corporate disregard remedy, the injustices that can result from improper use of the corporate form caused the court to change its position. The factors the court has considered when deciding whether to invoke the corporate disregard

analytic tool or standard by which to measure conduct. See Dobbyn, *supra* note 12, at 185-86 (years of quoting the formula have added little to its usefulness).

20. See notes 62-65 infra and accompanying text.

21. Minnesota commentators perhaps contributed to that attitude, urging that the corporate entity only be pierced in cases of actual common law fraud. See Note, *Corporations—Disregarding the Concept of a Separate Corporate Entity—Especially in Cases Lacking Elements of Fraud*, 10 Minn. L. Rev. 598, 599-600 (1926). For an early view advocating the abolition of the corporate disregard remedy on the rationale that the same result can almost always be reached through other legal principles, see 20 Harv. L. Rev. 223, 224 (1906).

22. One authority states:

[T]he steaming breath of the Industrial Revolution was hot on the backs of businessmen and lawyers. The barriers created by the South Sea Bubble Acts began to give way in England in the first ten years of the 19th century; and in the second and third decades here the old prejudices [against corporations] went by the board.

.... The corporate clothing of the early 19th century did not fit the burgeoning industry of the second half; and the community, perhaps wisely, decided that it would rather have economic growth than social control.


23. 53 Minn. 214, 54 N.W. 1115 (1893).
24. Id. at 219, 54 N.W. at 1116.
25. 142 Minn. 442, 172 N.W. 494 (1919).

26. The Minnesota court offered the following practical reasons for not piercing the corporate veil: (1) title to corporate property must be kept free from complication, (2) the transferable nature of stock supports keeping shareholders distinct from the corporate entity, and (3) the individual and corporate obligations of the shareholders should be kept separate. See Gallagher v. Germania Brewing Co., 53 Minn. 214, 219, 54 N.W. 1115, 1116 (1893).
remedy include fraud, failure to observe corporate formalities, inadequate capitalization, excessive control or dominance, and presence of subsidiary or affiliated corporations. The court’s treatment of each of these factors will be discussed below.

1. Fraud

The most important doctrinal shift in Minnesota corporate disregard law, presaged by earlier opinions, occurred in Matchan v. Phoenix Land Investment Co. In that case the shareholder utilized several corporations through which he passed property in an attempt to avoid his creditors. Characterizing the transactions as "grossly and intentionally fraudulent," the court held that the shareholder’s fraud was attributable to the corporation. In a vivid example of the metaphoric language so familiar to this area of the law, the court stated the following rule:

Where a corporation has been organized and used as an instrument of fraud; where, as here, an individual has incorporated himself in order to hinder and, if possible, defraud creditors, courts will go as far as necessary in disregarding the corporation and its doing in order to accomplish justice. Such a corporation is a mere parasitic growth, a mass of fungus, which will be lopped off clean whenever necessary to sound results.

Thus, the court in Matchan established the basic rule that the corporate entity will be disregarded when used by its shareholders to perpetrate a fraud.

The dominant theme in Minnesota corporate disregard law since Matchan has been the requirement of fraudulent shareholder conduct, although a recent case, Manufacturers Building, Inc. v. Heller, allowed disregard without a finding of fraud. In Heller the court disregarded a corporate entity to decide a dispute between its shareholders after the trial court found that fraud was not involved. This apparent contradic-

27. See Note, supra note 19.
29. 159 Minn. 132, 198 N.W. 417 (1924).
30. Id. at 137, 198 N.W. at 419.
31. Id. at 138, 198 N.W. at 420.
32. It is well established that fraud is a leading factor in disregard law. See 1 W. FLETCHER, supra note 8, § 44; Note, supra note 21.
34. 306 Minn. 180, 235 N.W.2d 825 (1975), noted in 3 WM. MITCHELL L. REV. 293 (1977).
tion can be explained by the fact that *Heller* did not involve corporate creditors but rather concerned a dispute among shareholders of a close corporation. In such a case, disregard can be justified on the rationale that partnership law often establishes more appropriately the rights of close-corporation shareholders *inter se* when third-party creditors are not involved. When third-party creditors are involved the fraud requirement is probably still applicable.

Cases following *Matchan* indicate that the fraud requirement does not contemplate strict common law fraud, but rather fraud in the more general sense of using the corporate entity in an unjust manner. These cases suggest that other factors may be relevant to whether the corporate entity should be disregarded, such as failure to follow corporate formalities, inadequate capitalization, and shareholder dominance of the corporation, but generally only if they are coupled with fraud or themselves result in fraud. Although fraud has dominated Minnesota corporate disregard law, the court has given weight to these other factors and therefore they do merit discussion.

### 2. Corporate Formalities

Corporations are expected to follow certain formalities, such as adopting bylaws, preparing minutes, keeping corporate and shareholder assets separate, and holding shareholders’ and directors’ meetings. Failure to comply with these requirements, however, is not fatal under the statutes to the corporate existence of an otherwise de jure corporation. Thus, in *Whitney v. Leighton*, the court held that evidence of

---

36. See Erickson-Hellekson-Vye Co. v. A. Wells Co., 217 Minn. 361, 380-82, 15 N.W.2d 162, 172-73 (1944) (corporate entity will be disregarded to obviate inequitable results); Prudential Ins. Co. of America v. A. Ankema Holding Co., 196 Minn. 154, 158, 264 N.W. 576, 578 (1936) (corporate entity will be disregarded to achieve some strong equitable result). This definition of fraud in disregard law is followed by most authorities. See, e.g., 1 W. FLETCHER, supra note 8, § 44 (actual or constructive fraud). Constructive or legal fraud has been defined to mean a breach of a legal or equitable duty that tends to deceive others or to injure public interests. Stern v. National City Co., 25 F. Supp. 948, 957 (D. Minn. 1938), aff’d sub nom. City Co. v. Stern, 110 F.2d 601 (8th Cir. 1940), rev’d on other grounds per curiam, 312 U.S 666 (1941).
37. See notes 41-51 infra and accompanying text.
38. See notes 52-58 infra and accompanying text.
39. See notes 59-65 infra and accompanying text.
40. See Note, supra note 19, at 222, 227 (failure to observe formalities and shareholder dominance are merely evidentiary facts which are not conclusive).
41. See MINN. STAT. § 301.24 (1976).
42. See id. § 301.34(2).
44. See MINN. STAT. §§ 301.25, .28 subd. 4(3) (1976).
45. See Moe v. Harris, 142 Minn. 442, 172 N.W. 494 (1919).
46. 225 Minn. 1, 30 N.W.2d 329 (1947), aff’d on rehearing, 225 Minn. 12, 30 N.W.2d 335 (1948).
failure to follow corporate formalities alone was not sufficient to justify corporate disregard. In Whitney, the defendant shareholder intermingled corporate and personal funds and failed to keep separate corporate financial records, yet the court held that "[i]n the absence of fraud, the corporation must be treated as a legal entity separate and apart from its stockholders."\(^47\) Whitney seems to have made it clear that lack of formalities, without a showing of fraud, is not sufficient to justify the piercing remedy.\(^48\)

Nonetheless, failure to observe corporate formalities is a factor the court can and normally will consider. For example, in General Underwriters, Inc. v. Kline,\(^49\) decided after Whitney, the court disregarded the corporate entity, emphasizing that the corporation kept no books of account, had no corporate minutes for the preceding four years, could not locate its corporate records, and had no separate corporate offices. The General Underwriters court also found the defendant shareholder had used the corporation as an instrument to defraud creditors.

Evidence of failure to observe corporate formalities pervades corporate disregard law.\(^50\) This emphasis suggests that the failure to observe corporate formalities is sufficient by itself to justify disregard of the corporate entity. Analysis of Whitney and General Underwriters, however, suggests that failure to observe formalities is relevant because it may show fraud or injustice. Thus, evidence of failure to observe corporate formalities is relevant in Minnesota corporate disregard law, but perhaps for reasons different than those in other jurisdictions. Moreover, failure to observe formalities may indicate the shareholder's view of the business organization, and the court legitimately may take this into consideration in deciding whether to disregard the corporate entity.\(^51\)

3. Inadequate Capitalization

The Minnesota Supreme Court has not had the opportunity to delineate the role that inadequate capitalization of a corporation by its shareholders should play in relation to the corporate disregard remedy.\(^52\) A

---

47. 225 Minn. at 8, 30 N.W.2d at 333.
48. Accord, Moe v. Harris, 142 Minn. 442, 172 N.W. 494 (1919) (court denied piercing remedy and suggested creditors might have a remedy against the shareholders on a common law fraud theory).
49. 233 Minn. 345, 46 N.W.2d 794 (1951).
51. E.g., Edward Finch Co. v. Robie, 12 F.2d 360, 362 (8th Cir. 1926); United States v. Figur, 80 F. Supp. 140, 141-42 (D. Minn. 1948). Disregard based on failure to observe formalities and fraud has been labelled the "identity" rule of the doctrine. E.g., Dobbyn, supra note 12, at 186-87. The metaphor "identity" suggests an impermissible failure to separate personal and corporate business and thus serves as a basis for disregard. Id.
52. Other courts have struggled with the role of inadequate capitalization. Compare, e.g., Minton v. Cavaney, 56 Cal. 2d 576, 579-80, 364 P.2d 473, 475, 15 Cal. Rptr. 641, 643 (1961) (in bank) (shareholders are personally liable "when they provide inadequate capitalization and actively participate in the conduct of corporate affairs") with, e.g., Harris
decision sometimes cited by other authorities as a leading inadequate capitalization case is Erickson v. Minnesota & Ontario Power Co. In Erickson a subsidiary corporation caused property damage to the individual plaintiff. The subsidiary was without funds to pay for the damage, apparently because the defendant parent corporation capitalized the subsidiary in a manner that left it without any revenue. The court held the parent corporation liable for the subsidiary's tort, presumably at least in part because the parent caused the subsidiary to be inadequately capitalized. Erickson, however, is not without ambiguity. The court purported to impose shareholder liability on agency principles rather than by disregarding the corporate entity of the subsidiary. Moreover, the court did not state clearly the role inadequate capitalization played in its decision. Nonetheless, Erickson does provide support for the proposition that inadequate capitalization can be a reason for imposing shareholder liability.

The Erickson decision could suggest that inadequate capitalization is sufficient, without a showing of fraud, to disregard a corporate entity. The court has never decided this issue, but it has suggested that inadequate capitalization is relevant because it tends to prove that fraud occurred. Although Minnesota law is by no means clear on this point, this suggests that inadequate capitalization probably is not sufficient to invoke the piercing remedy unless it amounts to a fraud upon the corporation's creditors.

v. Curtis, 8 Cal. App. 3d 837, 841, 87 Cal. Rptr. 614, 617-18 (1970) ("Appellants would have us declare that, per se, inadequate capitalization renders the shareholders, officers and directors liable for the obligations of the corporation. They cite no case so holding, and we know of none.").


54. 134 Minn. 209, 158 N.W. 979 (1916).

55. Id. at 214, 158 N.W. at 981; see 77 U. Pa. L. Rev. 808, 809 (1929) (citing Erickson for proposition that agency law is superior to application of disregard doctrine). For a general discussion of the law of agency and shareholder liability, see notes 89-93 infra and accompanying text.


57. In support of its decision to pierce, the court merely reviewed the capitalization facts and then held that the subsidiary was the "mere agency" of the defendant. See Erickson v. Minnesota & Ont. Power Co., 134 Minn. 209, 214, 158 N.W. 979, 981 (1916).

4. Shareholder Dominance

Many early Minnesota corporate disregard cases emphasize the dominance exercised over the corporation by the defendant shareholder. Some even suggest that dominance alone can be a basis for imposing personal liability upon shareholders, although these cases normally involve fraud as well as shareholder dominance. The shareholder dominance factor is an elusive one, especially in the close-corporation setting, for the close corporation invariably is dominated by its shareholders. The Minnesota Supreme Court recognized this in a relatively recent decision, Ahlm v. Rooney, where it held that shareholder dominance of a close corporation, without fraud, was not a sufficient basis for imposing shareholder liability. The court recognized that the corporation was completely dominated by the defendant shareholder, but stated this was a phenomenon inherent in closely held corporations. In light of Ahlm, dominance rightfully should play a minimal role in most future Minnesota corporate disregard cases.

5. Parent-Subsidiary and Affiliated Corporations

The limited liability principle is designed primarily to benefit individual shareholders, and therefore the policies favoring limited liability probably are not as strong in cases involving subsidiary or affiliated corporations. For this reason, the courts often are more willing to pierce the corporate veil if the shareholder is a corporation.


61. See cases cited in note 60 supra.

62. See Kramer, Symposium—The Close Corporation—Foreword, 18 L. & CONTEMP. PROB. 433, 433 (1953); cf. Note, Judicial Supervision of the One Man Corporation, 45 HARV. L. REV. 1084, 1086 (1932) (dominance standard means little in sole shareholder corporation context; courts will either pierce veil or respect it depending upon the result desired).

63. 274 Minn. 259, 143 N.W.2d 65 (1966).

64. Id. at 264, 143 N.W.2d at 69.

65. See notes 186-93 infra and accompanying text.


67. See H. HENN, supra note 1, §§ 147-148 (absent illegitimate purposes, individual shareholders must observe two requirements to retain recognition of corporateness; subsidiary or affiliated corporations must observe five); E. LATTY, supra note 66, at 194-95;
It is clear that a parent or control corporation's complete stock ownership in a subsidiary or affiliate is not sufficient alone to pierce the corporate veil. Beyond this principle, the Minnesota court's treatment of parent-subsidiary or affiliated corporations in disregard cases has not been consistent. In *Erickson v. Minnesota & Ontario Power Co.*, discussed earlier, the court held the parent corporation liable for the tort of its inadequately capitalized subsidiary. Similarly, the court in *Specht v. Missouri Pacific Railroad* held the parent liable for the subsidiary's tort because both corporations were part of the same business enterprise. In neither *Erickson* nor *Specht* did the court indicate fraud was a prerequisite to the imposition of shareholder liability upon the parent corporations. In the more recent case of *Di Re v. Central Livestock Order Buying Co.*, however, the court stated emphatically that "[in the absence of a claim and showing of fraud or other wrongful purposes, the subsidiary must be treated as a legal entity separate and apart from the parent."

Thus, *Di Re* could be viewed as altering any implications from the previous *Erickson* and *Specht* decisions, especially because the court's language in *Di Re* is much more specific than in *Erickson* or *Specht*. Yet the cases might be distinguished on the basis that *Di Re* was not a tort-creditor case while *Erickson* and *Specht* did involve tort

Hamilton, *The Corporate Entity*, 49 Tex. L. Rev. 979, 992 (1971); Note, supra note 53, at 872 n.1 (liability more limited when shareholder is not a corporation). But see Horowitz, *Disregarding the Entity of Private Corporations*, 14 Wash. L. Rev. 285, 293 (1939) (corporate entity more frequently disregarded when shareholder is individual rather than corporation). Some commentators reject the view that parent and control corporations should be treated differently, apparently on the rationale that the individual shareholders of the parent or control corporation suffer economic loss by the parent or control corporation's payment. See, e.g., 11 Ark. L. Rev. 450 (1957); 56 Mich. L. Rev. 299, 300 n.5 (1957). For a general discussion of parent-subsidiary disregard in cases involving contracts and torts, see Annot., 38 A.L.R.3d 1102 (1971) (liability of corporation for contracts of subsidiary); Annot., 7 A.L.R.3d 1343 (1966) (liability of corporation for torts of subsidiary).

68. *See, e.g.,* State v. Chicago & Nw. Ry., 133 Minn. 413, 415-16, 158 N.W. 627, 628 (1916).

69. 134 Minn. 209, 158 N.W. 979 (1916).

70. See notes 54-57 supra and accompanying text.

71. 154 Minn. 314, 191 N.W. 905 (1923). In *Specht*, a subsidiary was formed to avoid a large filing fee demanded by the state of Nebraska in which the railroad system was operating. An employee of the subsidiary was injured in Nebraska by a defective railroad car owned by the parent corporation. However, an agreement between the parent and its subsidiary provided that possession of all equipment entering Nebraska would pass to the subsidiary at the state line. The court held that the subsidiary was a mere agent of the parent. *Id.* at 320-21, 191 N.W. at 907-08.

72. 246 Minn. 279, 74 N.W.2d 518 (1956). In *Di Re*, the plaintiff was laid off by a subsidiary but was told that there was a position open for him with the parent corporation. Plaintiff refused the offer largely because the position was not consistent with his past training and skills. When plaintiff sought unemployment compensation, the subsidiary refused the claim, contending that the two corporations should be deemed to be a single employer and therefore the new position was merely a transfer. The court rejected the subsidiary's argument.

73. *Id.* at 284, 74 N.W.2d at 523.
creditors. This distinction can be justified on the rationale, discussed in greater detail elsewhere in this Note, that tort creditors normally do not have the opportunity to investigate the financial stability of the subsidiary. On the other hand, the Di Re court may have been reacting narrowly to the shareholders’ attempt in that case to pierce because corporate entities rarely are disregarded for the benefit of shareholders. Thus, Minnesota disregard law in the area of multiple corporations must be considered unsettled.

B. In re Will of Clarke—A Conceptual Modification

The previous discussion sets forth the traditional approach taken by the Minnesota Supreme Court in corporate disregard cases. In a small number of cases, however, the court has deviated from the traditional approach and has applied a conceptually different approach. The leading case applying this different approach is In re Will of Clarke, decided in 1939. Clarke involved questionable dividend payments made by a corporation, the stock of which constituted the corpus of a trust. The trustee also was the life beneficiary of the trust, and as trustee she caused the corporation to make large dividend payments to herself as life beneficiary of the trust. Remainder beneficiaries objected to the trustee’s questionable activities and sought to have her adjudged personally liable. The trustee denied liability, contending that the corporate entity was responsible for the excessive dividend policy. The Clarke court used this opportunity to embark on a basically philosophical discussion of the corporate disregard doctrine. The court emphasized that a corporation is not a legal fiction but rather is a real legal person and as such can never be disregarded. Although holding the trustee person-

74. See notes 151-93 infra and accompanying text.


76. 204 Minn. 574, 284 N.W. 876 (1939).

77. This distinction has long been debated in Minnesota law. Although the corporation is considered an entity separate and distinct from its shareholders, see, e.g., Corcoran v. P.G. Corcoran Co., 245 Minn. 258, 269, 71 N.W.2d 787, 795 (1955), its conceptual nature has been subject to dispute. The Minnesota court sometimes has viewed the corporation as a fiction having no existence independent of statute. See, e.g., Gallagher v. Germania Brewing Co., 53 Minn. 214, 218, 54 N.W. 1115, 1116 (1893). At other times the Minnesota court has viewed it as an entity having existence independent of statute. See, e.g., Matthews v. Minnesota Tribune Co., 215 Minn. 369, 373, 10 N.W.2d 230, 232 (1943). The Clarke court adopted the latter theory which apparently was central to the rationale that liability should be placed directly on the wrongdoer involved. The court’s analysis probably would not have suffered, however, had the court viewed the entity as a fiction instead of an independent entity. See I. Wormser, DISREGARD OF THE CORPORATE FICTION AND ALLIED CORPORATION PROBLEMS 43 (1927) (nature of corporate entity is a tempting but profitless discussion, more metaphysical than legal).
ally liable, the court offered the following rationale as a substitute for traditional disregard analysis: 78

Many cases present avowed disregard of corporate entity. . . . But they all come to just this—courts simply will not let interposition of corporate entity or action prevent a judgment otherwise required. Corporate presence and action no more than those of an individual will bar a remedy demanded by law in application to facts. . . . The method neither pierces any veil nor goes beyond any obstruction, save for its refusal to let one fact bar the judgment which the whole sum of facts requires.

For such reasons, we feel that the method of decision known as "piercing the corporate veil" or "disregarding the corporate entity" unnecessarily complicates decision. It is dialectically ornate and correctly guides understanding, but over a circuitous and unrealistic trail. The objective is more easily attainable over the direct and unencumbered route followed herein.

The Clarke reasoning provides a viable alternative to traditional disregard analysis. The court's point was a simple one: if an individual's fraudulent or inequitable activities, even if done on behalf of a corporation, indicate the individual should assume personal liability for his activities, then the individual should be held liable personally regardless of the existence of the corporate entity. 79

To a large extent, the distinction between Clarke and the more traditional approach is semantical, but Clarke also represents a shift in emphasis. Under Clarke, the activities of the individual defendant are scrutinized rather than those of the corporation. This shift in emphasis also could cause a shift in result. The result under traditional disregard analysis normally is to treat the corporation as a partnership and hold all shareholders liable as partners, even if some shareholders were not parties to the fraud or injustice. 80 The Clarke approach, however, would result in liability only to those persons who were parties to the fraud or injustice, a result arguably more defensible than that of the traditional corporate disregard approach. 81 Because the Minnesota court has followed both approaches in its allocation of liability, 82 it is unclear in Minnesota who should be held liable upon disregard.

---

78. 204 Minn. at 578-79, 284 N.W. at 878-79.
79. For a similar view, see Canfield, The Scope and Limits of the Corporate Entity Theory, 17 Colum. L. Rev. 128 (1917).
80. See, e.g., Manufacturers Bldg., Inc. v. Heller, 306 Minn. 180, 235 N.W.2d 825 (1975), noted in 3 Wm. Mitchell L. Rev. 293 (1977); 1 W. Fletcher, supra note 8, § 41.3.
If the *Clarke* rationale has any shortcoming it is that sufficient deference may not be given to the principle of limited shareholder liability. The standards promulgated in *Clarke* are vague and, if followed, possibly could result in shareholder liability to an extent that might undermine the utility of incorporation, especially for small businesses. This shortcoming could be avoided if fraud or injustice on the part of the shareholder was still required as a prerequisite to liability.

The present status of the *Clarke* approach is uncertain. At infrequent intervals the court will cite *Clarke* and apply its reasoning instead of following more traditional Minnesota corporate disregard concepts. In other cases, the court ignores the *Clarke* rationale and speaks in terms of disregarding the corporate entity or piercing the corporate veil. The Minnesota court’s failure to identify which of these conceptually different approaches (with potentially different results) should control represents one of the major uncertainties in Minnesota corporate disregard law.

C. Related Theories

The Minnesota Supreme Court and most other courts have developed several theories of law that either supplement or in appropriate cases supplant the corporate disregard theory. The primary related theories are agency, estoppel, and fraudulent conveyances law.

83. See Horowitz, *supra* note 67, at 288 n.18 (in *Clarke* the court rejected the disregard doctrine but substituted an equally unsatisfactory standard because of its vagueness).

84. *Clarke*’s foundation, of course, was a form of fraud; the trustee wrongfully appropriated trust funds to her own use and to the detriment of remainder beneficiaries. The court since *Clarke* has suggested that fraud is a requirement under the *Clarke* rationale. See General Underwriters, Inc. v. Kline, 233 Minn. 345, 349-50, 46 N.W.2d 794, 797 (1951).


87. In 24 MINN. L. REV. 107, 109 (1939) the writer suggested that the Minnesota Supreme Court in *Clarke* apparently “paved the way for a clearer understanding” of the relationship between corporations and their shareholders. Because the Minnesota court has cited both the *Clarke* theory and traditional disregard theory in support of its shareholder liability decisions, this appeal apparently has not been heeded.

1. Agency

Courts are fond of stating that a corporate entity can be disregarded because it was acting as an agent for its shareholders. Often when the courts refer to a corporation as a "mere agent" for its shareholders the agency language is used as a metaphor like "alter ego" or "instrumentality" and is not intended to represent a strict application of agency principles. It is wrong to refer to the application of agency principles as a method of disregarding a corporate entity; rather, agency law and corporate disregard law should be considered as distinct legal theories available for imposing shareholder liability.

Occasionally, however, a corporation does act as an agent for its shareholders. When this ground for imposing shareholder liability is available, it probably is a sound and preferable basis for imposing liability because agency law has relatively clear and well-developed standards. A finding of agency obviates the need to consider the applicability of the corporate disregard theory, and reference to agency as a basis for disregarding a corporate entity merely confuses the analysis. Thus,


90. For example, a federal court stated in New York Trust Co. v. Carpenter, 250 F. 668, 673 (6th Cir. 1918), aff'd on second appeal sub nom. Wheeling & L.E.R.R. v. Carpenter, 264 F. 772 (6th Cir. 1920):

The District Court used the word "agency" as a synonym of "adjunct," whatever that may mean, and as descriptive of a relation variously defined in the cases as "adjunct," "branch," "instrumentality," "dummy," "buffer," and "tool," but all in the sense of "means" through which a corporation's own business is actively prosecuted; or of the relation created when two corporations are in substance identical though operating under different names.


92. See New York Trust Co. v. Carpenter, 250 F. 668, 673 (6th Cir. 1918) ("if a corporation is the agent of another . . . through which the other, as principal, . . . carries on business, the liability of the principal will be ascertained through principles of law well-known and long-established"), aff'd second appeal sub nom. Wheeling & L.E.R.R. v. Carpenter, 264 F. 772 (6th Cir. 1920); Elvalsons v. Industrial Covers, Inc., 269 Or. 441, 452, 525 P.2d 105, 111 (1974); Annot., 38 A.L.R.3d 1102, 1116-19 (1971). See generally RESTATEMENT (SECOND) OF AGENCY (1958).

93. See, e.g., Note, Piercing the Corporate Veil in Louisiana, 22 Loy. L. Rev. 993, 1000 (1976).
the courts should guard against using agency law as a guise for imposing shareholder liability in cases where the facts indicate the corporation was not acting as an agent for its shareholders.

2. Estoppel

An additional concept that may be relevant to the shareholder liability question is that of equitable estoppel. An estoppel arises when a person’s conduct precludes him from asserting a right which he might otherwise have asserted because another person in good faith has relied detrimentally upon such conduct. The doctrine of estoppel has broad application in the shareholder liability area and can be used both by and against the person attempting to pierce the corporate veil.

Estoppel can be utilized on behalf of the plaintiff in cases where he did not know he was dealing with a corporation but instead believed he was contracting with the shareholder directly. For example, the Minnesota court has found individual liability in cases where individuals incorporated during a course of dealing with the plaintiff creditor. If the creditor was unaware of the incorporation and thought he was still dealing with individuals, and those individuals did not inform him otherwise, they will be individually liable to the creditor. A variation of this principle is found in Roberts v. Americana Nursing Homes, Inc., where plaintiff creditor obtained a judgment against defendant corporation and commenced garnishment proceedings. An affiliated corporation of the defendant intervened to assert that the funds sought by the plaintiff belonged to it, notwithstanding that the defendant possessed the funds. The court held the intervenor was estopped from asserting the separateness of the corporations because it had led the plaintiff to believe that the defendant owned the funds. When the intervenor argued that the court should not disregard the corporate entities involved, the court correctly noted that the doctrine of disregard was not applicable because the case was being decided on estoppel grounds.

The estoppel doctrine also can be utilized against the plaintiff credi-

95. See generally 1 W. FLETCHER, supra note 8, § 47.
96. See id. The same estoppel applies where creditors are misled as to which corporate debtor of a multiple-corporation enterprise they are dealing with. See, e.g., June v. Vibra Screw Feeders, Inc., 6 Mich. App. 484, 489, 149 N.W.2d 480, 482 (1967); Roberts v. Americana Nursing Homes, Inc., 293 Minn. 388, 196 N.W.2d 296 (1972) (per curiam); Stauffer v. Isaly Dairy Co., 4 Ohio App. 2d 15, 27-28, 211 N.E.2d 72, 80 (1965).
97. See Johnson Bros. Oil Co. v. Chies, 293 Minn. 363, 199 N.W.2d 441 (1972).
98. Id.; accord, e.g., S. Davis, Inc. v. McGuckin, 51 Misc. 2d 1071, 274 N.Y.S.2d 1007 (City Ct. 1966).
99. 293 Minn. 388, 196 N.W.2d 296 (1972) (per curiam).
100. Id. at 390, 196 N.W.2d at 297-98.
The most prevalent situation is when the creditor is aware that he is dealing with a corporation and the shareholders have not misrepresented the financial condition of the corporation. In this situation, especially if the shareholders had refused to or were not requested to guaranty the debt individually, the court is likely to find that the creditor is estopped from asserting the shareholders are individually liable for the debt. Thus, estoppel principles can be of value to defendant shareholders as well as plaintiff creditors.

3. Fraudulent Conveyances

A final area related to shareholder liability is fraudulent conveyances law. Under the Uniform Fraudulent Conveyances Act, a creditor of the transferor can have a conveyance set aside in three basic situations: first, where the transfer was made with actual intent to hinder, delay, or defraud the creditors of the transferor; second, where the transferor was insolvent at the time of the conveyance or was rendered insolvent by the conveyance and the transfer was made for less than fair consideration; and third, where the transfer was made for less than fair consideration by a business left with an unreasonably small amount of assets. Consequently, for example, if an insolvent corporation transfers assets to its shareholders for less than market value, corporate creditors can have that transfer voided. Conversely, if an insolvent shareholder transfers assets to his corporation for less than market value, creditors of the shareholder can have the transfer set aside. Fraudulent conveyances law, of course, is distinct from corporate disregard law. The Minnesota court in the past, however, occasionally has intermingled the two theories. This intermingling is unfortunate because fraudulent conveyances law is a specific statutory form of relief with definite standards and requirements, and it does not necessarily involve the disregard of any corporate entity. Therefore, the failure to distinguish the two theories only serves to render both more confusing.


102. See Wm. Mueller & Sons v. Chanhassen Redi Mix, 273 Minn. 214, 220, 140 N.W.2d 326, 330 (1966); State v. Rivers, 206 Minn. 85, 95, 287 N.W. 790, 794-95 (1939); Northern Bldg. & Loan Ass'n v. Withrow, 205 Minn. 413, 415-16, 286 N.W. 397, 398 (1939); Kingsley v. English, 202 Minn. 258, 261, 278 N.W. 154, 156 (1938); Richards v. Minnesota Sav. Bank, 75 Minn. 196, 206, 77 N.W. 822, 824 (1899).


104. Id. § 513.23 ("balance sheet" insolvency); id. § 513.25 (equity insolvency).

105. Id. § 513.24.


109. It is important to distinguish the fraudulent conveyances and corporate disregard
D. Shortcomings of Minnesota Corporate Disregard Law

The present shortcomings of Minnesota corporate disregard law cannot fairly be said to be severe or the fault of the Minnesota Supreme Court. The court's strong and relatively consistent emphasis on fraud indicates that it has maintained a healthy and necessary respect for the separateness of corporate entities, permitting disregard of corporate entities only when necessary to avoid fraud or injustice. Moreover, the court's decision refusing to pierce in the close-corporation setting merely because of dominance by the shareholders indicates the court is sensitive to the reality that valid small corporations inevitably are dominated by their shareholders. The shortcomings that do exist can be attributed primarily to the fact that the court has not had the opportunity in recent years to draw distinctions that probably should be drawn in this area. For example, it probably is sound to distinguish between tort and contract creditors, for the former normally have no opportunity to investigate the solvency of the debtor corporation while the latter, contract creditors, generally can investigate before contracting. Similarly, inadequate capitalization quite arguably should be a major factor in deciding whether to disregard a corporate entity, for as a matter of public policy, shareholders should be required to give the corporation sufficient capital to pay reasonably foreseeable debts, at least with regard to potential tort liabilities. Finally, it might be proper to distinguish parent-subsidiary and affiliated corporation cases from noncorporate shareholder cases on the rationale that corporate shareholders deserve less protection through limited liability than do individual shareholders. The Minnesota Supreme Court has made none of these distinctions, primarily because it has not been presented with cases in which these distinctions should have been made.

Some of the present shortcomings of Minnesota corporate disregard law, however, are attributable directly to Minnesota Supreme Court decisions. The uncertain status of In re Will of Clarke, which purported to eliminate the disregard theory in Minnesota, is a major theories because of the differences in result that apply. When a fraudulent conveyance is set aside, the creditor's remedy is only against the asset transferred. When the corporate entity is disregarded, the creditor's remedy is against all of the shareholder's nonexempt assets. See Comment, Theory of the Corporate Entity and the One-Man Corporation in Louisiana, 38 Tulane L. Rev. 738, 743 (1964).

10. See note 33 supra and accompanying text.
12. For a discussion of this distinction, see notes 151-93 infra and accompanying text.
13. For a discussion of the appropriate role of inadequate capitalization in disregard law, see notes 153-54, 164-85 infra and accompanying text.
14. For a discussion of the special role of multiple-corporation structures in disregard law, see notes 189-93 infra and accompanying text.
15. 204 Minn. 574, 284 N.W. 876 (1939).
16. See notes 76-87 supra and accompanying text.
example. The court also has failed to explain justifiable deviations it has made from the traditional fraud approach. For example, in the 1976 case of *Manufacturers Building, Inc. v. Heller,* a corporate veil was pierced without a finding of fraud. The court failed to distinguish the facts of *Heller,* which involved a dispute among the shareholders, from cases involving third-party creditors. *Heller,* therefore, raises the issue of whether a corporate entity can be disregarded without a showing of fraud in cases involving corporate creditors. Similarly, the court’s occasional failure to distinguish agency and fraudulent conveyance principles from the disregard doctrine has created confusion. Consequently, although the Minnesota Supreme Court’s emphasis on fraud is generally sound, Minnesota corporate disregard law is in need of clarification and, in some instances, change.

III. ALTERNATIVE THEORIES

Most courts have done little toward developing a coherent set of principles to govern the disregard of corporate entities. However, some courts and commentators have suggested alternatives to the vague standards presently applied by most courts. This section will discuss some of the noteworthy examples of those alternatives.

A. The Metaphor Approach

Corporate disregard law is laden with judicial pronouncements of metaphors that, in many cases, seem to serve as the basis for shareholder liability. “Alter ego,” “instrumentality,” or any of the other piercing metaphors accomplish this result. The purpose of the meta-

118. In *Heller,* the court found no evidence of fraud or unfair dealing. See 306 Minn. at 183, 235 N.W.2d at 827.
120. See notes 89-93, 103-09 supra and accompanying text.
121. See, e.g., Swanson v. Levy, 509 F.2d 859, 861-62 (9th Cir. 1975) (test of piercing the corporate veil has rarely been articulated with any clarity); Hanson Sw. Corp. v. Dal-Mac Constr. Co., 554 S.W.2d 712, 717 (Tex. Ct. App. 1977) (much confusion exists over the criteria necessary for disregarding the corporate entity). See generally Wang, supra note 19.
122. E.g., General Underwriters, Inc. v. Kline, 233 Minn. 345, 346, 46 N.W.2d 794, 796 (1951).
123. E.g., State v. McBride, 215 Minn. 123, 130, 9 N.W.2d 416, 420 (1943).
phor policy ostensibly is to point to some improper relation between the shareholders and the corporation that serves as the basis for disregard. What is important to the piercing decision, however, is not the selection of a guideless metaphor but rather is the shareholder conduct and nature of the claim involved in the case. Metaphors add nothing but confusion to the analysis and therefore should be avoided.

**B. The California Approach**

The California courts, and courts in other jurisdictions following the California lead, have created a fixed standard by which to evaluate corporate disregard cases. Sometimes labelled the "alter ego" rule, these courts will pierce a corporate veil where two facts have been established: (1) such a unity of interest and ownership between the corporation and its shareholders that the individuality of the corporation has ceased, and (2) the observance of the entity would sanction a fraud or

("hollow legal shell"); State v. Creamery Package Mfg. Co., 110 Minn. 415, 433, 126 N.W. 126, 129 (1910) (mere "cloak"). Professor Henn found 37 metaphors in common use. See H. Henn, supra note 1, at 250 n.2.

125. See Dobbyn, supra note 12, at 187 (common denominator of metaphor approach is concern for the relationship between shareholder and corporation).

126. In Berkey v. Third Ave. Ry., 244 N.Y. 84, 94, 155 N.E. 58, 61 (1926), Judge Cardozo recognized the evil of the metaphor approach in the parent-subsidiary corporations context: "The whole problem of the relation between parent and subsidiary corporations is one that is still enveloped in the mists of metaphor. Metaphors in law are to be narrowly watched, for starting as devices to liberate thought, they end often by enslaving it."


Much confusion exists in determining the criteria for disregarding the corporate entity. This confusion exists partially because of the words used to describe the condition. Courts have used such terms as "dummy," "sham," "instrumentality," "agency," "adjunct," "tool," "device," and "business conduit," to name a few. What these words mean relative to the fact situation of the case is elusive. Accord, Ballantine, supra note 91, at 18 (metaphors are too uncertain to be adopted as a test or rule of law); Fuller, supra note 6, at 1378-79 (metaphors often obscure the real issues involved). But see Taylor v. Standard Gas & Elec. Co., 306 U.S. 307, 322 (1939) (metaphors do not comprise a rule but rather merely designate the broader equitable principle that corporate entity will be disregarded when used to accomplish fraud or injustice).


DISREGARD OF THE CORPORATE ENTITY

promote injustice. To satisfy the first requirement, the plaintiff creditor ordinarily must prove the shareholder dominated the corporation and failed to observe corporate formalities, thus indicating the shareholders did not treat the corporation as a separate entity. The rationale of the two-tiered California approach appears to be that when the shareholders have not treated the corporation as a separate entity and, moreover, have used the entity as an instrument to perpetrate fraud or injustice, then the policies favoring incorporation are outweighed by those favoring compensation for creditors.

The California approach bears strong resemblance to present Minnesota law, especially with regard to the fraud or injustice requirement. The two-tier test might indicate that the second requirement, fraud, is insufficient by itself to pierce in California; thus, the creditor's burden would be greater there than in Minnesota. However, the facts in most Minnesota cases permitting corporate disregard indicate that the first requirement, unity of interest and ownership, also has been present. The creditor's burden in California, therefore, probably is not any greater than in Minnesota. In fact, the courts following the California rule have shown a marked willingness to employ the remedy.

The advantage of the California approach is that it provides some certainty to the application of the disregard doctrine and articulates the relevant conduct and policies involved rather than relying on vague metaphors. Its disadvantage is that it fails to distinguish among various fact situations, such as tort and contract cases and cases involving parent-subsidiary and affiliated corporations, that arguably should be


133. See Arnold v. Browne, 27 Cal. App. 3d 386, 397, 103 Cal. Rptr. 775, 783 (1972) (purpose of disregard doctrine not to protect every unsatisfied creditor; only where shareholders' bad faith conduct prevents payment will entity be disregarded).

134. In California, nonpayment of creditors through financial inability is not, without more, an inequitable result justifying disregard of the corporate entity. 30 S. CAL. L. REV. 538, 539 (1957). This approach is consistent with present Minnesota law. See Whitney v. Leighton, 225 Minn. 1, 8, 30 N.W.2d 329, 333 (1947) (must prove fraud), aff'd on rehearing, 225 Minn. 12, 30 N.W.2d 335 (1948).

135. See cases cited in note 33 supra.

136. See 2 G. HORNSTEIN, CORPORATION LAW AND PRACTICE § 751, at 138 n.18 (Supp. 1968); 30 S. CAL. L. REV. 538, 538 (1957) (many cases in which veil has been pierced under the broad California rule). The California courts are considered to be on the "forefront" of disregard cases involving inadequate capitalization. See Comment, supra note 66, at 136.

137. See Platt v. Billingsley, 234 Cal. App. 2d 577, 582, 44 Cal. Rptr. 476, 480 (1965) (long line of cases has established two criteria for piercing the corporate veil in California).

138. For a discussion of this distinction, see notes 151-93 infra and accompanying text.

139. For a discussion of this distinction, see notes 189-93 infra and accompanying text.
treated differently. The California approach, however, would improve present Minnesota law to the extent that it sets specific standards to be applied in most corporate disregard cases without radically changing the substance or flexibility of existing Minnesota law.

C. The Enterprise Entity Theory

Proposed by Adolph Berle in 1947, the enterprise entity theory of shareholder liability departs drastically from traditional disregard concepts. The theory applies to cases involving parent-subsidiary or affiliated corporation cases where business enterprises often are fragmented. Conceptually, the theory is quite simple. If one underlying business enterprise is composed of more than one corporate entity, then the entire enterprise should be held responsible for the liabilities of each component corporation. The classic New York taxi cases provide a vivid example for the application of Berle's theory. To minimize loss from foreseeable liabilities, individual taxis were separately incorporated as affiliates of a control corporation. Thus, if a taxi was involved in a serious accident, any payment for resulting liabilities was limited to the assets of the particular affiliate, typically a minimal amount, and the assets of the entire enterprise thereby were protected. Berle would ignore the separate components and hold the entire enterprise liable.

The enterprise entity theory is antithetical to traditional disregard theory and other corporate law principles which normally allow the

140. See Berle, The Theory of Enterprise Entity, 47 Colum. L. Rev. 343 (1947).
141. Id. at 354.
143. See Berle, supra note 140, at 354. In Specht v. Missouri P. R.R., 154 Minn. 314, 191 N.W. 905 (1923) the Minnesota Supreme Court seemed to apply a rationale similar to the enterprise entity theory. To avoid a large state filing fee, a railroad incorporated a subsidiary corporation to do business in that state. The subsidiary apparently was adequately capitalized, formalities were observed, and each corporation had virtually independent management. When an employee of the subsidiary was injured, he sued the parent and recovered. The court said: "Plainly, this whole railroad is one entity. The [subsidiary] corporation is a mere subsidiary agency of the defendant for carrying on the Nebraska section of this composite whole." Id. at 320, 191 N.W. at 907.
144. See Ballantine, supra note 91, at 17 ("Even when two or more corporations are associated together under common control as several branches or departments of a single common enterprise, they are still normally to be regarded as separate and independent legal entities."). The enterprise entity theory essentially collapses multiple-corporate structures into a single enterprise for liability purposes and thereby implicitly disregards the separate identities of all the corporations involved. This approach to corporate disregard conflicts with the general rules that multiple corporations are considered separate and distinct entities, see, e.g., Di Re v. Central Livestock Order Buying Co., 246 Minn. 279, 283, 74 N.W.2d 518, 523 (1956), and that sole stock ownership of one corporation by another does not destroy the former's legal entity, see, e.g., Belle City Malleable Iron Co.
use of complex corporate organizations. As a result, the theory has not been widely adopted. However, Berle's analysis does point to a potentially serious problem: the use of subsidiary and affiliated corporations can be abusive, especially where they obviously are undercapitalized in view of their foreseeable liabilities. Thus while most courts have been reluctant to adopt the enterprise entity theory, many of them, invoking traditional disregard principles, have exhibited a greater tendency to disregard a subsidiary's or affiliate's corporate status than that of a corporation owned by individual shareholders. This tendency would seem to be sound, for it is more onerous to impose liability on individuals than on a parent corporation whose own shareholders still retain limited liability (although they admittedly will suffer some financial loss if the parent is made to pay for the subsidiary's liabilities).

IV. Suggested Approach

The California and enterprise entity approaches offer valuable contributions to corporate disregard law, but neither is sufficiently comprehensive. The shortcomings of present Minnesota law call for a reevaluation of corporate disregard that draws from the best aspects of these approaches, present Minnesota law, and suggestions by other commentators. Set forth below is a suggested approach to corporate disregard. The basic premise of this suggested approach is that the courts should consider the nature of the claim involved before applying the corporate disregard remedy. There are essentially two types of creditor's claims: contract or consensual claims, and tort or nonconsensual claims. Each


145. See Milwaukee Motor Transp. Co. v. Commissioner of Taxation, 292 Minn. 66, 72-73, 193 N.W.2d 605, 609 (1971) ("There is nothing wrong with the organization of a subsidiary corporation to carry on a phase of the parent company's operations, and, in contemplation of law, the liabilities and obligations arising from such transactions between them may be the same as those existing between corporations having no common relationship.").


147. See Hanson v. Bradley, 298 Mass. 371, 380, 10 N.E.2d 259, 264 (1937) (not unusual for creators of subsidiary corporations to capitalize them inadequately and thereby impede creditors' ability to collect).


149. See E. Latry, supra note 66, at 193-201; Fuller, supra note 6, at 1377 n.13, 1382 (initial insulation against liability involved in individual shareholder case; double insulation involved in parent-subsidiary case).

150. Contract creditors may be considered consensual creditors because they consented to do business with the corporation. See Cataldo, Limited Liability with One-Man Com-
type will be considered separately, followed by a discussion of the allocation of liability among shareholders or others responsible for the loss.

A. Contract or Consensual Creditors

The consensual creditor normally intends to bargain with the corporation. In the usual case, the freedoms of contract are available during negotiations, including the opportunity to investigate the financial stability of the corporation and the ability to negotiate for shareholder guaranty of the obligation. If the creditor fails to take advantage of these opportunities, he should be deemed to have done so at his own risk, especially in view of the widespread understanding of the limited liability principle. Consequently, evidence of shareholder dominance, inadequate capitalization, or failure to observe corporate formalities...
should have little relevance in most consensual creditor disregard cases, unless they otherwise indicate a fraud on creditors. In these cases, the policies supporting limited liability should prevail over those favoring compensation of creditors because the equities of an unpaid creditor who was free to evaluate the corporate debtor and failed to obtain security are not compelling.

The policies favoring limited liability in consensual creditor cases, however, are significantly lessened when the transaction is tainted with fraud, deception, or misrepresentation. When the corporation’s financial adequacy is misrepresented or the fact of incorporation is suppressed, the consensual nature of the transaction is vitiated and the corporate veil should be pierced. Moreover, if the corporation, by fraudulent or unjust means, takes actions after the contract is consummated that render it difficult or impossible for the creditor to collect his debt from the corporation, the disregard remedy should be available. Application of the disregard remedy in these cases is analogous to ac-


154. See Ahlm v. Rooney, 274 Minn. 259, 263-64, 143 N.W.2d 65, 68-69 (1968); Comment, supra note 144, at 465 (a showing of control by shareholder over corporation may give rise to inference of fraud).


156. See, e.g., United Paperworkers Int'l Union v. Penntech Papers, Inc., 439 F. Supp. 610, 617-18 (N.D. Me. 1977) (fraud or misrepresentation required in the contract cases because parties are free to weigh the potential benefits and risks of the agreement); Glessipie, supra note 6, at 390-91; Comment, supra note 66, at 135.

157. See, e.g., Ahlm v. Rooney, 274 Minn. 259, 264, 143 N.W.2d 65, 69 (1966); Whitney v. Leighton, 225 Minn. 1, 8-9, 30 N.W.2d 329, 333 (1947), aff'd on rehearing, 225 Minn. 12, 30 N.W.2d 335 (1948); Note, supra note 88, at 1129 (failure to investigate should not bar recovery in cases of fraud or misrepresentation).

158. Comment, supra note 144, at 470 (this type of conduct indicates the transaction or its repercussions were not consensual in nature). Professor Bradley has proposed the following statute to govern disregard actions involving consensual creditors:

The existence of the corporation as a legal entity distinct from its shareholders and the shareholders' privilege of limited liability shall not be affected by the fact that the affairs of the corporation are directly managed by the shareholders; nor by the fact that the board of directors of the corporation are parties to agreements respecting the exercise of their powers; nor by the fact that lawful restrictions are imposed upon the transfer of the stock of the corporation. In the absence of actual fraud, persons who voluntarily engage in any kind of dealings or transactions with a corporation, on a corporate basis, may look only to the assets of the corporation for the satisfaction of claims arising out of those dealings or transactions.

Bradley, supra note 152, at 554.
tions for damages arising from contracts induced by false representation.159

B. Tort or Nonconsensual Creditors

The standards to be applied by the courts in cases involving tort or nonconsensual creditors should be significantly different from those applied in consensual creditor cases.160 The tort creditor normally does not intend to bargain with the corporation; unlike the consensual creditor, the nonconsensual creditor generally has no opportunity to investigate the financial adequacy of the corporation or to obtain shareholder guaranty of the liability.161 Consequently, the equities favoring compensation for nonconsensual creditors, especially where personal injury is involved, are much stronger than in consensual creditor cases.162 For this reason, factors such as inadequate capitalization, disregard of corporate formalities, and shareholder dominance should play a more important role in nonconsensual disregard cases than in consensual creditor cases.163

Inadequate capitalization in corporate disregard law is an elusive concept. In Minnesota, any corporation can commence business with a capitalization of $1,000164 and there is no requirement that public liabil-

---

159. See, e.g., I.L. Corse & Co. v. Minnesota Grain Co., 94 Minn. 331, 335, 102 N.W. 728, 729 (1905).
161. E.g., Hanson Sw. Corp. v. Dal-Mac Constr. Co., 554 S.W.2d 712, 717 (Tex. Ct. App. 1977) (courts are less reluctant to pierce in tort cases than in contract cases because the creditor in contract cases had the opportunity to select his debtor; in a tort case, no such selection is made); Comment, supra note 144, at 443-44.
162. E.g., Gillespie, supra note 6, at 392 (depending upon one's value system, it is arguable that the nonconsensual creditor should receive more sympathetic treatment than the consensual creditor); Note, supra note 88, at 1130 (involuntary creditor has greater equity); 10 Sw. L.J. 77, 79 (1956) (courts are more willing to pierce in tort cases).
163. See Gillespie, supra note 6, at 392 (shareholder dominance and failure to follow formalities are relevant because they suggest a measure of responsibility for corporation's actions). But see Comment, Should Shareholders Be Personally Liable for the Torts of Their Corporations?, 76 YALE L.J. 1190, 1193 (1967) (liability based on lack of formalities makes compensation depend upon purely fortuitous circumstances); 1975 WASH. U.L.Q. 201 (1975) (corporate activities unrelated to plaintiff's suit should be irrelevant). In the classic work, Douglas & Shanks, Insulation from Liability Through Subsidiary Corporations, 39 YALE L.J. 193 (1929), the authors proposed the following standards which parent corporations should follow to avoid liability to subsidiary tort creditors: (1) a separate and sufficient financial unit should be set up and maintained, (2) the day-to-day business of the two units should be kept separate, (3) the formal barriers between the two management structures should be maintained, and (4) the two units should not be represented as being one unit. Id. at 196-97. The authors suggest these considerations are less relevant in contract cases where fraud or an inequitable result apparently is required. See id. at 217-18.
164. See MINN. STAT. § 301.04(6) (1976). Obviously, minimum statutory capitalization does not offer much protection for corporate creditors. See Note, Statutory Minimum
ity insurance be maintained. Consequently, it probably is improper to impose shareholder liability simply because the corporation does not have sufficient assets to cover all tort liabilities; a more restrictive standard is necessary. A standard that has received judicial acceptance is that capitalization is inadequate when grossly disproportionate to the nature of the business and the risks reasonably foreseeable to the operation of the business. This standard is sound because it recognizes that limited liability is an important and justifiable reason for incorporation, yet it also recognizes that shareholders should have some duty to have funds or insurance available to compensate persons injured by the corporation's foreseeable torts.

In nonconsensual creditor cases, inadequate capitalization should be a critical factor, but it is unclear whether inadequate capitalization alone should justify imposition of shareholder liability. One can argue

Capitalization Requirements, 5 Willamette L.J. 331, 339 (1969); Comment, supra note 163, at 1190-91 (inadequately capitalized corporations are inevitable product of incorporation; modern statutes invite financial irresponsibility). It has been suggested that to protect creditors, existing stated capital requirements be abandoned in favor of higher capital requirements that cannot be reduced. See Note, The Inadequacy of Stated Capital Requirements, 40 U. Cin. L. Rev. 823, 841 (1971).

165. For most businesses, liability insurance is essential and the cost is not prohibitive. See Gillespie, supra note 6, at 402.


167. See Anderson v. Abbott, 321 U.S. 349, 362 (1944); Arnold v. Phillips, 117 F.2d 497, 502 (5th Cir.), cert. denied, 313 U.S. 583 (1941). State and federal statutes offer an alternative definition of inadequate capitalization that may be relevant to the capitalization definition in disregard law. Section five of the Uniform Fraudulent Conveyances Act and section 67(d)(2) of the Bankruptcy Act deem fraudulent any transaction that leaves the debtor with an unreasonably small capital from which to satisfy claims. See Sheahin, Complaint Alleging Inadequate Capitalization, 55 Ill. B.J. 881, 884 (1967).


169. See Gillespie, supra note 6, at 392; Hamilton, supra note 67, at 988 (inadequate capitalization should be important factor in determining whether shareholders will be held liable for corporate torts); Note, supra note 93, at 1013 (in cases of corporate negligence, inadequate capital should be a primary factor); cf. Schoenberg v. Benner, 251 Cal. App. 2d 154, 165, 59 Cal. Rptr. 359, 367 (1967) (contract case).


Several reasons support the view against basing disregard on inadequate capitalization only: (1) concern that hindsight would play too dominant a role in the evaluation, (2) difficulties apparent in formulating a workable measure, and (3) low statutory capitalization requirements are conclusive of the issue. 56 Mich. L. Rev. 299, 300 (1957).
that at least in cases involving grossly undercapitalized corporations with significant and readily foreseeable tort liabilities, such as blasting companies, inadequate capitalization alone should justify disregarding the corporate entity. It would be unconscionable to allow dangerous enterprises to do business without liability insurance and with only the statutory minimum of capitalization, thus shifting all risks of the business upon a public not having the means to obtain prior guaranty of compensation for resulting injuries. Thus, for firms that have significant tort liability exposure, shareholder liability to nonconsensual creditors should follow on the basis of inadequate capitalization alone. This standard is vague, but the courts should be capable of determining which corporations pose a serious risk to public safety and the reasonable amount of capital needed to compensate persons injured by corporate torts in view of that risk.

On the other hand, where a corporation does not have significant exposure to tort liability, inadequate capitalization alone may not justify shareholder liability. The lack of a legislative requirement of liability insurance and the minimal statutory capitalization requirement indicate a legislative intent favoring the limited liability principle even in tort cases. In these situations, an additional requirement that the shareholders must have disregarded corporate formalities by, for example, commingling corporate and shareholder funds or not keeping adequate corporate records might be reasonable. The rationale for this

171. See Mull v. Colt Co., 31 F.R.D. 154, 163 (S.D.N.Y. 1962) (taxi), aff'd sub nom. Mull v. Ford Motor Co., 368 F.2d 713 (2d Cir. 1966); Dixie Coal Mining & Mfg. Co. v. Williams, 221 Ala. 331, 128 So. 799 (1930) (compensation action for miner’s death); Corrigan & Schirott, supra note 148, at 129 (corporation engaged in dangerous activities may be undercapitalized regardless of amount); Note, supra note 93, at 1013 (if the business is risky, a greater amount of protection for creditors should be required).

172. See Walkovszky v. Carlton, 18 N.Y.2d 414, 426, 223 N.E.2d 6, 13, 276 N.Y.S.2d 585, 595-96 (1966) (dissenting opinion); Hamilton, supra note 67, at 988 (corporate disregard on the basis of inadequate capitalization prevents a risky business from transferring its risk of loss to innocent members of the general public).

173. See Minton v. Cavaney, 56 Cal. 2d 576, 579-80, 364 P.2d 473, 475-76, 16 Cal. Rptr. 641, 643-44 (1961) (in bank) (shareholder held liable for death of plaintiff’s daughter in corporation’s swimming pool; corporation had no assets); Comment, supra note 66, at 136 (inadequate capitalization is particularly relevant where corporation in contact with significant segment of public).

174. Expert testimony by accountants and financial analysts will aid in this process. Cf. Costello v. Fazio, 256 F.2d 903, 909 (9th Cir. 1958) (expert opinion of inadequate capitalization in bankruptcy). The courts are required to make similar determinations in analogous areas of the law, such as with the abnormally dangerous activities theory of strict liability in tort law. See, e.g., RESTATEMENT (SECOND) OF TORTS §§ 519-524 (1977); 3 WM. MITCHELL L. REV. 310 (1977).

175. See N. LATTIN, THE LAW OF CORPORATIONS 76-77 (2d ed. 1971) (popcorn man on street corner would be adequately capitalized at the $1,000 statutory minimum because little danger of large tort liability).

additional requirement involves what might be termed a "quid pro quo"\textsuperscript{177} theory: where the shareholders have not respected the existence of the corporate entity, the courts similarly should be less reluctant to recognize the corporate existence and limited liability. Legislatures and courts expect that shareholders will observe corporate formalities. Although disregard of formalities is not fatal to corporate existence,\textsuperscript{178} it is not unreasonable to withhold the limited liability characteristic of corporateness when the shareholders do not respect the corporation. In nonconsensual creditor cases involving inadequately capitalized corporations, the equities in favor of compensating victims of corporate torts are strong. When the shareholders of such corporations have disregarded corporate formalities, the balance should be tipped in favor of compensating victims of their torts by imposing shareholder liability.\textsuperscript{179} Thus, where a corporation not having significant tort liability exposure is inadequately capitalized and the shareholders fail to observe corporate formalities, the piercing remedy should be applied.\textsuperscript{180}

Evidence of failure to observe formalities typically will not have any causal relation to the nonconsensual creditor's injury. This standard, therefore, may be criticized for injecting irrelevant, purely fortuitous evaluations into the disregard analysis. Admittedly, this suggestion involves a value judgment. Failure to observe formalities suggests that the shareholders do not view their business organization as a corporation.\textsuperscript{181} The courts should view the organization similarly if the corporation is inadequately capitalized and is not exposed to significant tort liability.

A final and difficult question concerning inadequate capitalization must be addressed: should the inadequacy of capitalization be determined as of the commencement of business as a corporation or as of the commission of the tort?\textsuperscript{182} Because adequacy of capitalization in tort-

\textsuperscript{177} "Quid pro quo" means "something for something." \textsc{Black's Law Dictionary} 1415 (4th ed. 1968).

\textsuperscript{178} See note 45 \textit{supra} and accompanying text.

\textsuperscript{179} See Note, \textit{supra} note 88, at 1130-31.

\textsuperscript{180} Failure to observe corporate formalities without a showing of inadequate capitalization, however, should not justify shareholder liability in view of the strong policies supporting the corporate device. Note, \textit{supra} note 150, at 186-87.

\textsuperscript{181} Gillespie, \textit{supra} note 6, at 392 (shareholder failure to observe corporate formalities is relevant because it suggests a measure of responsibility for corporation's actions).

\textsuperscript{182} In \textit{Inadequate Capitalization: The California Approach, supra} note 152, at 823, the writer suggests that adequacy of capitalization should be measured at the time of incorpo-
creditor cases will often involve a determination of whether liability insurance has been purchased, the most reasonable rule probably would be to recognize a continuing obligation that the corporation be adequately capitalized. If a corporation is grossly undercapitalized in view of foreseeable tort liabilities, it should maintain an adequate liability insurance policy; if that corporation cannot afford such a policy, or neglects to obtain one, it should continue business at the shareholders' risk, not at the risk of the public. Consequently, corporations should be required to maintain adequate capitalization throughout corporate existence to assure compensation for claims of nonconsensual creditors. The requirement that shareholders maintain adequate capitalization probably should not, however, be applied in cases involving consensual creditors as distinguished from nonconsensual creditors. Because consensual creditors may investigate capitalization and obtain security, the risk of inadequate capitalization should be placed upon the creditor as a risk of business.

A final factor that may be relevant in nonconsensual creditor cases is shareholder dominance of the corporation. Shareholder dominance is a pervasive concept in corporate disregard law. The difficulty with using this factor is that no definition of dominance or control can be fashioned that distinguishes impermissible dominance from the dominance that typifies most corporations, especially close corporations. Thus, dominance or control probably is not a satisfactory factor to be considered in most cases.

ration, otherwise no corporation would ever be afforded limited liability at the time of financial difficulty. This suggestion equates inadequate capitalization for disregard purposes with mere insolvency. Inadequate capitalization in disregard law refers to capitalization grossly disproportionate to foreseeable liability in the business. See notes 167-68 supra and accompanying text. Thus at the time of business failure, liability would attach under the inadequate capitalization standard only if the amount involved was grossly disproportionate to the corporation's foreseeable liability, not if the corporation was merely insolvent. This Note proposes that adequate capitalization be an ongoing requirement. See text accompanying note 184 infra. If shareholders of financially threatened corporations fail to maintain adequate capitalization, they should accept the risk or cease doing business altogether. Dix, Adequate Risk Capital: The Consideration for the Benefits of Separate Incorporation, 53 Nw. U.L. Rev. 478, 494 (1958).


184. See DeWitt Truck Brokers, Inc. v. W. Ray Flemming Fruit Co., 540 F.2d 681, 686 (4th Cir. 1976); Dix, supra note 182, at 491; Comment, supra note 66, at 139.

185. See Comment, supra note 163, at 1201-04 (suggesting requirement of compulsory insurance for small corporations).


188. See Note, supra note 62, at 1086 (all one-shareholder corporations of necessity are dominated by their shareholders; therefore, any close corporation could be pierced if piercing were allowed on the basis of shareholder dominance alone). Professor Dobbyn, on the other hand, views the control element as crucial to the disregard analysis. He
The dominance or control factor should have some significance, however, in cases involving inadequately capitalized subsidiary or affiliated corporations without significant tort liability exposure, where the policies favoring limited liability are not as strong. In these cases, it is possible to formulate an acceptable standard of impermissible dominance or control. If a subsidiary or affiliated corporation has independent management that determines the capitalization of the corporation, then dominance or control is not present. If, however, the parent and subsidiary or control and affiliated corporations have virtually identical directors and officers, dominance and control probably are present. Dominance or control should then be considered as a factor, when combined with inadequate capitalization, to justify piercing in the multiple-corporation setting.

proposes a test of disregard for both consensual and nonconsensual claims upon a showing of shareholder control of a corporation and use of that control to hinder unjustly a creditor's ability to collect. Dobbyn, supra note 12, at 190. Dobbyn's reliance on the control factor in the close-corporation context seems to ignore the reality of control and dominance that typifies close corporations. See note 62 supra and accompanying text. 189. See note 66 supra and accompanying text.

190. In 1931 Professor Powell proposed the following three-part test of disregard in cases involving parent and subsidiary or affiliated corporation cases: (1) defendant's control, (2) defendant's fraud or wrong, and (3) unjust loss or injury to the creditor. F. Powell, Parent and Subsidiary Corporations 103-05 (1931). This test, incorporating the control and fraud rule that should govern multiple-corporation disregard cases, is still valid. Powell found several indicia of sufficient parent control:

(1) parent owns all of the subsidiary's stock;
(2) common directors or officers of corporations;
(3) parent finances the subsidiary;
(4) parent subscribes to all the stock of the subsidiary or otherwise causes its incorporation;
(5) subsidiary has grossly inadequate capital;
(6) parent pays salaries and other expenses or losses of the subsidiary;
(7) subsidiary has substantially no business except with the parent or has no assets except those conveyed to it by the parent;
(8) parent describes subsidiary as a department or division;
(9) parent uses subsidiary's assets as its own;
(10) directors and officers of subsidiary do not act independently but rather take orders from the parent;
(11) formal legal requirements of subsidiary are not observed.

Id.

191. See Cornwell v. Williams Bros. Lumber Co., 139 Ga. App. 773, 229 S.E.2d 551 (1976) (tort action against parent corporation; of eight directors only two were common to both and only three of eight shareholders were common; disregard not granted); Note, supra note 19, at 222 (affiliated corporations with identical shareholders may be operating in entirely different fields and have no business dealings in common).


193. See, e.g., Allegheny Airlines, Inc. v. United States, 504 F.2d 104, 113 (7th Cir. 1978)
C. Allocation of Liability

When the corporate disregard remedy is appropriate, the further issue arises concerning who should be held personally liable. Under traditional application of the remedy, which has been followed in Minnesota, the corporation is treated as a partnership and all shareholders are held liable as partners. This mechanical approach can unjustly punish innocent shareholders who may be only passive investors.

The Minnesota court in the case of In re Will of Clarke presented an alternative approach to the allocation of shareholder liability. Under Clarke only the individual responsible for the fraud or injustice will be held liable, thus avoiding the injustice of holding shareholders liable who are not responsible for the fraudulent or inequitable conduct of the corporation. The Clarke rule appears to be the better approach. Thus, each case should be analyzed separately to determine which shareholders perpetrated the fraud or reasonably could have stopped the fraud from occurring, rather than automatically holding all shareholders personally liable.

D. Summary

In summary, this Note advocates the use of varying standards in corporate disregard cases, depending upon the nature of the claim and the type of shareholder involved. In consensual or contract creditor cases, limited liability should be preserved unless: (1) the shareholders misrepresent the financial stability of the corporation or the fact of incorporation, or (2) the shareholders, after contracting, render it difficult or impossible for the creditor to receive payment for the debt because of fraud or other injustice. In nonconsensual or tort creditor cases, the standards should vary. If the corporation is engaged in a business involving significant foreseeable tort liability, inadequate capitalization alone should justify piercing the corporate veil. If the corporation is not engaged in a business involving significant foreseeable tort liability, both inadequate capitalization and disregard of corporate formalities by shareholders should be required. Finally, if the case involves parent and subsidiary or affiliated corporations not engaged in a business involving significant foreseeable tort liability, inadequate capitalization plus dominance should be sufficient to invoke the corporate disregard remedy.
V. EXCEPTIONAL APPLICATIONS OF THE CORPORATE DISREGARD THEORY

The corporate disregard doctrine described above is designed to apply in the typical case involving tort and contract creditors seeking to hold corporate shareholders personally liable for corporate debts. Corporate disregard also has application in cases not involving tort or contract creditors that require a special policy evaluation normally foreign to the typical case. Three types of these cases deserve special mention: cases involving probate administration, cases involving attempted evasion of statutes, and cases involving disputes among shareholders. It is important to recognize that the relative ease with which the courts sometimes disregard corporate entities in these cases is attributable primarily to peculiar policies not present in normal creditor disregard cases; therefore the language and standards contained in these special cases should not be relied upon in other corporate disregard cases.

A. Probate Administration

The doctrine of corporate disregard sometimes plays a role in the administration of estates, where the testator owned all the stock of a small corporation. The problem generally arises because the testator devises corporate property directly to his devisees, rather than devising the shares of the corporation. In these cases, the courts often are liberal in applying the corporate disregard remedy to uphold the devise, which would otherwise fail because the testator shareholder technically cannot transfer corporate property but rather can transfer only his shares in the corporation. The decision whether to pierce in these cases and treat the corporate property as that of the testator depends primarily upon whether corporate creditors would be disadvantaged. If corporate creditors would not be disadvantaged by disregarding the corporate entity, then there can be little objection to upholding the devise and thereby fulfilling the testator's intent.


199. See H. Ballantine, supra note 2, § 125; Fuller, supra note 6, at 1397-401.

200. See, e.g., In re Bauer's Will, 289 N.Y. 326, 332-33, 45 N.E.2d 897, 899 (1942) (one-shareholder corporation disregarded and corporate money used to pay gifts in shareholder-testator's will); In re Stukalo's Will, 7 Misc. 2d 1042, 166 N.Y.S.2d 478 (Sur. Ct. 1957) (testator owned 99 of 100 shares); In re Dunigan's Will, 177 Misc. 212, 215-16, 30 N.Y.S.2d 38, 42 (Sur. Ct. 1941); Fidelity Trust Co. v. Service Laundry Co., 160 Tenn. 57, 61-63, 22 S.W.2d 6, 8 (1929). But see Crane v. Horton, 287 Mass. 160, 163-64, 191 N.E. 391, 392 (1934). See also In re Trust Created by Warner, 263 Minn. 449, 458, 117 N.W.2d 224, 230 (1962) (where corporation is used only as convenient mode for administering trust property, it will be disregarded in accounting dispute).

201. See In re Turley's Estate, 160 Misc. 190, 192-93, 289 N.Y.S. 704, 706-07 (Sur. Ct. 1936) (where there are no intervening interests, corporate entity may be disregarded to effectuate decedent's intent); In re Winburn's Will, 136 Misc. 19, 22, 240 N.Y.S. 208, 210-
B. Avoidance of Statutory Obligations

Corporations sometimes are formed in an attempt by the shareholders to avoid the effect of obligations imposed by statutes. Not all such attempts necessarily are evil; they frequently are upheld as legitimate uses of the corporate entity.202

Shareholders cannot invoke the corporate entity as a defense to criminal prosecutions in cases where they are personally guilty of criminal conduct. For example, in State v. McBride203 defendant was charged with selling intoxicating liquor without a license. The sale was made by an employee of a corporation owned and managed by defendant. The corporation was a closed one and was dominated by defendant, who knew liquor was on the premises for purposes of sale. Defendant claimed he could not be held criminally liable for the criminal acts of the corporation's employee. The Minnesota Supreme Court disagreed, holding that the existence of a corporation was irrelevant and that defendant was guilty as an accessory because he hired and supervised the employee and attempted to use the corporation merely as a shield to protect himself from criminal liability. The court noted that corporate officers normally are not criminally liable for the acts of other agents of the corporation, but can be criminally liable as aiders, abettors, or accessories, despite the fact that a corporate entity is involved.204 The principles espoused in McBride are sound; the corporate entity cannot be the basis for negating criminal liability where the individual is personally responsible for the crime either directly or as an accessory.205 And although the McBride court spoke in terms of corporate disregard, that doctrine actually need not be invoked in these cases. Rather, the individual merely is being held personally responsible for his own criminal conduct.206

11 (Sur. Ct. 1930) (devise upheld; corporation had sufficient assets to satisfy corporate creditors).

202. For example, it is normally legitimate to form a corporation to avoid personal liability for future obligations. Canfield, supra note 79, at 141.

203. 152 Minn. 123, 9 N.W.2d 416 (1943).

204. Id. at 130, 9 N.W.2d at 420.


206. Direct criminal liability of shareholders is illustrated in the recent case of State v. Strimling, No. 47542 (Minn. Mar. 10, 1978). Defendant shareholders were prosecuted for submitting to the state fraudulent nursing home cost reports to obtain reimbursement from welfare funds for services rendered to low-income patients. Defendants' practice of diverting corporate assets to their own use resulted in the appearance of artificially high operating costs. The cost reports were prepared by an officer of the corporation. Defendants contended that they did not authorize or approve the practice and thus should be absolved from liability. The court held the respondeat superior argument irrelevant because the defendants were charged as aiders and abettors of the criminal acts. In response
Where the statute attempted to be avoided is noncriminal, the courts tend to take a different view than in criminal cases by attempting to distinguish between bona fide avoidance and impermissible evasion of statutory restrictions. Bona fide avoidance usually involves avoidance of a statute designed for the benefit of the individual who incorporates, as opposed to avoidance of statutes designed to protect third parties. For example, usury statutes are intended to shield individuals from overreaching by unscrupulous lenders, and they usually except corporate borrowers from their scope. The courts normally will permit individuals to incorporate for the purpose of avoiding usury statutes. The rationale for this result appears to be twofold: the interests of third-party creditors are not involved, and the individual who made the decision to incorporate should not thereafter be allowed to have the corporate entity disregarded for his own benefit.

Impermissible evasion, on the other hand, occurs where the corporate entity is used to evade a noncriminal statute that was enacted to protect the government or third parties. In this instance the courts have been more willing to apply the corporate disregard remedy. If the statute or regulation in question would be subverted by incorporation and the legitimate interests of the state or a third party would be adversely affected, the fact of incorporation will be ignored by the courts. Taxa-

to defendants’ alternative argument that the corporation ratified their actions, the court declared emphatically that the corporate entity cannot immunize shareholder criminal liability by ratification.

207. See Metropolitan Holding Co. v. Snyder, 79 F.2d 263, 266-67 (8th Cir. 1935); H. Ballantine, supra note 2, § 132.

208. See, e.g., Schenley Distillers Corp. v. United States, 326 U.S. 432, 437 (1946) (corporate entities will be disregarded when used to avoid a clear legislative purpose; they will not be disregarded when chosen to secure advantages and no violence to legislative purpose results if not disregarded).


211. See, e.g., Toffolon v. Town of Avon, __ Conn. ___, 378 A.2d 580, 587 (1977); Sams v. Redevelopment Auth., 431 Pa. 240, 244-45, 244 A.2d 779, 781 (1968); Evasion of Statutes, supra note 210, at 357-58; note 75 supra and accompanying text.

212. The rationale for this result apparently is that there can be no immunity granted to a corporation which will permit it to evade the policies established by the legislature. Evasion of Statutes, supra note 210, at 351.

213. See Canfield, supra note 79, at 135 (where statute is designed to prevent a “serious
tion cases provide a good example of this distinction. As a general rule, the corporate entity is a separate entity for taxation purposes. 214 Preferential tax treatment is a justifiable reason for incorporating in most cases. 215 However, the rule is well established that when incorporation is for the sole purpose of tax evasion the corporate entity will be disregarded for tax purposes. 216 This rule is commonly justified under the business purpose doctrine; if a corporation is formed for no business purpose except the evasion of taxation it may be disregarded. 217 Thus, proof of shareholder dominance, failure to observe corporate formalities, and inadequate capitalization normally should not be relevant if the corporation carried on a business activity and was more than merely a tax avoidance device. 218

C. The Internal-Dealings Rule

The internal-dealings rule of corporate disregard law is a little-used rule that can be applied to settle conflicts among shareholders of a close corporation where the rights of third parties and creditors are not involved. 219 The apparent rationale of the rule is that when a close corpora-

---

214. E.g., Webber v. Knox, 97 F.2d 921, 923 (8th Cir. 1938) (corporation and sole shareholder not identical for purposes of computing capital gains holding period); George A. Hormel & Co. v. United States, 10 F. Supp. 623, 626 (D. Minn.) (a corporation and its shareholders generally are separate and distinct in tax matters), appeal dismissed, 82 F.2d 1011 (8th Cir. 1935); Milwaukee Motor Transp. Co. v. Commissioner of Taxation, 292 Minn. 66, 73, 193 N.W.2d 605, 609 (1971) (courts are reluctant to disregard separate legal entities merely to grant shareholders tax relief); Cargill, Inc. v. Spaeth, 215 Minn. 540, 547, 10 N.W.2d 728, 732 (1943) (corporation and shareholder will be treated separately for income tax purposes except where corporation is used merely for tax avoidance purposes).

215. See B. Bittker & J. Eustice, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS § 1.02 (3d ed. 1971) (disparity between relatively flat corporate rates and graduated individual rates is constant inducement to investment in corporations).


217. See Minnesota Farm Bureau Sec. Inc. v. United States, 63-1 U.S.T.C. (CCH) ¶ 9138 (D. Minn. 1963); James Realty Co. v. United States, 176 F. Supp. 306, 311 (D. Minn. 1959), aff’d, 280 F.2d 394 (8th Cir. 1960); Community Hosp. Linen Serv., Inc. v. Commissioner of Taxation, 245 N.W.2d 190, 195 (1976); Note, Disregard of the Corporate Entity in Tax Cases, 80 U. PA. L. REV. 892, 895 (1932) (suggesting that the disregard doctrine in tax law is normally premised on fraud).

218. See, e.g., Taylor v. Commissioner, 445 F.2d 455, 457 (1st Cir. 1971); Skarda v. Commissioner, 250 F.2d 429, 433-35 (10th Cir. 1957).

tion is operated basically as a partnership, then partnership law is the most appropriate source to determine the rights of shareholders _inter se._ This rule can be valuable in determining these shareholder rights where corporate law does not satisfactorily do so. However, the rule should not be invoked where legislatively or judicially created principles of corporate law adequately resolve the dispute or are designed to resolve the dispute. Thus, the rule should be viewed as supplementing corporate law principles rather than displacing them.

VI. Conclusion

The corporate device helped bring this nation's economy from its agrarian origins to the modern industrial model that it is today. Limited liability of shareholders played a prominent role in that development, but the evils that can result from its employment for improper purposes cannot be ignored. The doctrine of corporate disregard recognizes the equities in favor of the unpaid creditor as well as the policies favoring corporateness.

Development of the corporate disregard doctrine by the courts often has been equivocal and deficient in analysis of the important policies involved; metaphors predominate, remedies are confused, and standards are absent. Although the Minnesota corporate disregard law is no more refined than most other jurisdictions, it is unique, for it offers two approaches to corporate disregard. One is the traditional approach, with its emphasis on fraud, and the second is the _Clarke_ approach, which simply places liability on the wrongdoer involved without pretending to pierce any corporate veil. Moreover, in _Ahlm v. Rooney_ the court recognized the fallacy of the pervasive dominance factor in disregard law. The Minnesota court has established a good foundation for disregard analysis. Yet, its overall approach still cannot be considered sufficiently comprehensive.

This Note has advocated the use of varying standards for the courts to observe in disregard actions. Application of the doctrine should depend upon the nature of the claim and type of shareholder involved. The nature of the claim is important because different types of claims in-
volve different policies affecting limited liability. The disregard remedy should be available to consensual creditors only upon a showing of some fraud or misrepresentation. Nonconsensual creditors, on the other hand, should face a less restrictive burden; because they are unable to choose their debtor, their ability to be compensated should rest upon different considerations. Thus, inadequate capitalization, failure to observe corporate formalities, and dominance should have some relevance. Finally, only those persons who cause the fraudulent or unjust result should be held liable when the corporate disregard remedy is invoked.