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VEIL-PIERCING UNBOUND

PETER B. OH*

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Veil-piercing is an equitable remedy. This simple insight has been lost over time. What started as a means for corporate creditors to reach into the personal assets of a shareholder has devolved into a doctrinal black hole. Courts apply an expansive list of amorphous factors, attenuated from the underlying harm, that engenders under-inclusive, unprincipled, and unpredictable results for entrepreneurs, litigants, and scholars alike.

Veil-piercing is misapplied because it is misconceived. The orthodox approach is to view veil-piercing as an exception to limited liability that is justified potentially only when the latter is not, a path that invariably leads to examining scenarios based on different types of creditors/claims, corporations, and shareholders. But the occasion to seek derivative relief from a shareholder arises only when a claim cannot be enforced against a defendant corporation. Veil-piercing is thus a secondary remedy, detached from limited liability and its rationales.

To fix veil-piercing, corporate law must look beyond itself. For centuries the law of restitution has featured the constructive trust, an equitable remedy that disgorges misappropriated assets from unjustifiably enriched parties. This Article novelly re-conceives veil-piercing as constructive trust and

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demonstrates how its application to judgment-proof corporations can yield more coherent and effective results.

INTRODUCTION

Veil-piercing is an equitable remedy. This simple insight has been lost over time. Since the dawn of modern civilization, corporations have been able to enshroud themselves in a "veil" of limited liability.[1] And by the early nineteenth century, courts began to "pierce" this veil to reach into the personal assets of a shareholder.[2] Today, veil-piercing has become one of the most litigated issues within corporate law,[3] permeating the entire business landscape, from ordinary transactions to environmental disasters.[4]

But from its inception, veil-piercing has been an abysmal failure. There is no uniform test for veil-piercing, which typically requires demonstrating that a corporation was an "alter ego" or "instrumentality," controlled or dominated by a shareholder to perpetuate a fraud, wrong, or injustice that proximately caused loss or injury to a plaintiff.[5] To apply this complex test, courts have compiled an expansive list of ex post fact-specific factors, none of which is dispositive, weighted, or necessarily related to the underlying harm.[6]

And then there are the metaphors. Despite Justice Cardozo's venerable caution that "[m]etaphors in law are to be narrowly watched, for starting as devices to liberate thought, they end often by enslaving it,"[7] veil-piercing has

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[1] Incarnations of limited liability can be found in early Byzantine, Islamic, and Roman law. *See, e.g.*, Timothy P. Glynn, *Beyond "Unlimiting" Shareholder Liability: Vicarious Tort Liability for Corporate Officers*, 57 VAND. L. REV. 329, 336 & nn.20-22, 337 & nn.23-24 (2004) (delineating origins and citing sources).

[2] In the United States, the "cradle" of veil-piercing, KAREN VANDEKERCKHOVE, PIERCING THE CORPORATE VEIL 76 (2007), vestiges of the practice can be traced back to 1809, *see* Bank of the U.S. v. Deveaux, 9 U.S. (5 Cranch) 61, 75 (1809) ("[I]t is said that you may raise the veil which the corporate name interposes and see who stand behind it."); Fairfield Cnty. Tpk. Co. v. Thorp, 13 Conn. 173, 179 (1839) ("There are cases . . . in which courts have drawn aside the veil and looked at the character of the individual corporators . . . .").

[3] Peter B. Oh, *Veil-Piercing*, 89 TEX. L. REV. 81, 90 n.59 (2010).

[4] *See, e.g.*, FRANKLIN A. GEVURTZ, CORPORATION LAW § 1.5, at 69 (2d ed. 2010) (describing veil-piercing as "the area of corporation law which the attorney seeking to avoid corporate practice is most likely to confront"); *see also* United States v. Bestfoods, 524 U.S. 51, 61-64 (1998) (fashioning a variant of veil-piercing for claims brought under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA)).

[5] FREDERICK J. POWELL, PARENT AND SUBSIDIARY CORPORATIONS: LIABILITY OF A PARENT CORPORATION FOR THE OBLIGATIONS OF ITS SUBSIDIARY § 3, at 4-6 (1931).

[6] *See, e.g.*, Associated Vendors, Inc. v. Oakland Meat Co., 26 Cal. Rptr. 806, 813-15 (Dist. Ct. App. 1962) (listing twenty factors); Cathy S. Krendl & James R. Krendl, *Piercing the Corporate Veil: Focusing the Inquiry*, 55 DENVER L.J. 1, 52-55 (1978) (listing thirty-one factors).

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

enabled judges to unleash their inner poet. The imagery of a corporate "alter ego" or "instrumentality" has proven too seductive for courts to resist engaging in "jurisprudence by metaphor or epithet,"[8] liberally conjuring up a mish-mash of gilded allusions.[9]

All of this has exacted a steep price from entrepreneurs and litigants. Somehow they must navigate their way through an "incoherent"[10] and "intellectually disturbing"[11] doctrine that more closely resembles a tolerated evil than a preferred good. The task of justifying veil-piercing has been described as "an exercise in futility: an attempt to articulate doctrinal standards for an area all too often characterized by ambiguity, unpredictability, and even a seeming degree of randomness."[12] Not surprisingly, this has prompted calls to discard the doctrine altogether.[13]

Veil-piercing is misapplied because it is misconceived. For about a century, veil-piercing has been regarded as an exception to, and thus "inextricably linked with[,] the predicate principle of limited liability. Hence, what one makes of veil piercing depends in the first instance on one's view of limited liability."[14] Pursuant to this view, veil-piercing is justified potentially only when limited liability is not.

This stems from limited liability being framed as loss-allocation.[15] The orthodox approach defines the scope of shareholder liability according to its distributive impact on different types of creditors/claims, corporations, and shareholders.[16] And nowhere is the approach more apparent than within empirical studies of veil-piercing. Published two decades ago, the seminal

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[8] PHILLIP L. BLUMBERG, THE LAW OF CORPORATE GROUPS: PROCEDURAL PROBLEMS IN THE LAW OF PARENT AND SUBSIDIARY CORPORATIONS 8 (1983).

[9] *See, e.g.*, HARRY G. HENN & JOHN R. ALEXANDER, LAWS OF CORPORATIONS § 146, at 344 n.2 (3d ed. 1983) (listing some of the "verbal characterizations, epithets, and metaphors" in which "judicial opinions indulge"); *see also* People v. Clauson, 41 Cal. Rptr. 691, 694 (Dist. Ct. App. 1965) ("If the corporation . . . has been acting as a juristic monkey to help pull the stockholder[']s income-chestnuts out of the [income-tax-law-]fire then the court will deal with the stockholder-cat as though it was the corporation-monkey's paw." (quoting Albert Lévitt, *Disregarding the Corporate Entity in Tax Cases*, 22 TAXES 457, 458 (1944))); *cf.* THIS IS SPINAL TAP (Spinal Tap Prod. 1984) ("The musical growth of this band cannot even be charted. They are treading water in a sea of retarded sexuality and bad poetry." (quote from character Marty diBergi, played by Rob Reiner)).

[10] David Millon, *Piercing the Corporate Veil, Financial Responsibility, and the Limits of Liability*, 56 EMORY L.J. 1305, 1381 (2007).

[11] ROBERT CHARLES CLARK, CORPORATE LAW 38 (1986).

[12] Stephen M. Bainbridge, *Abolishing Veil Piercing*, 26 J. CORP. L. 479, 507 (2001).

[13] *Id.* at 535; Douglas C. Michael, *To Know a Veil*, 26 J. CORP. L. 41, 42 (2001).

[14] Bainbridge, *supra* note 12, at 481; *see also infra* Part I.

[15] *See infra* Part I.B.

[16] *See, e.g.*, Bainbridge, *supra* note 12, at 487 fig.1; Michael, *supra* note 13, at 46 ("[I]t was recognized that veil-piercing cases could be productively analyzed if divided by the type of case or plaintiff.").

study is designed entirely from loss-allocation analysis,[17] and that path has been followed by all subsequent empirical veil-piercing studies.[18]

But this is a path to hell,[19] dependent upon mistaken assumptions.[20] The orthodox approach posits a mutually exclusive choice between limited or

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[17] Robert B. Thompson, *Piercing the Corporate Veil: An Empirical Study*, 76 CORNELL L. REV. 1036, 1044 (1991) (examining approximately 1600 veil-piercing cases according to whether they arose from contract, criminal, statutory, or tort claims; involved close or public corporations; and targeted corporate or individual shareholders); *see also infra* notes 98-106 and accompanying text.

[18] *See* Christina L. Boyd & David A. Hoffman, *Disputing Limited Liability*, 104 NW. U. L. REV. 853, 877 (2010) (examining 690 federal district court cases from 2000 to 2005); Nicholas L. Georgakopoulos, *Bankruptcy Veil-Piercing: Bypassing Broken Nodes?*, 27 EMORY BANKR. DEV. J. 471, 473-75 (2010) (extrapolating from West Key Number searches of 244,258 contract and/or tort cases from 1947 to 2010); Nicholas L. Georgakopoulos, *Contract-Centered Veil Piercing*, 13 STAN. J.L. BUS. & FIN. 121, 129 (2007) (extrapolating from West Key Number searches of 175,316 contract and/or tort cases from 1947 to 2003); Lee C. Hodge & Andrew B. Sachs, Empirical Study, *Piercing the Mist: Bringing the Thompson Study into the 1990s*, 43 WAKE FOREST L. REV. 341, 347 (2008) (sampling 228 cases from 1986 to 1995); John H. Matheson, *The Modern Law of Corporate Groups: An Empirical Study of Piercing the Corporate Veil in the Parent-Subsidiary Context*, 87 N.C. L. REV. 1091, 1108 n.5, 1110 (2009) (examining 360 parent-subsidiary cases from January 1, 1990 to March 1, 2008); Richmond McPherson & Nader Raja, Empirical Study, *Corporate Justice: An Empirical Study of Piercing Rates and Factors Courts Consider When Piercing the Corporate Veil*, 45 WAKE FOREST L. REV. 931, 940 (2009) (sampling 236 cases from 1996 to 2005); Geoffrey C. Rapp, *Preserving LLC Veil Piercing: A Response to Bainbridge*, 31 J. CORP. L. 1063, 1068, 1071-72 (2006) (examining sixty-one limited liability company rulings from 1997 to 2005); *see also* Charles Mitchell, *Lifting the Corporate Veil in the English Courts: An Empirical Study*, 3 COMPANY FIN. & INSOLVENCY L. REV. 15, 20-24, app. at 24-28 (1999) (examining 290 British cases from 1859 up to and including 1998); Ian Ramsay & David B. Noakes, *Piercing the Corporate Veil in Australia*, 19 COMPANY & SEC. L.J. 250, 261 (2001) (examining 104 Australian cases up to and including 1999); Peter B. Oh, Piercing v. Lifting 9, 14 (Nov. 17, 2012) (unpublished manuscript) (on file with author) (examining 188 British cases from 1888 up to and including 2006). There have been, however, some minor refinements to Thompson's loss-allocation approach. *See, e.g.*, Boyd & Hoffman, *supra*, at 886-901 (parsing various substantive claims and reorganizing data by type of creditor).

[19] *Cf.* PERCY BYSSHE SHELLEY, PROMETHEUS UNBOUND 37 (Lawrence John Zillman ed., Yale University Press 1968) (1820) (reinterpreting in poetic form the classic play by Aeschylus, *Prometheus Bound*, about the banishment and then liberation of Prometheus, whom Shelley envisioned to resemble Satan, in that he "leads us to weigh his faults with his wrongs, and to excuse the former because the latter exceed all measure," but whom Shelley also thought distinctly represented "the type of the highest perfection of moral and intellectual nature, impelled by the purest and the truest motives to the best and noblest ends").

[20] *Cf.* Paul A. David, *Clio and the Economics of QWERTY*, 75 AM. ECON. REV. 332, 332 (1985) ("A *path-dependent* sequence of economic changes is one of which important influences upon the eventual outcome can be exerted by temporally remote events,

unlimited liability, in which veil-piercing serves to correct misallocated loss.[21] On one level the choice is false because limited liability continues to be upheld even in scenarios where it is broadly recognized to be unjustified.[22] From a positive and normative standpoint, there is thus no basis to presume that efficiency-based rationales for limited liability necessarily govern veil-piercing. On another level the choice is incomplete because analysis of limited liability is preoccupied with the law of obligations, that is, claims by contract and tort creditors.[23] From an empirical and theoretical standpoint, the current framework does not or cannot account for, respectively, property and unjust enrichment, the remaining two pillars of private law.[24]

These problems reflect a deeply flawed conception of veil-piercing. For if the analysis for limited liability is so clear and compelling, why is unlimited liability analysis such a convoluted inquiry? To date, no one has supplied a satisfactory answer.[25] The reason may be that everyone apparently has forgotten that veil-piercing originated as an equitable procedure to remedy the problem of unenforceable judgments. The earliest forms of shareholder liability were envisioned as incidental provisional relief, available only when none could be had from a corporation.[26] Accordingly, whether an initial claim lay in contract, property, tort, or unjust enrichment against a *corporation* had no ultimate bearing on whether liability should be imposed on a *shareholder*. Veil-piercing thus was detached from the question of corporate liability.

In this light the shambled state of veil-piercing is hardly a surprise. Over the years there have been incessant attempts to rehabilitate veil-piercing. Some have argued for codifying the common law test in the hope that legislative guidance and statutory interpretation might constrain courts.[27] Others instead

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including happenings dominated by chance elements rather than systematic forces."); O.W. Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 472-73 (1897).

[21] *See, e.g.*, Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89, 109 (1985) ("The [veil-piercing] cases may be understood, at least roughly, as attempts to balance the benefits of limited liability against its costs."); *see also infra* notes 53-60 and accompanying text.

[22] *See infra* Part I.A.

[23] *Cf.* RUDOLPH SOHM, THE INSTITUTES: A TEXTBOOK OF THE HISTORY AND SYSTEM OF ROMAN PRIVATE LAW § 77, at 371 (James Crawford Ledlie trans., Oxford at the Clarendon Press 3d ed. 1907) ("An obligation arises either from a declaration of consensus, i.e. ex contractu, or from an act done in contravention of the law, i.e. ex delicto."); *id.* (acknowledging that the category does not comprise even the entire universe of possible obligatory-esque claims, including "obligationes quasi ex contractu" and "obligationes quasi ex delicto" (internal quotation marks omitted)); *infra* Part I.B.

[24] *See, e.g.*, JAMES GORDLEY, FOUNDATIONS OF PRIVATE LAW: PROPERTY, TORT, CONTRACT, UNJUST ENRICHMENT 3 (2006); *see also infra* notes 121-130 and accompanying text.

[25] *Cf. infra* note 183.

[26] *See infra* Part I.

[27] *See, e.g.*, Rebecca J. Huss, *Revamping Veil Piercing for All Limited Liability Entities:*

have focused on simplifying the test, proposing ways to distill the universe of existing factors into their essential ingredients.[28] But all of these approaches are premised on loss-allocation analysis. Until this conceptual path linking veil-piercing and limited liability can be extirpated, the prospect of a cogent remedy will remain illusory.

To fix veil-piercing, corporate law must look beyond itself. And to find the solution, one need look no further than Justice Cardozo, who regarded conventional veil-piercing with such eloquent contempt.[29] Years before dallying with veil-piercing, Cardozo had coronated the constructive trust as "the formula through which the conscience of equity finds expression."[30] For centuries the law of restitution has provided courts with this means to enforce

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Forcing the Common Law Doctrine into the Statutory Age, 70 U. CIN. L. REV. 95, 96 (2001); John H. Matheson & Raymond B. Eby, *The Doctrine of Piercing the Veil in an Era of Multiple Limited Liability Entities: An Opportunity to Codify the Test for Waiving Owners' Limited-Liability Protection*, 75 WASH. L. REV. 147, 152 (2000). *But see, e.g.*, I. MAURICE WORMSER, DISREGARD OF THE CORPORATE FICTION AND ALLIED CORPORATION PROBLEMS 37-38 (1927) (dismissing this idea as "not only impossible but preposterous"). Nevertheless, there have been some legislative attempts to control veil-piercing. *See, e.g.*, Oh, *supra* note 3, at 121-23 (analyzing the effects of numerous revisions to article 2.21A of the Texas Business Corporation Act, which imposes an actual fraud requirement on veil-piercing claims grounded in contract).

[28] *See, e.g.*, Bainbridge, *supra* note 12, at 535 (advocating a test partially derived from the factors of fraud and siphoning of funds, on the basis that "these tests are workable"); *see also infra* Part III.A-B.

[29] *See supra* note 7 and accompanying text. Cardozo's eloquence ironically obscured, if not undermined, his own attempt to fix veil-piercing. *See* Berkey v. Third Ave. Ry. Co., 155 N.E. 58, 61 (N.Y. 1926) ("The logical consistency of a juridical conception will be indeed sacrificed at times, when . . . essential to the end some accepted public policy may be defended or upheld."); STEPHEN B. PRESSER, PIERCING THE CORPORATE VEIL § 1:4, at 1-24, 1-21 (2004) ("Shrouding his own analysis irretrievably in the mists of metaphor," Cardozo's "ringing phrases, when analyzed, yield little of substance."). Cardozo's proposed test essentially relies on basic agency principles, supplemented with public policy, to thwart a perceived "perversion" of limited liability as a state-conferred privilege; premised on this now-defunct concession theory, the test has suffered the same fate. *See, e.g.*, Bainbridge, *supra* note 12, at 495 ("It has been over half-a-century since corporate legal theory, of any political or economic stripe, took the concession theory seriously."); Michael, *supra* note 13, at 57 ("It makes no logical sense to base veil-piercing in a theory of corporate privilege.").

[30] Beatty v. Guggenheim Exploration Co., 122 N.E. 378, 380 (N.Y. 1919); *see also* Meinhard v. Salmon, 164 N.E. 545, 548 (N.Y. 1928) ("A constructive trust is . . . the remedial device through which preference of self is made subordinate to loyalty to others."). Indeed, the new *Restatement of Restitution* is modeled upon Cardozo's conception of the constructive trust. RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT § 55(1) cmt. a (2011) ("The remedy described by § 55 is intended to be the same, in scope and in function, as the remedy described by Cardozo.").

judgments by disgorging misappropriated assets from the hands of unjustifiably enriched parties.[31]

At first blush the match seems perfect to even the most jaded skeptic. Never have two remedies been so misunderstood. Like veil-piercing, the constructive trust has been denigrated as a troubled child of equity.[32] Moreover, the constructive trust has been banished from the family of ordinary trusts,[33] forced to reside within the shadowy world of quasi-law.[34] And, to make matters even worse, the constructive trust involves elements of unjust enrichment, the shifty relative everyone knows but prefers to avoid.[35]

But in truth the constructive trust is what veil-piercing should be. Over time, veil-piercing has been stripped of its equitable nature and remedial structure.[36] These attributes, however, pristinely remain with the constructive trust, which can supply alternative relief to an inferior, initial remedy in either equity or

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[31] *See* RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT § 55(1) ("If a defendant is unjustly enriched by the acquisition of title to identifiable property at the expense of the claimant or in violation of the claimant's rights, the defendant may be declared a constructive trustee . . . of the property in question and its traceable product."); RESTATEMENT (FIRST) OF RESTITUTION: QUASI-CONTRACTS AND CONSTRUCTIVE TRUSTS § 160 (1937) ("Where a person holding title to property is subject to an equitable duty to convey it to another on the ground that he would be unjustly enriched if he were permitted to retain it, a constructive trust arises."); *infra* note 142.

[32] *Cf. infra* notes 143-149 and accompanying text.

[33] *See, e.g.*, RESTATEMENT (FIRST) OF RESTITUTION: QUASI-CONTRACTS AND CONSTRUCTIVE TRUSTS § 160 cmt. a ("Constructive trusts are not dealt with in the Restatement of Trusts . . . ."); 5 AUSTIN WAKEMAN SCOTT & WILLIAM FRANKLIN FRATCHER, THE LAW OF TRUSTS § 461, at 300-02 (4th ed. 2006) (examining why constructive trusts are covered by the *Restatement (First) of Restitution*).

[34] Other condemned cohabitants of this world include quasi-contracts and quasi-torts. *See infra* note 147. *But cf.* PETER BIRKS, AN INTRODUCTION TO THE LAW OF RESTITUTION 30 (1985) ("The common law has found no use for quasi-tort."). Birks notes "'[q]uasi-' and 'constructive' have the same sense," which is aptly captured by one of his "sillier Oxford stories":

> The college's rules forbid the keeping of dogs. The Dean keeps a dog. Reflecting on the action to be taken, the governing body of the college decides that the labrador is a cat and moves to next business. That dog is a constructive cat. Deemed, quasi- or fictitious, it is not what it seems. When the law behaves like this you know it is in trouble, its intellect either genuinely defeated or deliberately indulging in some benevolent dishonesty. . . . If cuckoos had to be quasi-thrushes or constructive blackbirds we should know less about them.

Id. at 22.

[35] The shiftiness can be attributed partially to the status of restitution, which is often interchanged with unjust enrichment, as a substantive claim *and* a remedy. *See, e.g.*, RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT § 1 cmt. e ("A liability in unjust enrichment (restitution) is enforced by restitution's characteristic remedies . . . and a claim in unjust enrichment (restitution) is subject to characteristic defenses.").

[36] *See infra* Part I.

law.[37] Accordingly, the constructive trust's principles and rationales operate independently of whatever kind of creditor/claim, corporation, or shareholder is within the original suit.

And the constructive trust is not just lipstick on the veiled pig. Unlike loss-allocation, the constructive trust concerns the location of benefit, namely whether retention of a misappropriated asset is justified.[38] Further, unlike veil-piercing, this inquiry is not restricted to a shareholder, but instead follows and traces a disputed asset to its ultimate holder.[39] Moreover, once that holder has been designated a constructive trustee, the plaintiff is conferred proprietary rights to the asset.[40] And when the constructive trustee is insolvent, these rights take priority over any general unsecured creditors;[41] indeed, although not a necessary condition, bankruptcy is the context where the constructive trust excels.

This Article novelly re-conceives veil-piercing as constructive trust. Part I evinces how the orthodox approach to veil-piercing as an exception to limited liability has no positive or normative merit, either empirically or theoretically. Part II proceeds to introduce the constructive trust and demonstrate its superiority over prominent alternatives. Part III concludes by showing how the constructive trust can be applied to a triad of classic veil-piercing scenarios in a more principled manner and with more effective outcomes than the current approach.

I. LIBERATING PIERCING FROM THE VEIL

Limited liability has been romanticized to mythical proportions. Capping the personal risk of shareholders has been hailed as "the greatest single discovery of modern times"[42] and "one of the first principles of American law."[43] These lofty accolades are bolstered by rationales so compelling that they have framed

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[37] *See infra* Part II.A.

[38] *See infra* notes 145-46, 159 and accompanying text.

[39] *See infra* notes 165-67 and accompanying text.

[40] *See infra* notes 189-92 and accompanying text.

[41] *See infra* notes 193-96 and accompanying text.

[42] NICHOLAS MURRAY BUTLER, WHY SHOULD WE CHANGE OUR FORM OF GOVERNMENT? 82 (1912) ("Even steam and electricity are far less important than the limited liability corporation, and they would be reduced to comparative unimportance without it."); *see also* WORMSER, *supra* note 27, at 14 ("[M]any immigrants doubtless possess full knowledge of th[e] fact [that limited liability is the greatest advantage of incorporation] before coming within hailing distance of the Statue of Liberty.").

[43] PRESSER, *supra* note 29, § 1.1, at 1-4 to -5 ("It is now accepted as one of the first principles of American law that those who own shares in corporations . . . normally are not liable for the debts of their corporations."); *see also* William W. Cook, *"Watered Stock" – Commissions – "Blue Sky Laws" – Stock Without Par Value*, 19 MICH. L. REV. 583, 583 n.4 (1921) (quoting President of Harvard University Charles William Eliot: "[T]he privilege of limited liability [is] the corporation's most precious characteristic. [And it] is by far the most effective legal invention for business purposes made in the nineteenth century . . . .").

and governed limited liability's primary exception, veil-piercing. The question of when a shareholder should be held liable personally for corporate debts is answered by determining when limited liability is not justified. This invariably leads to analysis of various scenarios, based on different types of creditors/claims, corporations, and shareholders.

This Part shows how this path has been paved with mistaken notions. The first Section evinces the illogic of conceiving limited liability in exclusive terms with veil-piercing qua unlimited liability. The second Section then exposes the illegitimacy of analyzing veil-piercing in connection with different types of creditors/claims or corporations. After this conception and analysis are shown to be dead ends that must be abandoned, piercing is left standing alone as a post-judgment equitable remedy, independent of the veil of limited liability and its rationales.

A. *Delimiting Liability*

The rationales for limited liability have mutated over time. Prior to 1809, when the first general incorporation statute was enacted, *un*limited liability apparently was the initial default rule.[44] But the advent of the War of 1812 provided a patriotic reason for states to limit the liability of shareholders as a means of making the corporate form accessible to entrepreneurs of all kinds and means.[45] Roughly a century later, with the shift from a concessionary to contractarian paradigm for conceiving the firm, the justifications for limited liability correspondingly embraced a modern preference for economic efficiency.[46] Today, those principles unquestionably govern not only limited liability, but its chief exception, veil-piercing.

One justification for limited liability is enhanced firm governance. The characteristic separation between corporate ownership and control inherently generates agency costs.[47] Managers have an incentive to minimize these costs

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[44] *See* Act of Mar. 3, 1809, ch. 65, § 6, 1809 Mass. Acts 464, 466; Oscar Handlin & Mary F. Handlin, *Origins of the American Business Corporation*, 5 J. ECON. HIST. 1, 10 (1945) ("Examination of contemporary Anglo-American law . . . strikes at the very roots of the common assumption that limited liability was always an essential attribute of corporateness . . . ."); Morton J. Horwitz, Santa Clara *Revisited: The Development of Corporate Theory*, 88 W. VA. L. REV. 173, 208 (1985) ("[T]ruly limited shareholder liability was far from the norm in America even as late as 1900.").

[45] PRESSER, *supra* note 29, § 1:3, at 1-14 to -15 (arguing that limited liability served "as a means of encouraging the small-scale entrepreneur, and of keeping entry into business markets competitive and democratic. Without [limited liability], it was believed, only the very wealthiest men . . . could possess the privilege of investing in corporations." (emphasis omitted)).

[46] *See id.* at 1-16 ("[W]hether or not the *democratic* justification has since been lost sight of, the *economic argument* of the public's potential gains from a policy of limited liability . . . has remained the primary justification for limited liability."); Larry E. Ribstein, *Limited Liability and Theories of the Corporation*, 50 MD. L. REV. 80, 83-84, 130 (1991).

[47] *See* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial*

because unrestricted transferability provides dissatisfied shareholders with an option for disinvestment.[48] Limited liability not only promotes such transferability, but also permits managers to pursue more profitable projects due to the capped risk for shareholders.[49] As a result, investors can assume a passive role with respect to monitoring the firm and their fellow shareholders' solvency.[50]

Another justification for limited liability is more facile shareholding. With the amount of risk restricted to the purchase price, shares can be a fungible and normalized reflection of different firms' value.[51] And by stabilizing the extent of total liability, investors can reduce risk even further by diversifying their stock portfolios.[52] In this way limited liability stimulates broad participation within capital markets.

These well-established economic rationales all share a basic premise. As Stephen Presser has noted, "[t]he principal thrust of law and economics analysis of limited liability has been to demonstrate that the rule is *more efficient than a rule of unlimited liability*."[53] In contractarian terms the issue assumes the form of a hypothetical ex ante bargaining session that asks: "If the shareholders and creditors could costlessly bargain . . . would they adopt a rule of limited or unlimited personal liability?"[54] The choice seems quite natural,

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Behavior, Agency Costs and Ownership Structure, 3 J. FIN. ECON. 305, 308 (1976).

[48] Easterbrook & Fischel, *supra* note 21, at 94-95 ("The costs of the separation of investment and management (agency costs) may be substantial. . . . Investors individually respond to excessive agency costs by disinvesting.").

[49] *Id.* at 97 ("[M]anagers maximize investors' welfare by investing in any project with a positive net present value. They can accept high-variance ventures . . . without exposing the investors to ruin."). Some might prefer to say "externalized" rather than "capped" risk. Nina A. Mendelson, *A Control-Based Approach to Shareholder Liability for Corporate Torts*, 102 COLUM. L. REV. 1203, 1206, 1239 (2002) ("[T]he presence of a controlling shareholder likely will prompt a corporation to externalize more costs than if the corporation's equity is diffusely held by many very small shareholders."). *But see* Easterbrook & Fischel, *supra* note 21, at 98 ("Limited liability is an arrangement under which the loss largely lies where it falls. Loss is swallowed rather than shifted.").

[50] *See* David W. Leebron, *Limited Liability, Tort Victims, and Creditors*, 91 COLUM. L. REV. 1565, 1570-74 (1991).

[51] *See* Paul Halpern et al., *An Economic Analysis of Limited Liability in Corporation Law*, 30 U. TORONTO L.J. 117, 129-31 (1980).

[52] Henry G. Manne, *Our Two Corporation Systems: Law and Economics*, 53 VA. L. REV. 259, 262 (1967) ("One of the great advantages of the large corporate system is that it allows individuals to use small fractions of their savings for various purposes, without risking a disastrous loss if any corporation in which they have invested becomes insolvent.").

[53] PRESSER, *supra* note 29, § 1:7, at 1-35 (emphasis added).

[54] Bainbridge, *supra* note 12, at 486-87; *see also* Richard A. Posner, *The Rights of Creditors of Affiliated Corporations*, 43 U. CHI. L. REV. 499, 522 (1976) (suggesting that one test for disregarding limited liability due to corporate misrepresentation "would be to differentiate among types of creditors in terms of their information costs"). Stephen Presser asserts that Posner "is simply developing an argument, the inappropriateness of piercing the

given the historical prominence of unlimited liability,[55] as well as its default status in the event of defective incorporation.[56] Along these lines, the merits of any prospective increase in shareholder liability are to be measured against the costs of sacrificing limited liability.[57]

Indeed, this premise girds the relation between limited liability and veil-piercing. Because the latter results in joint and several liability for shareholders, its net effect mimics pure unlimited liability.[58] Accordingly, the orthodox approach is to conceptualize veil-piercing qua unlimited liability as a contiguous exception to limited liability.

Figure 1. Limited Liability – Veil-Piercing

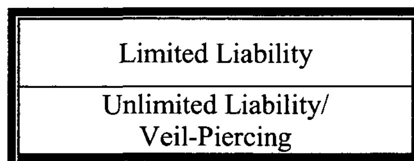

Figure 1 simply depicts the conventional view that, "[o]nce the appropriate limits of limited liability are understood, veil piercing can police those limits. That understanding, however, depends on a sound sense of the policy basis for limited liability . . . ."[59] Indeed, some have even argued that the difficulties with veil-piercing are the product of "a failure to identify what is at stake in a veil piercing case: the very principle of limited liability for the shareholders."[60]

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veil in a contractual context, already advanced by [Frederick] Powell." PRESSER, *supra* note 29, § 1:7, at 1-38.

[55] *See supra* notes 44-45 and accompanying text.

[56] Fred S. McChesney, *Doctrinal Analysis and Statistical Modeling in Law: The Case of Defective Incorporation*, 71 WASH. U. L.Q. 493, 496-97 (1993) (characterizing defective incorporation as a subset of veil-piercing). *But see* Timothy R. Wyatt, Note, *The Doctrine of Defective Incorporation and Its Tenuous Coexistence with the Model Business Corporation Act*, 44 WAKE FOREST L. REV. 833, 847-51 (2009) (criticizing McChesney's assertion).

[57] There are, however, alternatives to limited liability. *See, e.g.*, Easterbrook & Fischel, *supra* note 21, at 101-03 (assessing the possibility of investor insurance purchased by the firm).

[58] Henry Hansmann & Reinier Kraakman, *Toward Unlimited Shareholder Liability for Corporate Torts*, 100 YALE L.J. 1879, 1932 (1991) ("[V]eil-piercing is itself simply a form of unlimited liability."). *But cf., e.g.*, Leebron, *supra* note 50, at 1578-79 ("Liability in excess of a corporation's assets might be assessed against shareholders either on a joint and several or on a pro rata basis. . . . However, any joint liability rule probably would be coupled with a contribution rule. . . . [Joint liability coupled with contribution, in some aspects, would be] equivalent to a pro rata rule . . . ." (footnote omitted)).

[59] Millon, *supra* note 10, at 1311; *see also supra* note 14 and accompanying text.

[60] Jonathan M. Landers, *A Unified Approach to Parent, Subsidiary, and Affiliate*

The principle, however, has its own limitations. A common distinction for limited liability concerns its justifications for close versus public corporations.[61] Unlike their close peers, shareholders of public corporations tend to be passive investors that enjoy the benefit of unrestricted transferability.[62] Accordingly, the corporate governance justifications for limited liability would seem to be stronger in the publicly held context.[63]

And yet public corporations do present a moral-hazard problem.[64] Limited liability gives managers an incentive to pursue overly risky projects that inure to shareholders.[65] Further, moral hazard tends to be even more pervasive when there are affiliates or subsidiaries,[66] a common setup for public corporations.[67]

Questions in Bankruptcy, 42 U. CHI. L. REV. 589, 620 (1975).

[61] Easterbrook & Fischel, *supra* note 21, at 109-10 ("The distinction between close and public corporations is supported by economic logic. . . . This has profound implications for the role of limited liability."); Manne, *supra* note 52, at 278 ("As we begin to examine the differences between [these two types of] corporations, it becomes apparent that the two are extremely dissimilar.").

[62] *Cf.* Manne, *supra* note 52, at 279 ("Participants in a small business have a very real interest in knowing and controlling the identity of other participants. Thus it is not surprising to find that restrictions on share transferability are very common with small corporations.").

[63] Millon, *supra* note 10, at 1314 ("The argument for limited liability may be less compelling as to shareholders of close corporations than as to those of publicly held companies."). Certainly, the distinction enjoys considerable empirical support, as every veil-piercing study has found that plaintiffs prevail exclusively against close corporations. *E.g.*, Oh, *supra* note 3, at 110 tbl.3 (finding a 0.00% veil-piercing rate in four cases involving a public corporation); Thompson, *supra* note 17, at 1055 tbl.7 (finding a 0.00% veil-piercing rate in nine cases involving a public corporation); Robert B. Thompson, *Piercing the Veil Within Corporate Groups: Corporate Shareholders as Mere Investors*, 13 CONN. J. INT'L L. 379, 384 (1999) (updating his 1991 study with an additional ten years of cases, and still finding that "[p]iercing the veil is a doctrine directed exclusively at close corporations and corporate groups"). This finding, however, serves less to vindicate limited liability's rationales, and more to reflect the reality that public corporations tend to feature disperse shareholding that in turn precludes a sufficient level of control or domination to justify veil-piercing. *See, e.g.*, GEVURTZ, *supra* note 4, § 1.5.3, at 78 ("[R]equiring control screens out piercing against the shareholders of a publicly traded corporation . . . . This provides a doctrinal underpinning to explain the fact that there never has been a case in which the court pierced to hold shareholders in a public corporation liable for the company's debts.").

[64] The moral-hazard problem is not restricted to publicly held corporations. On the contrary, the problem arguably is more pernicious within the closely held context. Halpern et al., *supra* note 51, at 141 (stating that the moral hazard problem "is likely to be more severe for small, tightly held companies than for larger companies"). The point here is merely to illustrate that, even within the most compelling scenarios, efficiency-based justifications do not determine the complete scope of limited liability.

[65] *Id.* at 140-41.

[66] Easterbrook & Fischel, *supra* note 21, at 111 ("[T]he moral-hazard problem is probably greater in parent-subsidiary situations because subsidiaries have less incentive to insure."); Leebron, *supra* note 50, at 1617, 1619 ("With regard to integrated subsidiaries,

Accordingly, there is a broad consensus that limited liability should not apply in these situations.[68]

This consensus, however, does not rest on efficiency grounds. Under the shareholding rationale,[69] imposing joint and several liability for mass risk would discourage investment, as well as open the door to judgment-proof firms.[70] And, under the corporate-governance rationale, the loss due to mass risk presents no direct concern to shareholders, provided agency costs are relatively low.[71] On balance, then, limited liability should apply to firms that engage in mass-risk activities, even when they have a negative net social value.[72] The unpalatable nature of this conclusion, even for the staunchest

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there is little reason to respect the separate corporate entities when noncontractual tort claimants are involved. . . . It is unclear what justifies the legal presumption against veil piercing between related corporations on behalf of noncontractual creditors.").

[67] Lynn M. LoPucki, *The Death of Liability*, 106 YALE L.J. 1, 21 (1996) ("Th[e] parent-subsidiary ownership strategy is in wide use among the largest companies in America. Most large companies consist of numerous corporate entities. Limiting liability – that is, defeating part of it – is the principal reason for creating those entities." (footnote omitted)).

[68] *E.g.*, Mendelson, *supra* note 49, at 1204 ("There is little disagreement that limited shareholder liability for corporate torts can encourage socially costly corporate activity – risky activity selected because the corporation and its shareholders do not bear all the expected costs of the activity." (footnote omitted)); *id.* at 1204 n.2 (citing sources). A notable few, however, maintain an agnostic position. *See, e.g.*, Easterbrook & Fischel, *supra* note 21, at 104 ("Externalization of risk imposes social costs and thus is undesirable. The implications of this point, however, are unclear, both because modifying limited liability has its costs and because moral hazard would exist without limited liability.").

[69] *See supra* notes 51-52 and accompanying text.

[70] *See* Bainbridge, *supra* note 12, at 492 ("[I]t would be prohibitively costly for the creditor of a corporation to bring individual suits against thousands of geographically diverse investors."); Hansmann & Kraakman, *supra* note 58, at 1903 ("There is no doubt that unlimited liability . . . would increase the cost of equity. . . . If shareholders faced joint and several liability for all corporate debts . . . these costs might be very large."). Along with numerous other commentators, Hansmann and Kraakman instead provocatively propose a regime of pro rata liability. *Id.* at 1903 & n.69. Not everyone agrees with this proposal, however. *See, e.g.*, Bainbridge, *supra* note 12, at 496-500 (criticizing the proposal and citing other critical sources). The proper scope and form of limited liability are beyond the purview of this paper; the point here is merely that limited liability and its rationales do not extend logically to veil-piercing.

[71] *See supra* notes 47-50 and accompanying text. To be sure, shareholders would be concerned if mass risk resulted in a diminished share price, but the effect is indirect as such liabilities would be diluted and spread over time, during which there would be ample opportunity for exit.

[72] *See* Hansmann & Kraakman, *supra* note 58, at 1883 ("Since limited liability permits cost externalization, a corporation engaged in highly risky activities can have positive value for its shareholder, and thus can be an attractive investment, even when its net present value to society as a whole is negative."). A useful parallel is the theory of efficient breach of contracts. *See* Richard Craswell, *Contract Remedies, Renegotiation, and the Theory of Efficient Breach*, 61 S. CAL. L. REV. 629, 630, 638 (1988) ("Since so many contract

proponents of limited liability,[73] belies that limited liability's "real policy basis . . . does not appear to be efficiency. Instead, the goal seems to be to promote investment by transferring risk from investors to creditors."[74] This is the apparent goal of legislatures, which uniformly embrace broad limited liability.[75] Consequently, the task of minimizing moral hazard has fallen to courts, which have imposed liability on corporate agents in specialized scenarios.[76]

But this is not veil-piercing. Pure veil-piercing enables a plaintiff to reach the personal assets of only a *shareholder*.[77] From a strict efficiency standpoint, courts can and should impose liability on a shareholder that induces a corporation to generate mass risk with a negative net value. Liability in these situations is directed at corporate *agents*, such as directors and officers, and yet still analyzed within the veil-piercing rubric.[78] And because the remedy is designed for shareholders, courts have had to adapt the multiple factors that already bear little, if no, connection with the underlying harm.[79] As a result,

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remedies depart in one direction or the other from the 'ideal' of perfect compensation, the prospect of inefficient breaches . . . would seem to loom large.").

[73] *See supra* note 49.

[74] Millon, *supra* note 10, at 1317.

[75] *See* Bainbridge, *supra* note 12, at 500 (highlighting that states apparently refuse to repeal limited liability "for mass torts, or indeed, torts of any kind" and that "[t]he availability of limited liability in related contexts . . . likewise has been reaffirmed"); Millon, *supra* note 10, at 1314 ("Corporate statutes all confer limited liability in general terms. . . . There is no distinction between contract- and tort-based claims or between closely held or public corporations.").

[76] *See infra* note 80.

[77] Helen Anderson, *Piercing the Veil on Corporate Groups in Australia: The Case for Reform*, 33 MELB. U. L. REV. 333, 342 (2009) ("'Pure' veil-piercing occurs where liability is imposed simply because a legal person occupies the position of a shareholder.").

[78] *Cf.* United States v. Bestfoods, 524 U.S. 51, 64-67 (1998) (examining vicarious liability provisions within CERCLA). With unanimous support Justice Souter acknowledged that, "whereas the rules of veil piercing limit derivative liability for the actions of another corporation, CERCLA's 'operator' provision is concerned primarily with direct liability for one's own actions." *Id.* at 65. The Court, however, ultimately rejected the suggestion from courts and commentators that an "indirect, veil-piercing approach can subject a parent corporation to liability only as an owner, and not as an operator" under CERCLA. *Id.* at 64 n.10.

[79] *See supra* note 6 and accompanying text. In *Bestfoods*, for instance, the Court realized that the amorphous veil-piercing standards for parent-subsidiary control could not be adapted to directors and officers, and instead fashioned an even more nebulous test:

> [T]he presumption that an act is taken on behalf of the corporation for whom the officer claims to act is strongest when the act is perfectly consistent with the norms of corporate behavior, but wanes as the distance from those accepted norms approaches the point of action by a dual officer plainly contrary to the interests of the subsidiary yet nonetheless advantageous to the parent.

Bestfoods, 524 U.S. at 70 n.13. Tellingly, though, the Court backed away from its own test,

limited liability has spawned a group of cases that look and stumble like veil-piercing, but in fact are not.[80]

This mutation belies how limited liability and veil-piercing are misaligned. The rationales for limited liability justify its preservation within a broad range of scenarios.[81] But that justification does not quadrate perfectly with the scope of veil-piercing qua unlimited liability:

Figure 2A. The Mass Risk Scenario[82]

<table>
<tr><td>Limited Liability</td><td rowspan="2">Mass Risk
Scenario</td></tr>
<tr><td>Unlimited Liability/
Veil-Piercing</td></tr>
</table>

Figure 2A depicts the mass risk scenario as an area where limited liability applies, albeit unjustifiably, while the shaded box represents the gap where courts have attempted to stretch veil-piercing beyond its original form with distortive results. The problem, however, cannot be ascribed to just a misapplication of veil-piercing; somewhat understandably courts have elected the path of least resistance by exploiting a malleable common law test for veil-piercing rather than chipping away at the statutory strictures of limited liability.

Rather, the principal culprit is a mistaken premise that limited liability and veil-piercing are mutually exclusive. The moral-hazard problem highlights the relevance of broad policy considerations, in addition to efficiency, to determining the proper scope of limited liability. In the specific case of mass

stating that it was not an "attempt to recite the ways in which the Government could show that dual officers or directors were in fact acting on behalf of the parent." *Id.*

[80] *See, e.g.*, Worth v. Tyler, 276 F.3d 249, 262 (7th Cir. 2001) (rejecting application of "alter ego" theory for individual liability under Title VII); UA Local 343 of the United Ass'n of Journeymen v. Nor-Cal Plumbing, Inc., 48 F.3d 1465, 1475 (9th Cir. 1994) ("The alter ego doctrine as developed in labor law is analytically different from the traditional veil-piercing doctrine as developed in corporate law."); Lumpkin v. Envirodyne Indus., Inc., 933 F.2d 449, 461 (7th Cir. 1991) ("[T]he corporate veil may be pierced more easily in ERISA cases . . . to promote the federal policies underlying the statute . . . ."); Morris Okun, Inc. v. Harry Zimmerman, Inc., 814 F. Supp. 346, 348 (S.D.N.Y. 1993) (distinguishing statutory trust for sellers and suppliers under the Perishable Agricultural Commodities Act "from the piercing the veil doctrine"); Comm'r v. RLG, Inc., 755 N.E.2d 556, 563 (Ind. 2001) ("The responsible corporate officer doctrine is distinct from piercing the corporate veil, and explicitly expands liability beyond veil-piercing.").

[81] *See, e.g.*, sources cited *supra* notes 61-63 and accompanying text.

[82] Mass risk is merely one example of the misalignment between limited liability and veil-piercing. Another scenario concerns affiliate or sibling entities owned by a common shareholder. *See infra* Part III.C.

risk, a choice is posed between stimulating corporate investment and protecting social welfare.[83] Courts currently misframe the choice in terms of whether to impose personal liability on corporate agents.[84] But even if the inquiry were focused properly on shareholders, the competing policies implicated by mass risk have no bearing on whether veil-piercing will occur. Instead a myriad of independent and unweighted factors determine whether a judgment against a corporation will be satisfied by resort to personal assets.[85] The application and scope of veil-piercing thus are detached from the dynamics of the moral hazard problem, which accounts for the unpredictable and unprincipled doctrinal state of affairs.

Instead, shareholder liability should be conceived as a balancing test. On the one hand, whether liability should be applied on a limited or unlimited basis is an ex ante inquiry, which turns on efficiency and policy considerations.[86] On the other hand, whether creditors should be awarded relief from a shareholder's (or agent's) personal assets is an ex post inquiry, which involves traditional veil-piercing or some other kind of remedy.[87] These inquiries, therefore, should be de-linked:

Figure 2B. The Mass Risk Scenario Redux

<table>
<tr><th colspan="2">EX ANTE</th><th>EX POST</th></tr>
<tr><td>Limited Liability</td><td rowspan="2">Mass Risk Scenario</td><td rowspan="2">Veil-Piercing</td></tr>
<tr><td>Unlimited Liability</td></tr>
</table>

To be sure, a regime of unlimited liability has the same ultimate effect as veil-piercing, in that a shareholder is personally responsible for corporate debts;[88] conversely, for that shareholder, veil-piercing does entail displacing

[83] *See supra* notes 69-75 and accompanying text.

[84] *See supra* note 76 and accompanying text; *cf.* Leebron, *supra* note 50, at 1587 ("Even assuming that shareholders who would be held liable will cause managers to act efficiently in taking potential losses into account . . . there may be costs to unlimited liability that outweigh its benefits.").

[85] *See supra* note 6.

[86] *See supra* notes 50-57, 69-75 and accompanying text.

[87] Kevin M. Warsh, *Corporate Spinoffs and Mass Tort Liability*, 1995 COLUM. BUS. L. REV. 675, 696 (describing "what Professor [Reinier] Kraakman calls 'ex post remedies,' a series of legal doctrines that further protect contract creditors from the management and equityholders: veil-piercing, fraudulent conveyance law and equitable subordination"); *see also infra* Part II.B.

[88] *See supra* note 58 and accompanying text.

limited liability. But the present approach to veil-piercing does not take into account whether limited liability is justified. And there is no necessary logical relationship between the propriety of protecting the corporate form and awarding a remedy such as veil-piercing.[89]

B. *Disclaiming Piercing*

The conceptual shadow cast by limited liability has stunted veil-piercing in another crucial way. Pursuant to the conventional view, the scope of veil-piercing can be defined simply by determining the scenarios where limited liability is justified. To organize these scenarios, scholars began to classify veil-piercing cases based on different types of substantive claims. What was once a scheme borne largely from convenience, however, has become an integral, but deficient, feature of veil-piercing analysis.

The approach originated with William Douglas and Carrol Shanks.[90] Their early analysis of parent-subsidiary cases framed shareholder liability in terms of loss-allocation: "The issue is whether the loss resulting from a contract or tort claim against the subsidiary will be placed on it or the parent.... For analytical reasons the cases will be grouped according to whether the claim is tort or contract."[91] Those analytical reasons subsequently were articulated by Elvin Latty, who observed that parent-subsidiary liability cases

> present narrower issues, to be solved by principles ... [that] follow[] more or less beaten paths in fields of law often quite remote from that of stockholder liability.... Many of the cases that purport to be, or are cited as being, decided upon a broad ground of stockholder's liability really involve the stockholder's own torts or contracts.[92]

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[89] This can be gleaned by the uncertainty over whether veil-piercing should be available against unincorporated business entities. *See* Larry E. Ribstein, *Reverse Limited Liability and the Design of Business Associations*, 30 DEL. J. CORP. L. 199, 216-19 (2005) (focusing on reverse-piercing, but also demonstrating how traditional veil-piercing is ill-equipped for asset partitioning within partnerships).

[90] *See* William O. Douglas & Carrol M. Shanks, *Insulation from Liability Through Subsidiary Corporations*, 39 YALE L.J. 193, 194 (1929). One commentator has speculated that "[t]he trend toward principled analysis probably began with Alexander Hamilton Frey's 1951 discussion of defective incorporation." Michael, *supra* note 13, at 46 (citing Alexander Hamilton Frey, *Legal Analysis and the "De Facto" Doctrine*, 100 U. PA. L. REV. 1153, 1153 (1952)). Douglas and Shanks' work, however, antedates Frey's, which Michael admits is "not directly relevant to the veil-piercing issue." *Id.*

[91] Douglas & Shanks, *supra* note 90, at 194-95 ("The problem here is to ascertain the manner of organization and operation which is necessary in order to secure the insulation from liability which the organizers desired and which the legal system permits. . . . On analysis the problem resolves itself into one of allocation of losses.").

[92] ELVIN R. LATTY, SUBSIDIARIES AND AFFILIATED CORPORATIONS: A STUDY IN STOCKHOLDERS' LIABILITY §§ 22-23, at 77-78 (1936); *see also supra* note 23.

The distinction between contract and tort thus was introduced only to classify various shareholder liability cases.[93]

Latty had the foresight to recast this distinction in terms of creditors. In his view, the boundaries of contract and tort were drawn in ways that failed to reflect differences between veil-piercing cases within the parent-subsidiary context.[94] Decades later, Henry Manne explained that the risk of corporate insolvency simply represents a cost of doing business for voluntary creditors, who have incentives to insure themselves, unlike involuntary creditors, who are victims of unforeseeable harms.[95]

However drawn, the distinction continues to serve as a prism for identifying scenarios when shareholder liability is justified.[96] As one commentator has observed, "modern veil-piercing analysis has created at least three types of cases," organized by the plaintiff's original claim.[97] This is most clearly manifest within the methodology employed by the legion of empirical veil-piercing studies. Loss-allocation analysis supplies the blueprint for Robert Thompson's seminal study, which collected data from approximately 1600 veil-piercing opinions on claims within four substantive areas: contract,

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[93] *Cf.* Holmes, *supra* note 20, at 462 ("If you commit a tort, you are liable to pay a compensatory sum. If you commit a contract, you are liable to pay a compensatory sum unless the promised event comes to pass, and that is all the difference."); Roy Kreitner, *Fault at the Contract-Tort Interface*, 107 MICH. L. REV. 1533, 1534-37 (2009) (recounting how tort and contract law had "switch[ed] positions" with regard to fault by the late nineteen century, which contributed to the realignment of these two respective areas of private law "along the border between public regulation and private ordering").

[94] LATTY, *supra* note 92, § 49, at 201 ("To make the classification more significant, the line of distinction should perhaps be drawn between involuntary and voluntary creditors, inasmuch as there may be some doubt as to whether . . . e.g., claimants under a breech [sic] of warranty, should be treated like those, say, who lend money to the subsidiary."). Latty's observation, however, tends to be disregarded in modern analysis. *See, e.g.*, Bainbridge, *supra* note 12, at 487 n.40 (using "the terms 'contract creditor' to encompass all classes of voluntary creditors and 'tort creditor' to encompass all classes of involuntary creditors"); Millon, *supra* note 10, at 1316 ("Involuntary, or tort, creditors are in a quite different situation [than voluntary creditors with claims based on obligations arising out of contract].").

[95] *See* Manne, *supra* note 52, at 263 ("[A]t least in the case of voluntary creditors – which certainly includes most business creditors – the risk of insolvency is regularly understood and, where significant, treated as any other cost. . . . This last explanation of limited liability does not account for the problem of the involuntary creditor, or . . . noncommercial creditors."); *see also* Easterbrook & Fischel, *supra* note 21, at 107-09 (arguing that, with respect to involuntary creditors, the incentives for insurance are shifted to the corporation). *But see* Halpern et al., *supra* note 51, at 147 ("[M]erely because a creditor is 'involuntary' does not in every case conclude the case against limited liability.").

[96] The same function is performed by the conventional distinctions between closely and publicly held corporations, as well as between individual and corporate shareholders. *See supra* note 63; *infra* note 224.

[97] Michael, *supra* note 13, at 54.

criminal, statute, and tort.[98] And that basic approach has served as the template for all subsequent empirical veil-piercing studies.[99]

Moreover, despite Thompson's caution,[100] his study ignited a controversy about veil-piercing in relation to contract versus tort claims. The prevailing view of courts and commentators, regardless of ideological stripe, long has been that contract creditors should have less success with veil-piercing because of the opportunity to assess and insure themselves from risk.[101] Thompson's study, however, found that requests for veil-piercing occur and prevail considerably more often when couched in contract than tort,[102] a result that he acknowledged, "more than any other in the project, go[es] against the conventional wisdom."[103]

My re-examination of opinions has restored the wisdom in favor of tort and involuntary creditors, but even these results are unsatisfying. Federal and state courts inexplicably still pierce in contract and voluntary creditor claims at rates far higher than what one might expect, while the margin between these rates and, respectively, tort and involuntary-creditor claims hardly reflects the disparate strength of these rationales.[104] Existing empirical data thus have provided only part of the story about veil-piercing litigation.[105]

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[98] Thompson, *supra* note 17, at 1058 tbl.9 (reporting veil-piercing rates for contract, criminal, statute, and tort claims); Robert B. Thompson, *Piercing the Veil: Is the Common Law the Problem?*, 37 CONN. L. REV. 619, 628 (2005) ("Recognizing a corporation as separate from its shareholders is a way of allocating risk in a business transaction." (emphasis omitted)); *see also supra* note 17 and accompanying text. *But cf.* Oh, *supra* note 3, at 94 nn.77-78 (noting that the approximate total dataset for Thompson's study matches the total number of claims, manifesting a reduction of multiple claims within each opinion into one data entry).

[99] *See supra* note 18.

[100] Thompson, *supra* note 63, at 392 ("I would discourage devoting too much attention to whether corporate law conflicts with tort law . . . .").

[101] *E.g.*, PHILLIP I. BLUMBERG, THE LAW OF CORPORATE GROUPS: TORT, CONTRACT, AND OTHER COMMON LAW PROBLEMS IN THE SUBSTANTIVE LAW OF PARENT AND SUBSIDIARY CORPORATIONS § 8.04, at 163 (1987) ("[V]ery special pressures in tort require a different treatment than [veil-piercing] cases arising in other areas of the law, such as contract."); Easterbrook & Fischel, *supra* note 21, at 112 ("Courts are more willing to disregard the corporate veil in tort than in contract cases. . . . Contract creditors . . . are compensated ex ante for the increased risk of default ex post. Tort creditors, by contrast, are not compensated."); Leebron, *supra* note 50, at 1601 ("[A]lmost every commentator has paused to note that limited liability cannot be satisfactorily justified for tort victims . . . .").

[102] Thompson, *supra* note 17, at 1058 tbl.9 (reporting a veil-piercing rate of 41.98% for contract versus 30.97% for tort); Thompson, *supra* note 63, at 385 (reporting that "new data suggests that the judiciary is still reluctant to pierce the veil in tort cases").

[103] Thompson, *supra* note 17, at 1058; *cf.* PRESSER, *supra* note 29, § 1:7, at 1-36 n.5 (noting that Thompson's results "appear to be on their way to becoming the conventional wisdom").

[104] *See* Oh, *supra* note 3, at 125 tbl.8 (finding a veil-piercing rate of 46.24% for contract versus 47.75% for tort); *id.* at 142 tbl.15 (finding a veil-piercing rate of 47.50% for

This may be because all of the studies share a conceptual deficiency. To date, no one has classified veil-piercing opinions based on substantive claims arising in either property or unjust enrichment.[106] And these claims have been neglected almost entirely by commentators.[107] The neglect is curious, particularly in light of the historical conception of shareholder liability as a property-based *mesne process*.[108] And the continued use of veil-piercing as an equitable remedy should have exposed the incompleteness of an analysis confined to contract and tort.[109]

The omission is due to our dependence on loss-allocation analysis. The initial framing by Douglas and Shanks reflects their contemporary fancy with splitting the unitary domain of obligations within Roman Law into contract and tort along the lines of fault.[110] While the line has been re-drawn by economic analysis, the contract-tort divide continues to thrive within agency and, by extension, corporate law.[111] Pursuant to this orthodox approach, the scope of

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voluntary creditors versus 52.83% for involuntary creditors).

[105] Even an attempt to combat selection effects by analyzing veil-piercing dockets yields materially similar results. *See* Boyd & Hoffman, *supra* note 18, at 886-901.

[106] *See supra* note 18. Data for these claims are reported, if at all, within the diverse category of statutory claims. *See* Oh, *supra* note 3, at 129 tbl.10 (reporting twenty-two real property and forty-nine remedial veil-piercing cases arising under a statute); *see also* Boyd & Hoffman, *supra* note 18, at 887 fig.7 (presenting cause-of-action data for "Equitable Solutions" and "Property Law," as distinguished from "Enforcement Mechanisms," "Other State Claims," "Other Federal Claims," and "Veil Piercing," although the basis for that distinction is not clear and the categories are not necessarily of comparable scope).

[107] *But see* Warner Fuller, *The Incorporated Individual: A Study of the One-Man Company*, 51 HARV. L. REV. 1373, 1397 (1938) (describing veil-piercing claims in property law); Jason W. Neyers, *Canadian Corporate Law, Veil-Piercing, and the Private Law Model Corporation*, 50 U. TORONTO L.J. 173, 238 (2000) ("[I]f X *would have* been found liable under a general tort, contract, unjust enrichment, or statutory analysis, the court *will* find them liable through some sort of 'veil-piercing.'").

[108] *See, e.g.*, Act of Mar. 4, 1800, ch. 80, § 8, 1799 Mass. Acts 481, 484 ("[I]n any judgment to be rendered against said Corporation, [a] Plaintiff, not being able to find any property of the Corporation to attach on *mesne process*, or whereon to levy his Execution, shall have the right of attaching or levying his Execution on any . . . individual Members of the Corporation, in the same manner as if the Action had been brought and the judgment rendered against them in their individual capacity.").

[109] *See* 1 WILLIAM MEADE FLETCHER ET AL., FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 41.10, at 136-37 (perm. ed., rev. vol. 2006) ("A claim based on the alter ego theory is not in itself a claim for substantive relief, but rather is procedural. . . . It has been said that the alter ego doctrine is thus remedial, not defensive, in nature.").

[110] *See supra* note 23 and accompanying text. The influence of obligations on loss-allocation analysis might explain why Thompson's empirical study of veil-piercing did not recognize fraud as a separate substantive claim. *See* Oh, *supra* note 3, at 95-97.

[111] *See* Caroline Bradley, *Transatlantic Misunderstandings: Corporate Law and Societies*, 53 U. MIAMI L. REV. 269, 279 (1999) ("[M]uch of corporate law is an adaptation of the rules of tort, contract, and agency to fit a special legal form . . . ."); Eric Rasmusen,

veil-piercing turns on a choice of whether shareholder liability should be limited or unlimited,[112] which then migrates into an analysis of different types of creditors/claims.

Contributing to this migration is concern over the mass-risk scenario. Even when analyzed by Ronald Coase,[113] the prospect of third parties bearing risk from corporate torts was more hypothetical than real. That started to change two decades ago, setting the stage for Henry Hansmann and Reinier Kraakman's provocative proposal of a pro rata shareholder liability regime for corporate torts.[114] Notably, they distance their analysis from the familiar entry point of examining the effect of shareholder liability on capital markets:

> In the past, limited liability has generally been seen as a problem of corporate law. . . . Consequently, the formal boundaries of the corporation that have been established for purposes of contractual rights should also be respected in tort. One of the principal points we wish to make is that this is not so. . . . Rather, shareholder liability should be seen as a standard problem of tort law.[115]

They instead embrace the least-cost avoider analysis that thrives within agency law.[116] But that analysis, Hansmann and Kraakman reason, does not apply to contract creditors, which can determine and insure themselves against the risks posed by limited liability.[117]

Independent of its merits,[118] Hansmann and Kraakman's argument is ultimately quite conventional. Even when the view of corporate law is set aside, veil-piercing remains within the orthodox framework, in which limited liability is mutually exclusive of veil-piercing.[119] According to them, "[t]o

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Agency Law and Contract Formation, 6 AM. L. & ECON. REV. 369, 379 (2004) ("Agency law often seems a hybrid of tort and contract.").

[112] *See supra* notes 58-60 and accompanying text.

[113] R.H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1, 1-2 (1960).

[114] Hansmann & Kraakman, *supra* note 58, at 1880-81 ("Changes in technology, knowledge, liability rules, and procedures for mass tort litigation have for the first time raised the prospect of tort claims that exceed the net worth of even very large corporations.").

[115] *Id.* at 1916; *see also supra* notes 51-52 and accompanying text.

[116] *See* Rasmusen, *supra* note 111, at 369; Eric A. Posner, *Agency Models in Law & Economics* 11 (Univ. of Chi. Law Sch., John M. Olin Law & Econ. Working Paper No. 92, 2d Series, 2000), *available at* http://ssrn.com/abstract=204872; *cf.* United States v. Carroll Towing Co., 159 F.2d 169, 173 (2d Cir. 1947) ("[I]f the probability be called P; the injury, L; and the burden, B; liability depends on whether B is less than L multiplied by P: i.e., whether B < PL.").

[117] Hansmann & Kraakman, *supra* note 58, at 1919 ("The case against limited liability in tort does not extend to contract. There are compelling reasons for retaining limited liability as the background rule for contract creditors."); *see also supra* note 101 and accompanying text.

[118] *See supra* note 70.

[119] *See supra* notes 59-60 and accompanying text.

decide that there are *any* circumstances in which shareholders can be held liable for tort damages . . . is to discard limited liability in principle. . . . In sum, the distinction between 'liberalized veil-piercing' and 'unlimited liability' is largely rhetorical."[120] And once shareholder liability is justified for corporate torts, Hansmann and Kraakman maintain, the principles of loss-allocation in tort should control veil-piercing.[121]

Tort, however, hardly exhausts the scope of shareholder liability.[122] Hansmann and Kraakman may have disavowed the view from corporate law, but not that from economic analysis. They apparently have taken their cue from Guido Calabresi and A. Douglas Melamed's classic framework, in which efficiency considerations govern liability rules, and not initial entitlements.[123] Adjunct to that framework is a general reluctance of economic analysis, as well as its hypothesis of an efficient common law,[124] to engage real property.[125]

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[120] Hansmann & Kraakman, *supra* note 58, at 1932.

[121] *Id.* ("[A]s soon as one has recognized that shareholders can be personally liable for corporate torts in principle, one is logically driven to employ general principles of tort law – rather than formalities of corporate structure – to determine the scope of their potential liability."). Hansmann and Kraakman do admit that distinguishing between contract and tort damages presents "difficulties . . . in areas, such as products liability and workplace injuries." *Id.* at 1920. But they dismiss such difficulties on the basis that "courts must already draw the line between tort and contract in other contexts, such as the enforceability of waivers of warranties"; thus, there "should be no need to develop an extensive new jurisprudence for this purpose." *Id.* at 1921. Moreover, while warranty claims are indeed a "freak hybrid born of the illicit intercourse of tort and contract," William L. Prosser, *The Fall of the Citadel (Strict Liability to the Consumer)*, 50 MINN. L. REV. 791, 800 (1966), the track record of courts in this regard is hardly exemplary, *see, e.g.*, Glenn D. West & W. Benton Lewis, Jr., *Contracting to Avoid Extra-Contractual Liability – Can Your Contractual Deal Ever Really Be the "Entire" Deal?*, 64 BUS. LAW. 999, 1009-10 (2009) ("Even since courts have enforced express warranties as contractual promises, many courts have continued to recognize a separate tort claim for breaches of those express warranties . . . .").

[122] Indeed, corporate torts arguably do not even exhaust the scope of involuntary creditor claims. *See* Manne, *supra* note 52, at 263 (explaining that laborers, "[a]s the principal victims of industrial accidents, [] formerly constituted the most numerous group of involuntary creditors"). In fairness, Hansmann and Kraakman are concerned principally with corporate torts, but the pair's analysis is heavily premised on classic loss-allocation.

[123] Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089, 1110 (1972).

[124] *See, e.g.*, Richard A. Posner, *The Law and Economics Movement*, 77 AM. ECON. REV. 1, 5 (1987) ("Common law (i.e., judge-made) rules are often best explained as efforts, whether or not conscious, to bring about . . . efficient outcomes.").

[125] *See* Thomas W. Merrill & Henry E. Smith, *What Happened to Property in Law and Economics?*, 111 YALE L.J. 357, 359 (2001). This is not to say that economic analysis cannot explain some aspects of property law, *see* Harold Demsetz, *Toward a Theory of Property Rights*, 57 AM. ECON. REV. 347, 347 (1967), only that the focus tends to be unduly narrow in general, and virtually non-existent in corporate law. *But see* Henry Hansmann &

Nevertheless, no positive account of shareholder liability focused exclusively on the law of obligations can purport to be complete,[126] as real property claims can and do support veil-piercing.[127] And analyses derived from real property principles have yielded some of the more intriguing alternatives to veil-piercing.[128]

In contrast, the neglect of unjust enrichment is not surprising at all. This pillar of private law has been kicked aside within common law jurisdictions[129] and dismissed by economic analysis. As a species of restitution,[130] unjust enrichment concerns gain-based recovery, in contrast to the loss-based recovery that preoccupies compensation[131]:

> The essence of restitutionary claims is often said to be the focus on the defendant's gain as opposed to the plaintiff's loss. From an economic perspective, this is immediately anomalous. Economic analysis generally sees legal intervention as a response to conduct that imposes *harm* .... [T]he presence of a gain as such is not a reason for the law to become concerned.[132]

Whereas economic analysis justifies liability on the basis of efficient allocation, restitutionary principles resort to disgorgement for fair redistribution. With respect to veil-piercing, economic analysis thus has very little to say, much less prescribe, about wrongful benefits.

These omissions are but by-products of the true flaw in veil-piercing. The various types of substantive claims all entail certain remedies. Whether these

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Reinier Kraakman, *The Essential Role of Organizational Law*, 110 YALE L.J. 387, 390 (2000) ("[O]rganizational law is much more important as property law than as contract law.").

[126] The more natural pairing would seem to be between contract and property, given their focus on a particular kind of subject matter, whereas tort law, by virtue of its focus on a category of conduct, that is, wrongdoing, has "family ties to criminal, contract, property, and regulatory law, not to mention alternative compensation schemes." 1 DAN B. DOBBS, THE LAW OF TORTS § 7, at 10 (2000).

[127] Oh, *supra* note 3, at 129 tbl.10 (reporting twenty-two real property cases with a veil-piercing rate of 54.55%, which exceeds that for the overall dataset).

[128] *See infra* Part II.B.

[129] PETER BIRKS, UNJUST ENRICHMENT 3 (2d ed. 2005) ("Of the subjects which form the indispensable foundation of private law, unjust enrichment is the only one to have evaded the great rationalization achieved since the middle of the 19th century in both England and America . . . .").

[130] *See infra* note 151 and accompanying text.

[131] BIRKS, *supra* note 129, at 3.

[132] Christopher T. Wonnell, *Unjust Enrichment and Quasi-Contracts*, *in* 2 ENCYCLOPEDIA OF LAW AND ECONOMICS 795, 796 (Boudewijn Bouckaert & Gerrit de Geest eds., 2000) (citations omitted). To be clear, this is not to suggest that the rise of economic analysis entirely explains the virtual disappearance of restitution from American academic curriculum and discourse. *See* BIRKS, *supra* note 129, at 4; *infra* note 160 and accompanying text.

remedies are compensatory or restitutionary in nature is less relevant than the fact that they apply to the defendant *corporation*. These remedies are thus *primary*, in that their justification is linked to the nature and properties of the initial claim. Only if and when that corporation is incapable of satisfying an adverse judgment can a plaintiff then proceed to seek redress from a corporation's *shareholder*:

> A finding of fact of [veil-piercing] . . . creates no cause of action. It merely furnishes a means for a complainant to reach a second corporation or individual upon a cause of action that otherwise would have existed only against the first corporation. An attempt to pierce the corporate veil is a means of imposing liability on an underlying cause of action such as a tort or breach of contract.[133]

Veil-piercing is thus a *secondary* remedy that becomes ripe only when there is an unenforceable award for its underlying substantive claim:

Figure 3: Veil-Piercing

EX ANTE			EX POST
Shareholder Liability	*Creditor/Claim*	*Remedy$_1$*	*Remedy$_2$*
Limited	Contract	Equity/ Law	Veil-Piercing (Equity)
Unlimited	Tort		
???	Property		
N/A	Unjust Enrichment		

Figure 3 properly depicts veil-piercing de-linked from orthodox loss-allocation analysis. The scope of shareholder liability, limited or unlimited, is shown in privity with obligatory claims, respectively, contract or tort creditors, along with their adherent initial remedy in equity or law. Also represented is the uncertainty or inapplicability of shareholder liability with, respectively, property and unjust enrichment claims.[134] All of these columns appear under the umbrella of ex ante analysis, as they are driven by efficiency and the policy

[133] FLETCHER ET AL., *supra* note 109, § 41.10, at 136-37 (citations omitted).

[134] The status of property and unjust enrichment are addressed within the framework of restitution. *See infra* notes 149-55 and accompanying text.

logic of loss-allocation.[135] In contrast, veil-piercing involves an ex post inquiry about the equitable need for incidental relief,[136] and thus stands alone.

II. RECONCEIVING PIERCING

Stripped of the veil of limited liability, piercing reveals its true form. Originally conceived as a provisional remedy, piercing was available incidentally and only when no relief could be had from a corporation.[137] Inspired by the English chancery system, American legislatures conferred courts with discretionary equitable power, unfettered by any concern for the type of creditors/claims, corporations, or shareholders, to reverse wrongful conduct. This is the essence of the law of restitution. And nothing epitomizes the aim and function of this domestically endangered, but nonetheless vital, domain better than the constructive trust.[138]

This Part explains how to re-conceive piercing as constructive trust. The first Section removes the cloud of confusion and obscurity that enshrouds the constructive trust, delineating its components and structurally comparing them with piercing. The second Section proceeds to flesh out the constructive trust's mechanics and merits relative to the doctrine of substantive consolidation and fraudulent transfer law, each of which has been proposed as a potential replacement for veil-piercing.

A. *Demystifying the Constructive Trust*

Realizing the equitable nature of piercing reveals a superior remedial option, the constructive trust. Considered to be "[b]y all odds the most important contribution of equity to the remedies for prevention of enrichment,"[139] this "purely . . . remedial institution"[140] empowers courts to issue an "order declaring that the defendant [] holds a disputed asset on trust for the

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[135] *See supra* notes 69-76 and accompanying text.

[136] *See supra* notes 87 and accompanying text.

[137] *See, e.g.*, Corning v. McCullough, 1 N.Y. 47 (1847) (involving a charter that provided for joint and several liability only when "a creditor may, after judgment obtained against the corporation, and execution returned unsatisfied, sue any stockholder and recover his demand").

[138] *See* Andrew Kull, *Rationalizing Restitution*, 83 CALIF. L. REV. 1191, 1195 (1995) ("To put it bluntly, American lawyers today (judges and law professors included) do not know what restitution is. The subject is no longer taught in law schools, and the lawyer who lacks an introduction to its basic principles is unlikely to recognize them in practice."); *id.* at 1197 n.17 ("The enfeebled state of American restitution stands in sharp contrast to the situation in England, Canada, Australia, and the Commonwealth generally. In all of these countries, restitution . . . currently enjoys belated but unprecedented judicial attention and academic favor.").

[139] JOHN P. DAWSON, UNJUST ENRICHMENT: A COMPARATIVE ANALYSIS 26 (1951).

[140] Roscoe Pound, *The Progress of the Law, 1918-1919*, 33 HARV. L. REV. 420, 421 (1920).

plaintiff."[141] For centuries, the constructive trust has been an equitable tool wielded to enforce judgments via disgorgement.[142]

Unfortunately, like veil-piercing, this device is often misunderstood. As a preliminary matter, the constructive trust is not even a proper trust:

> An express trust and a constructive trust are not divisions of the same fundamental concept. They are not species of the same genus. They are distinct concepts. A constructive trust does not, like an express trust, arise because of a manifestation of an intention to create it, but it is imposed as a remedy to prevent unjust enrichment. A constructive trust, unlike an express trust, is not a fiduciary relation . . . .[143]

Instead, the constructive trust is a "species of equitable remedy, comparable in function to the injunction or decree of specific performance."[144] No element of consent is necessary because a constructive trust is judicially imposed;[145] a court simply declares that a defendant holds a disputed asset for the benefit of a plaintiff.[146] The result is a fictional trust,[147] where the wrongfully deprived

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[141] Anthony Duggan, *Constructive Trusts from a Law and Economics Perspective*, 55 U. TORONTO L.J. 217, 217 (2005); *see also supra* note 31.

[142] As with veil-piercing, *see supra* note 2, the precise origins of the constructive trust are unknown. *Compare* 1 GEORGE E. PALMER, THE LAW OF RESTITUTION § 1.3, at 9-10 (1978) ("The beginnings of constructive trust can be found in seventeenth century English cases . . . [many of which] arose out of the Statute of Frauds of 1677 . . . ."), *with* DAWSON, *supra* note 139, at 26 (describing the constructive trust as having "emerged from the fog of eighteenth-century equity"). The earliest American judicial reference to the constructive trust appeared in *Lessee of Thompson v. White*, 1 U.S. (1 Dall.) 424, 427 (Pa. 1789) ("[W]here there has been a fraud in gaining a conveyance from another, the grantee may be considered as a mere trustee."). *See also* Swearingham v. Stull's Ex'rs, 4 H. & McH. 38, 40 (Md. 1797) ("[T]his Court, when the ends of justice required it, hath always raised a constructive trust, and compelled the trustee to perform it . . . .").

[143] RESTATEMENT (FIRST) OF RESTITUTION: QUASI-CONTRACTS AND CONSTRUCTIVE TRUSTS § 160 cmt. a (1937); *see also* RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT § 55 cmt. b (2011) ("It is commonly repeated that a constructive trust is 'not a real trust' since it is 'only a remedy.' One might go further and explain that the term 'constructive trust' . . . is only a manner of speaking.").

[144] John H. Langbein, *The Contractarian Basis of the Law of Trusts*, 105 YALE L.J. 625, 631 (1995); *see also infra* note 159.

[145] A. J. OAKLEY, CONSTRUCTIVE TRUSTS 1 (2d ed. 1987) ("Unlike all other trusts, a constructive trust is imposed by the court as a result of the conduct of the trustee and therefore arises quite independently of the intention of any of the parties."); George P. Costigan, Jr., *The Classification of Trusts as Express, Resulting, and Constructive*, 27 HARV. L. REV. 437, 448, 450 (1914) ("Express trusts and resulting trusts are trusts by the real or the presumed intention of the parties, but . . . a constructive trust is a law-imposed trust." (footnote omitted)).

[146] *See* PALMER, *supra* note 142, § 1.4, at 26 (Cumulative Supp. No. 2 1998) (asserting that a plaintiff-beneficiary need not even "expressly seek a constructive trust for the court to exercise its equitable powers and grant one").

plaintiff is a "beneficiary" and the wrongful acquirer is deemed to be a "trustee."[148]

Further, the constructive trust is not restricted to unjust enrichment. Within the United States, the constructive trust is conventionally regarded "as a means of correcting wrongdoing or remedying unjust enrichment."[149] This unduly narrow conception of the constructive trust stems from a traditional account of civil restitution as a means for exclusively redressing unjust enrichment.[150] That account once was espoused avidly by Peter Birks, who renounced it just prior to his death, having realized that obligations can warrant restitution.[151]

Birks, though, left intact the unique status accorded to property. Within his expanded account, civil law is divided entirely between the dual goals of

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[147] GEORGE GLEASON BOGERT, THE LAW OF TRUSTS AND TRUSTEES § 471, at 8 (rev. 2d ed. 1978) ("A constructive trust, or as frequently called an involuntary trust, is a fiction of equity."). The relationship between the constructive trust and the law of trusts is akin to that between quasi-contracts and the law of contracts. BIRKS, *supra* note 34, at 22 ("[I]n relation to the restitutionary event the terms chiefly relied upon are 'quasi-contract' and 'constructive trust.' . . . 'Quasi-' and 'constructive' have the same sense."); *see also supra* note 34 and accompanying text.

[148] The constructive trustee also is not subject to any fiduciary duties, as is the case with actual trusts. SCOTT & FRATCHER, *supra* note 33, § 462, at 304 ("[A] court of equity does not treat the constructive trustee for all purposes as though he were in reality a trustee . . . it will not impose upon him the numerous fiduciary obligations that are imposed upon the trustee of an express trust.").

[149] Langbein, *supra* note 144, at 631; *see also* RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT, § 55 cmt. b (2011) ("A court has the power to reassign title . . . as a means of rectifying unjust enrichment."); Duggan, *supra* note 141, at 219 ("In Canada, the courts, following the United States [sic] lead, have developed the 'remedial' constructive trust to prevent unjust enrichment. . . . The remedial constructive trust is not part of English or Australian law.").

[150] *See* BIRKS, *supra* note 34, at 17 ("Restitution and unjust enrichment identify exactly the same area of law. The one term simply quadrates with the other."); *see also* RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT, § 1 cmt. b ("The law of restitution is predominantly the law of unjust enrichment . . . ."). While acknowledging that "the law of restitution is very far from imposing liability for every instance of what might plausibly be called unjust enrichment," and that "the concepts of unjust enrichment and restitution (in the literal meaning of 'restoration') correlate only imperfectly," the drafters of the new *Restatement* maintain that "the terms of 'restitution' and 'unjust enrichment' . . . generally be treated as synonymous." *Id.* § 1 cmts. b & c.

[151] BIRKS, *supra* note 129, at 4 ("The law of gain-based recovery is larger than the law of unjust enrichment. Every unjust enrichment gives rise to a right to restitution and therefore belongs in the law of restitution. But that proposition cannot be turned around . . . ."); *see also* Andrew Burrows, *Foreword* to BIRKS, *supra* note 129, at vii ("This new edition was important to [Birks] and, with characteristic commitment, he was still working on it, despite ever-failing health, until a few days before he died."); *cf.* BIRKS, *supra* note 34, at 25 ("Restitution is not the only mechanism against unjust enrichment. . . . [I]t might equally be said that prevention (by deterrence and anticipation) should be contrasted with reversal (by restitution).").

compensation and restitution,[152] which translate respectively into obligations (that is, contract and tort) and unjust enrichment.[153] Property, the fourth pillar of private law, thus would appear to be neglected in a manner reminiscent of veil-piercing.[154] The comparison would be apt if property was conceived of as a substantive claim; instead, according to Birks, property represents a class of remedies, namely those in rem, as distinguished from those in personam.[155]

These conceptual shifts provide some crucial keys to veil-piercing. Because restitution functions to complement, and not supplant, compensation, in rem relief is incidental to the ordinary means for compensating breaches of contract or tortious wrongs.[156] This supporting remedial role goes a long way toward explaining property's negligible presence as a substantive claim within veil-piercing cases,[157] as well as the abundance of veil-piercing requests arising in contract over tort.[158] Only when the initial remedy, in equity or at law, is ineffectual will restitutionary remedies be applied, which is the precise function performed by the constructive trust.[159]

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[152] *See* BIRKS, *supra* note 129, at 11 ("'Restitution' and 'compensation' are partners. Compensation is loss-based recovery. Restitution is gain-based recovery.").

[153] *See* BIRKS, *supra* note 34, at 53-55 (depicting "the entire subject of restitution" as comprising wrongs and unjust enrichment, with consent encompassing most contracts, and other events, including the constructive trust, comprising "residue"); BIRKS, *supra* note 129, at 21 (referencing four categories of civil wrongs, "torts, equitable wrongs, breaches of statutory duty not amounting to a tort, and breaches of contract," which can be formulated as "manifestations of consents and wrongs" occurring before "unjust enrichments").

[154] *See supra* notes 24, 121-30 and accompanying text.

[155] BIRKS, *supra* note 34, at 49-53; BIRKS, *supra* note 129, at 28-30.

[156] *See* Robert Chambers, *Constructive Trusts in Canada*, 37 ALTA. L. REV. 173, 181-82 (1999) ("Where the consequences mean that restitution is potentially available, the law faces two questions . . . is this the sort of wrong which gives the victim a right to restitution and, if so, should that right be (or include) a right *in rem* (a constructive trust) or merely a right *in personam* (to an account of profits or restitutionary damages)?").

[157] *See supra* notes 106-09, 123-27 and accompanying text.

[158] *See supra* note 102 and accompanying text. *But see* David Millon, *The Still-Elusive Quest to Make Sense of Veil-Piercing*, 89 TEX. L. REV. 15, 25-27 (2009) (asserting that veil-piercing claims may arise less often in tort because of a smaller universe of potential creditors as well as the availability of liability insurance). This observation also may explain the relative paucity of veil-piercing grounded in unjust enrichment, which is disfavored as compared to contract. *See* BIRKS, *supra* note 34, at 47 ("[T]he plaintiff can never put himself in a better position by suing in unjust enrichment rather than in contract. Otherwise the law of restitution would subvert bargains.").

[159] David Hayton, *Personal Accountability of Strangers as Constructive Trustees*, 27 MALAYA L. REV. 313, 314 (1985) (describing the constructive trust as "a fiction which provides a useful remedy where no remedy is available in contract or in tort"); *see also* Duggan, *supra* note 141, at 217 ("[S]ometimes the constructive trust serves . . . a 'perfectionary' function: the court grants the remedy to enforce an express or implied bargain between [plaintiff] and [defendant]." (citing Chambers, *supra* note 156, at 183)).

The remedy thus is detached from the underlying claim's dynamics. Whether the suit involves a substantive claim grounded in contract, property, tort, or unjust enrichment, or concerns a voluntary or involuntary creditor, has no bearing on the application of a constructive trust.[160] To qualify as a constructive beneficiary, a plaintiff simply must be deprived of an asset through some wrongful means.[161] Accordingly, all that matters is whether the process by which the asset was misappropriated warrants equitable relief.

This orientation to process extends to the defendant's enrichment. As a species of restitution, the constructive trust concerns the propriety of benefits, not losses.[162] Accordingly, the nature and extent of the harm caused by a misappropriated asset is not relevant.[163] All that matters is whether the retention and enjoyment of the asset is sufficiently wrongful to justify its return to the plaintiff.[164]

Moreover, the constructive-trust inquiry is not party-specific. Because the focus is on the status of the misappropriated asset, it is simply "traced" from the initial wrongdoer to its ultimate custodian.[165] Provided the transfer was not

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[160] *See supra* note 145 and accompanying text. *But cf.* Saul Levmore, *Explaining Restitution*, 71 VA. L. REV. 65, 67-68 (1975) (performing an economic analysis of the entire law of restitution with a focus on the cause of action, not the choice of remedy, which parallels loss-allocation analysis).

[161] The constructive trust also addresses transactions that the law treats as ineffective or productive of wrongful gain, such as those that are invalid by reason of mistake. *See, e.g.*, Michigan v. Little River Band of Ottawa Indians, No. 5:05-CV-95, 2006 WL 2092415, at *4 (W.D. Mich. July 26, 2006) ("The party seeking to have a constructive trust imposed bears the burden of establishing fraud, misrepresentation, concealment, undue influence, duress, or some other circumstance that would make it inequitable for the holder of legal title to retain the property."); Costigan, *supra* note 145, at 451 ("[W]hether fraudulent retention is called actual fraud or constructive fraud, it is sufficient justification for raising a constructive trust.").

[162] ROBERT GOFF & GARETH JONES, THE LAW OF RESTITUTION 14 (2d ed. 1978) ("The object of a restitutionary claim is to strip a defendant of a *benefit* which he has unjustly gained at the plaintiff's expense."); *see also supra* notes 151-152 and accompanying text.

[163] *Cf.* BIRKS, *supra* note 129, at 39 ("Every problem in unjust enrichment can be unlocked by asking these five questions: (i) Was the defendant enriched? (ii) Was it at the expense of this claimant? (iii) Was it unjust? (iv) What kind of right did the claimant acquire? (v) Does the defendant have a defence?").

[164] *See infra* notes 237-41 and accompanying text.

[165] *See* OAKLEY, *supra* note 145, at 8 ("[T]he imposition of a constructive trust gives rise to the relationship of trustee and beneficiary which, on any view, is sufficient to satisfy the prerequisites of such an equitable tracing claim."). There are multiple conceptions of tracing, which have been described in a variety of confusing ways. *See, e.g.*, 2 DAN B. DOBBS, DOBBS LAW OF REMEDIES: DAMAGES-EQUITY-RESTITUTION § 6.1, at 11-26 (2d ed. 1993) (discussing different tracing methods for various scenarios). The constructive trust is compatible with any of these conceptions, but arguably the most clear and precise account has been formulated by Lionel Smith, whose "rules-based tracing" focuses on value, rather than assets or property, and consists of two distinct processes: following and claiming. *See*

on a bona fide basis,[166] whatever party currently holds the asset will qualify as a constructive trustee. And even if altered or substituted, the asset nevertheless will be subject to a proprietary claim that can result in disgorgement.[167]

The constructive trust is thus structurally suited to classic veil-piercing scenarios. Unlike orthodox loss-allocation analysis, which sifts through the different types of creditors/claims, corporations, and shareholders to determine when an exception should be made,[168] the constructive trust takes all of these variables as given. By focusing on whether a corporation's inability to satisfy a judgment results in an unjustifiable allocation of benefits, the principles governing the constructive trust entirely avoid the pitfall of trying to justify a remedy by resorting to attributes of the original claim.[169] And the inquiry is sufficiently flexible to accommodate any transfer of benefit from a corporation to its shareholder(s).[170]

B. *Dismantling the Alternatives*

To revamp veil-piercing via extra-corporate principles is hardly a radical proposition. Indeed, this tack has been attempted numerous times over the years. One notable attempt resorts to bankruptcy, which features a triad of corporate disregard doctrines – equitable subordination, substantive consolidation, and veil-piercing – each of which is designed for specific situations.[171] In a spirited exchange with Judge Richard Posner, Jonathan Landers endeavored to unify these doctrines in relation to parent-subsidiary and affiliate corporate arrangements.[172] For Landers, veil-piercing amounts to

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LIONEL D. SMITH, THE LAW OF TRACING 10 (1997) (distinguishing "following," an entirely factual and mechanical exercise that "is not a claim or a right in itself" and "does not make anyone liable," from "claiming," a justificatory exercise that determines whether liability should attach along with the award of certain proprietary rights to a victim).

[166] OAKLEY, *supra* note 145, at 8 ("[I]t is not possible to maintain an equitable tracing claim [against] . . . a bona fide purchaser of a legal interest in the property for value without notice of the adverse claim of the beneficiary under the constructive trust.").

[167] *See* SMITH, *supra* note 165, at 6 ("Tracing identifies a new thing as the potential subject matter of a claim, on the basis that it is the substitute for an original thing which was itself the subject matter of a claim."); R. M. Goode, *The Right to Trace and Its Impact in Commercial Transactions – I*, 92 L.Q. REV. 360, 370 (1976) ("[T]he right to follow denotes a right to trace the asset into a changed form . . . .").

[168] *See supra* notes 16-18 and accompanying text.

[169] *See supra* notes 156-61 and accompanying text.

[170] *See infra* notes 244, 267-69 and accompanying text.

[171] *See* Landers, *supra* note 60, at 590 ("Although all have a common source in the division of one business into more than one corporate entity, these . . . situations have commonly been analyzed individually under the legal rubrics of equitable subordination, piercing the corporate veil, and consolidation of related bankrupts.").

[172] *See id.* at 589-90; Posner, *supra* note 54, at 499-500 (arguing that Landers' "neglect of economic principles vital to an understanding of credit transactions, limited liability, and corporate affiliation undermines both his general approach and his specific conclusions").

an inadequate "viability-procedural observance analysis," in which courts determine whether a defendant corporation was actually a viable business that has been held out publicly as such.[173] According to Landers, this approach is inferior to substantive consolidation.[174]

Nevertheless, Landers' effort leaves much to be desired. On the one hand, substantive consolidation is over-inclusive, because the assets and liabilities of all related entities are pooled together, with the result that "some general creditors fare better and others worse."[175] On the other hand, substantive consolidation is under-inclusive, because the doctrine does not reach beyond formal bankruptcy.[176] Moreover, Landers' analysis of veil-piercing is essentially a case study of the orthodox loss-allocation approach and its pitfalls. Preoccupied with preserving limited liability, veil-piercing assumes the familiar form of a mutually exclusive exception;[177] accordingly, the only apparent option for salvaging veil-piercing is for Landers to rearrange the

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The exchange emerged during a visit at the University of Chicago Law School by Landers, who recounts that "the issues discussed [within this triad of articles] became somewhat of a cause célèbre." Jonathan M. Landers, *Another Word on Parents, Subsidiaries and Affiliates in Bankruptcy*, 43 U. CHI. L. REV. 527, 527 n.† (1976).

[173] Landers, *supra* note 60, at 621, 623 ("The model for corporateness requires both economic viability and the observance of certain procedural formalities. While this proposed test is not precise or capable of quantification, it is possible to reconcile most of the piercing cases by reference to its criteria.").

[174] *Id.* at 633-34 (rejecting veil-piercing on the basis that the multiple enterprise factors are based "on the largely mythical theory that the owners will respect the corporate integrity of constituent companies"). Landers ultimately concludes, however, that no complete unitary approach is possible. *Id.* at 652 ("[A] theory of complete fusion . . . would be in direct conflict with the corporate law that permits separate incorporation of subsidiaries and related companies . . . .").

[175] Douglas G. Baird, *Substantive Consolidation Today*, 47 B.C. L. REV. 5, 6 (2005); *see also* Union Sav. Bank v. Augie/Restivo Baking Co., 860 F.2d 515, 519 (2d Cir. 1988) (applying an even stricter test for substantive consolidation that requires proving its inurement to the benefit of *all* creditors).

[176] In fairness, Landers explicitly is concerned only with the fragmentation of corporate disregard doctrines within federal bankruptcy law. But even he recognizes a "dearth of bankruptcy authority on the veil piercing question," the orientation of which to state law and limited liability statutes represents "practical constraints [that] make a consistent judicial rule based on economic reality impossible." Landers, *supra* note 60, at 625-26. Regardless, even within bankruptcy, substantive consolidation "lacks the solid foundation one usually expects of doctrines so firmly embedded in day-to-day practice" and "lives in a peculiar nether-world" between fraudulent conveyance and veil-piercing law. Baird, *supra* note 175, at 15, 21.

[177] *See* Landers, *supra* note 60, at 623-26 (struggling to reconcile the "basic policy behind limited liability," the logic of contract and tort cases, and "some standard . . . for distinguishing cases where piercing is appropriate from those where it is not"); *supra* Part I.A.

hodgepodge of existing attenuated factors.[178] Given such an awkward and limited framework,[179] there is no wonder why any kind of alternative, in or out of bankruptcy, might seem attractive.

Another notable effort tries to absorb veil-piercing within the law of fraudulent conveyance. Inspired by the similarities Landers identified between equitable subordination and veil-piercing, Robert Clark provocatively suggested that these doctrines could be viewed as mere permutations of fraudulent conveyance.[180] Unlike substantive consolidation, the Uniform Fraudulent Conveyance Act, its successor, the Uniform Fraudulent Transfer Act, and the Bankruptcy Code collectively supply protections against attempts to hinder, delay, or defraud creditors of corporations within the zone of insolvency.[181] And, unlike veil-piercing, fraudulent conveyance law provides relief that does not require "complete revocation of limited liability," yet is not restricted to the amount of inadequate capitalization.[182]

Unfortunately, Clark's proposal falls short in a number of respects. As a preliminary matter, the law of fraudulent conveyance is arguably no less amorphous and unsettled than veil-piercing.[183] What is clear about fraudulent-

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[178] *See* Landers, *supra* note 60, at 621-22 (formulating the viability-procedural observance test simply in terms of various factors within the conventional veil-piercing test). In Landers' test, economic viability groups together adequate capitalization and siphoning of funds, as well as fraud, misrepresentation, and illegality, whereas procedural observance concerns corporate formalities and commingling. *Id.*

[179] *See supra* Part I.B; *infra* Part III.A-B.

[180] Robert Charles Clark, *The Duties of the Corporate Debtor to Its Creditors*, 90 HARV. L. REV. 505, 505 (1977) ("In particular, the doctrines of equitable subordination and piercing the corporate veil may be seen as applications of the same notions of securing the moral obligations of debtors to creditors which are at work in fraudulent conveyance law."). More precisely, Clark regards equitable subordination as "a functional substitute for, though not an equivalent of, a trustee action 'to pierce the corporate veil' under state law," *id.* at 535, which he contends is an application of fraudulent conveyance law.

[181] 11 U.S.C. § 548(a)(1) (2006); UNIF. FRAUDULENT TRANSFER ACT § 4(a)(1), 7A U.L.A. 58 (2006); UNIF. FRAUDULENT CONVEYANCE ACT § 7, 7A U.L.A. 378 (2006) (withdrawn 1984).

[182] *See* Clark, *supra* note 180, at 547 ("[A]ffirmatively responding to plaintiff's requests to pierce the veil in either of these ways may fail to compensate completely outside creditors for harm wrongfully caused them if the personal assets of the defendants are insufficient to fill the need.").

[183] *See* Douglas G. Baird & Thomas H. Jackson, *Fraudulent Conveyance Law and Its Proper Domain*, 38 VAND. L. REV. 829, 830 (1985) ("The difficulty that courts and legislatures have faced for hundreds of years has been one of trying to define what kinds of transactions hinder, delay, or defraud creditors."); Kenneth C. Kettering, *Securitization and Its Discontents: The Dynamics of Financial Product Development*, 29 CARDOZO L. REV. 1553, 1620 (2008) ("[T]he limitless generality of fraudulent transfer law precludes any definition more systematic than that previously offered: it is the residual tool by which courts have policed undesirable debtor behavior when no more specialized tool is at hand."). One critique of Clark's approach is that "bounded rationality, the institutional constraints on

conveyance provisions is that they can be circumvented quite easily by disguising an asset transfer as a distribution of dividends.[184] Clark commendably acknowledged this problem, for which he offers only a largely aspirational prescription that "court[s] can and should hold that . . . fraudulent conveyance rules preempt the dividend rules of state corporation laws."[185] But this seemingly simple fix actually opens up a Pandora's Box of problems. To expand fraudulent conveyance law in this way effectively would render ordinary corporate transactions, in or out of bankruptcy, hostage to creditors, as even a proper distribution might qualify as a transaction.[186] Indeed, even without such an expansion, current fraudulent conveyance law arguably regards all sorts of valid transactions, such as leveraged buyouts, to be injurious to creditors.[187] So instead of the "shotgun remedy" supplied by veil-piercing,[188] Clark has recommended a blunt sledgehammer.

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judicial decisionmaking, and the incentives to shirk from agency cost theory, all argue for ways to decide [veil-piercing] cases using minimal effort," and thus might suggest that "[s]lapping the requisite veil piercing epithet on a case is just a shortcut, and doing so is far more consistent with judicial incentives than puzzling through the complexities of fraudulent transfer law." Bainbridge, *supra* note 12, at 523. Whether the complexity of fraudulent transfer law exceeds that of the current veil-piercing test, with its laundry list of attenuated factors, is a close call. But the framing of a suit is a choice that primarily lies with the plaintiff, who has incentives to select the most promising test, and not the judge. Regardless, Bainbridge's criticism fails to engage the merits of Clark's approach, and simply represents a debatable explanation for the status quo that he too would prefer to avoid.

[184] Landers, *supra* note 60, at 596 ("Since any gratuitous distribution to a related company constitutes a dividend, the law of fraudulent conveyances provides little protection for creditors beyond that already provided in state corporation statutes forbidding dividends that invade capital or that will render a corporation insolvent.").

[185] Clark, *supra* note 180, at 558. Clark subsequently has touted that his "argument now has case law support." CLARK, *supra* note 11, § 2.5, at 89 (citing Wells Fargo Bank v. Desert View Bldg. Supplies, Inc., 475 F. Supp. 693 (D. Nev. 1978), *aff'd mem. op.*, 633 F.2d 221 (9th Cir. 1980)). But, almost a quarter century later, no other case appears to have followed suit, which may be because current fraudulent conveyance law is "concerned [with] individual rather than corporate debtors," and thus ill-prepared to deal with routine transfers such as distributions. Baird & Jackson, *supra* note 183, at 832.

[186] *See* Baird & Jackson, *supra* note 183, at 834 ("Treating transfers by a debtor that make creditors as a group worse off as fraudulent conveyances is overbroad because many ordinary transfers that a debtor makes do this."); *id.* at 853 (describing a scenario where a "firm issues new preferred debt and then uses the proceeds as a dividend," and concluding that "there seems to be little reason for fraudulent conveyance law to control" the distribution for lax creditors). A more sinister possibility is that fraudulent conveyance law gives creditors an incentive to void relevant transactions that ultimately may release their own obligations.

[187] *See id.* at 834 ("If one applies fraudulent conveyance law to leveraged buyouts . . . one might work counter to the interests of those creditors who, before the fact, would have wanted their debtor to have the power to enter into such transactions."); *id.* at 850-53

In contrast, the constructive trust represents a surgical knife. Transforming a defendant into a constructive trustee confers the plaintiff-beneficiary with a choice of two remedies: (1) the constructive trustee may be held personally liable for essentially what amounts to a breach of trust, or (2) the plaintiff-beneficiary may exercise proprietary rights to the misappropriated assets.[189] Which remedy applies is an election made on an ex post basis,[190] and thus the plaintiff-beneficiary can make an informed decision about how to maximize recovery.

When the constructive trustee is solvent, the choice turns on the asset's value. On the one hand, if the misappropriated property has depreciated, its original value can be recovered by holding the constructive trustee personally liable.[191] On the other hand, if the misappropriated property has appreciated, the original value and its identifiable fruits can be recovered by exercising the plaintiff-beneficiary's proprietary rights.[192]

An insolvent constructive trustee also presents a clear choice. Because the remedy of personal liability will result in the claim ranking with, rather than ahead of, general unsecured creditors,

> the only situation in which the beneficiary is likely to choose to rely on the personal liability of the constructive trustee . . . will be where the property which is the subject matter of the constructive trust has fallen in value to a percentage of its original value smaller than the percentage that is likely to be paid out by the trustee in bankruptcy to the general creditors.[193]

Otherwise, the proprietary rights will push the plaintiff-beneficiary to the front of the general, unsecured line;[194] this "valuable trump" is thus essentially

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(demonstrating how fraudulent conveyance law distorts arm's-length transactions in leveraged buyouts).

[188] Clark, *supra* note 180, at 547 ("The piercing cases appear to employ a shotgun remedy, that is, a remedy less precisely responsive than those invoked in fraudulent conveyance cases, but one more biased toward a punitive result than those invoked by the doctrine of equitable subordination.").

[189] *See* OAKLEY, *supra* note 145, at 1 ("[W]hen property is declared to be the subject-matter of a constructive trust, the imposition of that trust produces liabilities both of a proprietary and of a personal nature for the constructive trustee.").

[190] *See, e.g.*, Meinhard v. Salmon, 164 N.E. 545, 549 (N.Y. 1928) (imposing a constructive trust that presented plaintiff with an ex post option to receive shares or join a misappropriated lease).

[191] OAKLEY, *supra* note 145, at 5-6.

[192] *Id.*

[193] *Id.* at 6; *see also id.* at 6 n.13 (adding that when the property has depreciated at the hands of the constructive trustee, "it will always be in the beneficiary's interest . . . to both recover the property and claim damages for the fall in its value").

[194] SCOTT & FRATCHER, *supra* note 33, § 481.2, at 398 ("In a great many of the cases in which the owner of property seeks to follow it and impress a constructive trust or equitable lien upon the product of the property . . . the claimant is given priority over the general

a priority accorded to the plaintiff-beneficiary,[195] and will be almost "inevitably cho[sen]."[196]

The priority can be justified on a number of grounds. From a property rights standpoint, the constructive trust represents a pre-bankruptcy claim on a misappropriated asset that must be forfeited by its current holder, who possesses bare legal title.[197] Similarly, from a relative-entitlements standpoint, the priority serves to protect the superior constructive trust claim that the plaintiff-beneficiary did or would possess outside of bankruptcy.[198] Additionally, from a corrective-justice standpoint, the priority denies general unsecured creditors the ability to benefit unjustifiably from an asset that otherwise would not be available for distribution.[199]

III. PIERCING VIA THE CONSTRUCTIVE TRUST

Traditional veil-piercing is replete with distinctions and factors. Scenarios typically are classified along the lines of whether they involve voluntary or involuntary creditors/claims, close or public corporations, and individual or corporate shareholders.[200] Even the simplest scenarios are analyzed through the prism of numerous factors that themselves may be mere proxies for certain phenomena. Navigating through all these scenarios can be a rather daunting exercise.

This Part takes a sleeker approach to demonstrating how the constructive trust can be applied in lieu of veil-piercing. Unlike orthodox loss-allocation analysis, the constructive trust operates independent of the type of

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creditors of the wrongdoer.").

[195] HANOCH DAGAN, THE LAW AND ETHICS OF RESTITUTION 297 (2004) ("If this restitution claimant succeeds in asserting . . . a constructive trust . . . she can simply reclaim what is deemed to be equitably hers. Thus, this fortunate claimant gets, in effect, a priority . . . .").

[196] OAKLEY, *supra* note 145, at 6-7.

[197] *See* Andrew Kull, *Restitution in Bankruptcy: Reclamation and Constructive Trust*, 72 AM. BANKR. L.J. 265, 287 (1998) ("A decree that certain assets are held in constructive trust for the benefit of a claimant means that, in the judgment of the court, the claimant has a right of ownership in those assets superior to that of the person with possession and legal title.").

[198] Duggan, *supra* note 141, at 246 ("Applying the relative entitlements theory[,] . . . since [plaintiff's] constructive trust claim would have had priority over the claim of an execution creditor outside [defendant's] bankruptcy, it prevails over unsecured creditors inside [defendant's] bankruptcy.").

[199] Emily L. Sherwin, *Constructive Trusts in Bankruptcy*, 1989 U. ILL. L. REV. 297, 332. *But see* Kull, *supra* note 197, at 288-89 (criticizing Sherwin's claim that "it is wrong to regard the constructive trust claim as having an equitable interest in property, or to consider that a constructive trust has any existence apart from its judicial declaration" as being based on "a purported analysis in terms of property interests [that] is unduly formalistic and ultimately arbitrary").

[200] *See supra* notes 94-98 and accompanying text.

creditor/claim, corporation, or shareholder involved in the original suit; the relevant inquiry instead is the flow of unjustified benefits. Accordingly, classic veil-piercing scenarios can be organized by the dimensional flow of assets (1) horizontally from a corporation to a controlling shareholder, (2) vertically from a subsidiary up to a parent corporation, and (3) diagonally from a corporation to an affiliate or sibling via or at the behest of a common controlling shareholder. Each of these dimensions also is connected with a different component of the traditional veil-piercing test, with the net result taking into account all possible types of factors. Across this triad of increasingly complex scenarios, the constructive trust is shown to yield comparable, if not superior, results than traditional veil-piercing.

A. *One Dimension*

The most basic scenario features a corporation with one shareholder. As one court has stated: "In all the experience of the law, there has never been a more prolific breeder of fraud than the one-man corporation. It is a favorite device for the escape of personal liability."[201] Whether that is empirically accurate or not,[202] the presence of only one shareholder does simplify conventional veil-piercing by effectively dispensing with any need to determine whether sufficient control or domination exists. The inquiry thus is streamlined toward evidence of intent to commit some kind of fraud, wrong, or injustice.[203]

This evidence can assume many forms, all of which are problematic. Despite its intuitive relevance, fraud or misrepresentation is not dispositive, much less required, in all jurisdictions.[204] What constitutes a sufficient showing, actually or constructively,[205] has produced inconsistent results that

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[201] *In re* Dixie Splint Coal Co., 31 F. Supp. 283, 288 (W.D. Va. 1937); *see also* Bernard F. Cataldo, *Limited Liability with One-Man Companies and Subsidiary Corporations*, 18 LAW & CONTEMP. PROBS. 473, 482 (1953) ("These sentiments [toward corporate disregard] have special significance with respect to one-man companies . . . . His complete dominion and superior knowledge carry opportunities for manipulation and maneuvering.").

[202] *See* Thompson, *supra* note 17, at 1055 tbl.7 (reporting that veil-piercing cases most frequently involve parent-subsidiary structures, but the highest success rate concerns requests against only one individual shareholder and that the "differences between the one, two or three person corporations, and the other close corporations are statistically significant").

[203] *See supra* note 5 and accompanying text. The proximate-causation requirement is omitted here to sharpen the substantive contrast with constructive-trust analysis. The harm-or-loss requirement is discussed in Part III.B.

[204] *Compare* FLETCHER ET AL., *supra* note 109, § 41.25, at 165 (stating that "corporate existence can be disregarded without a specific showing of fraud" and providing supporting cases), *with* Iceland Telecom, Ltd. v. Info. Sys. & Networks Corp., 268 F. Supp. 2d 585, 591 (D. Md. 2003) ("[A]ll binding precedent from the state courts of Maryland . . . give this Court no example of when a Court should pierce the corporate veil absent a showing of fraud . . . .").

[205] *Compare, e.g.*, Mobil Oil Corp. v. Linear Films, Inc., 718 F. Supp. 260, 268 (D. Del.

belie an unsettled standard that either challenges courts or presents them with an opportunity for results-oriented rulings.[206] Indeed, the same difficulty plagues undercapitalization, a popular proxy for fraud or misrepresentation.[207] Over time judicial focus on the amount of capital has shifted from the time of incorporation to that of the alleged misconduct,[208] while morphing into something called "financial responsibility"[209] and meandering into whether funds have been siphoned for a shareholder's personal use.[210]

1989) ("Fraud or something like it is required."), *and* Menetti v. Chavers, 974 S.W.2d 168, 174 (Tex. App. 1998) ("[T]he actual fraud requirement [for contractual obligations] should be applied, by analogy, to tort claims . . . ."), *with* Associated Vendors, Inc. v. Oakland Meat Co., 26 Cal. Rptr. 806, 813 (Dist. Ct. App. 1962) ("[T]he doctrine does not depend on the presence of actual fraud, it is designed to prevent what would be fraud or injustice, if accomplished.").

[206] *See, e.g.*, Sea-Land Servs., Inc. v. Pepper Source, No. 88 C 4861, 1992 WL 168537, at *4-5 (N.D. Ill. July 10, 1992) (deeming evidence that a shareholder engaged in individual tax evasion and gave oral assurance that the corporation would pay any freight bills "if there were sufficient corporate funds" as constitutive of fraud).

[207] *See* William P. Hackney & Tracey G. Benson, *Shareholder Liability for Inadequate Capital*, 43 U. PITT. L. REV. 837, 859 (1982) ("There is no question today but that inadequate capital is considered by all courts to be one of the most important factors in cases imposing liability on shareholders for corporate obligations."). There is, however, some dispute about whether undercapitalization is equally relevant for contract versus tort creditors. *Compare id.* at 867 ("The courts seem more inclined to hold shareholders liable for the torts of their corporations than for their contracts when . . . inadequate capitalization is present, and the textwriters generally support this position." (footnote omitted)), *with* Adolf A. Berle, *The Theory of Enterprise Entity*, 47 COLUM. L. REV. 343, 349 n.15 (1947) ("In all cases insufficient capitalization is persuasive evidence that the enterprise was not separate.").

[208] The shift can be attributed to the relaxation of minimum-capital requirements within incorporation statutes down to a nominal amount, if any at all. *See* Millon, *supra* note 10, at 1337 ("Corporation statutes no longer include requirements for minimal initial capitalization or ongoing levels of capital.").

[209] *See, e.g.*, Radaszewski v. Telecom Corp., 981 F.2d 305, 309-10 (8th Cir. 1992) (interpreting "capital" as including "financial responsibility"). Harvey Gelb has argued that veil-piercing should apply when an entity has been operated in a "financially irresponsible" manner. Harvey Gelb, *Limited Liability Policy and Veil Piercing*, 9 WYO. L. REV. 551, 573 (2009). This virtual reincarnation of the undercapitalization factor, however, relies entirely upon classic loss-allocation analysis. *See supra* notes 177-78 and accompanying text. Moreover, defining "financially irresponsible" conduct is hardly a simple task and arguably would have countervailing economic effects. *Cf.* LoPucki, *supra* note 67, at 88-89 (delineating the negative effects of imposing a financial responsibility requirement on entrepreneurs to thwart judgment-proofing strategies).

[210] *See, e.g.*, Pierson v. Jones, 625 P.2d 1085, 1089 n.1 (Idaho 1981) ("As to the issue of undercapitalization, the issue is not whether the corporation was initially undercapitalized, but whether [defendant] drained the corporate assets for his own use.").

These factors have gone astray because they are misdirected. Although it is the most dispositive factor within veil-piercing opinions,[211] the absence or presence of fraud or misrepresentation does not assert itself as strongly as other factors do when couched in a substantive fraud claim.[212] This curious reality may be explained by judicial confusion about what exactly must be the subject of fraud or misrepresentation to justify veil-piercing. Some courts follow the orthodox view that fraud or misrepresentation within the original exchange between a plaintiff and a corporation obviates the ability to account properly for risk.[213] But others examine the extent to which peripheral fraud or misrepresentation by a shareholder is responsible for a corporation's inability to satisfy a judgment,[214] which is what undercapitalization purports to establish, albeit indirectly and imperfectly.[215]

No such confusion exists with respect to the constructive trust. Imposition of this remedy can be triggered by the presence of fraud or misrepresentation, as well as concealment, undue influence, or duress.[216] Unlike veil-piercing, however, the constructive trust inquiry focuses on whether the *means* by which the asset has been transferred renders its retention by the current holder unjustified. Because the constructive trust applies only when an initial remedy within either equity or law is ineffectual,[217] there is no connection with the underlying substantive claim.

These types of wrongful conduct also comport with loss-allocation. The opportunity of voluntary creditors to bargain and insure themselves against risk generally negates any need for ex post compensation.[218] That need clearly reasserts itself when the distortive effects of fraud or misrepresentation are present.[219] Further, concealment, undue influence, and duress are all forms of

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[211] Oh, *supra* note 3, at 133-34 tbl.12 (reporting fraud or misrepresentation to be dispositive in 989 cases, followed by injustice or unfairness in 890 cases); *see also id.* at 137 (presenting evidence of a substitution effect with other rationales when evidence of fraud or misrepresentation is absent).

[212] *See id.* at 136 tbl.13 (reporting a veil-piercing rate for fraud or misrepresentation that is lower than when evidence of a sham or shell, siphoning of funds, instrumentality, alter ego, or domination is absent or present).

[213] *See, e.g.*, Easterbrook & Fischel, *supra* note 21, at 112.

[214] *See, e.g.*, FLETCHER ET AL., *supra* note 109, § 41.32, at 196-97 ("In cases of fraud . . . the courts may regard the real parties responsible and grant relief against them . . . based on the principles of equity.").

[215] *See* Hackney & Benson, *supra* note 207, at 888 ("[T]he remedy of denying limited liability goes beyond providing compensation for harm actually traceable to the undercapitalization and may yield a punitive result. . . . 'Piercing the veil' solely for undercapitalization . . . would convert an investor into a guarantor.").

[216] *See supra* note 161 and accompanying text.

[217] *See supra* note 159 and accompanying text.

[218] *See supra* note 101 and accompanying text.

[219] *See* Easterbrook & Fischel, *supra* note 21, at 112 ("Th[e] distinction between contract and tort creditors breaks down when the debtor engages in fraud or misrepresentation.").

unconscionable conduct that excuse enforcement of bargains.[220] Notably, though, none of these excuses recognized by the constructive trust constitutes a ground for veil-piercing.[221] Accordingly, the wrongful-conduct component can yield a more comprehensive and yet precise form of relief for voluntary creditors.[222]

B. *Two Dimensions*

The parent-subsidiary structure presents a more complex scenario. Despite the contrary insistence of courts and some scholars,[223] the test for veil-piercing operates in materially different ways when the controlling shareholder is a corporation, rather than an individual.[224] This is largely because the additional layer of limited liability enjoyed by that shareholder exacerbates the moral-hazard problem.[225] Accordingly, modern loss-allocation analysis, which emerged from an exclusive preoccupation with the parent-subsidiary

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[220] *See* George S. Geis, *Economics as Context for Contract Law*, 75 U. CHI. L. REV. 569, 598 (2008) (reviewing VICTOR GOLDBERG, FRAMING CONTRACT LAW: AN ECONOMIC PERSPECTIVE (2006)) ("Parties lacking real intent – through flaws from incapacity, fraud, duress, mistake, and so on – should not be able to draw upon the power of the law to back their bargains." (emphasis omitted)).

[221] *Cf. supra* note 5 and accompanying text.

[222] This component does not include voluntary creditors, but their compensation is supplied through the constructive trust's unjustified enrichment analysis. *See infra* notes 237-41 and accompanying text.

[223] *See, e.g.*, HARRY G. HENN, HANDBOOK OF THE LAW OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES § 148, at 258 (2d ed. 1970) ("Generally-speaking, the principles governing one-man, family, and other close corporations are applicable to subsidiary and other affiliated corporations." (footnote omitted)); Bainbridge, *supra* note 12, at 528 ("Under current law, the nature of the ultimate shareholder-defendant – corporation or natural person – is irrelevant.").

[224] Empirical studies uniformly find federal and state courts are far more reluctant to reach into the personal assets of a corporate, as compared to an individual, shareholder. *See* Matheson, *supra* note 18, at 1153 ("Piercing [within the parent-subsidiary situation] occurs about half as often as in the overall universe of piercing decisions."); Oh, *supra* note 3, at 110 tbl.4 (finding a veil-piercing rate of 41.17% for corporate versus 51.69% for individual shareholders); Thompson, *supra* note 17, at 1055 tbl.7 (finding a veil-piercing rate of 37.21% for corporate versus 43.13% for individual shareholders). This chasm rebuts a broadly held conviction that veil-piercing should prevail more often in the parent-subsidiary context. *See infra* note 227.

[225] *See* BLUMBERG, *supra* note 101, at xl ("[M]ost of the presumed advantages of limited liability are simply irrelevant where corporate groups are involved."); Kurt A. Strasser, *Piercing the Veil in Corporate Groups*, 37 CONN. L. REV. 637, 638 (2005) ("While traditional corporate law has not articulated different rules for a parent company in its role as a shareholder than for individual investor shareholders, parent companies in fact present different policy issues and their limited liability should be determined by a different analysis.").

scenario,[226] believes the presumption of separateness should not apply to corporate shareholders.[227]

The chief problem lies in determining what constitutes separateness. To assess whether a subsidiary is the "alter ego" or "instrumentality" of a parent, courts typically examine the extent to which formal corporate practices and commingled operations exist.[228] This seemingly simple inquiry, however, is quite difficult to apply due to the peculiar nature and diverse forms of corporate groups.[229] Over time courts have developed a checklist of circumstantial factors, which are neither weighted nor connected to the underlying harm, resulting in a pastiche of unpredictable precedent.[230]

One possibility that has enticed but never gained much traction with courts is to reconfigure parent-subsidiary relations in terms of agency law.[231] Analysis along these lines tends to focus on the extent to which a subsidiary qualifies as an agent subject to the control of a corporate parent, as a principal, for actions taken on its behalf.[232] Liability incurred by the subsidiary-agent then might be imputed to its parent-principal. This apparent-authority scheme, however, is not a perfect fit with veil piercing scenarios, which frequently lack the requisite evidence of a traceable manifestation from the principal-parent.[233] As a result,

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[226] *See supra* notes 91-94 and accompanying text.

[227] *See* Easterbrook & Fischel, *supra* note 21, at 110-11 ("Courts' greater willingness to allow creditors to reach the assets of corporate as opposed to personal shareholders is . . . consistent with economic principles."); Landers, *supra* note 60, at 623 ("[C]ourts may have a greater proclivity to reach corporate, as opposed to individual, stockholders.").

[228] *E.g.*, Koch Ref. v. Farmers Union Cent. Exch., Inc., 831 F.2d 1339, 1345 (7th Cir. 1987) ("Evidence indicative of an alter ego relationship includes . . . intermingling of corporate identities or funds."); *see also* David H. Barber, *Piercing the Corporate Veil*, 17 WILLAMETTE L. REV. 371, 377-78 (1981) ("The intent behind the formalities prong of the piercing test . . . is to prevent shareholder-owners from impairing the interests of other parties by carrying this unity of interest too far.").

[229] *Cf.* Millon, *supra* note 10, at 1361 (stating that "corporate shareholders do not participate in control of the firm simply by virtue of their status as such" but instead "exercise control only indirectly").

[230] *See supra* notes 6-12 and accompanying text.

[231] *See* Robert B. Thompson, *Agency Law and Asset Partitioning*, 71 U. CIN. L. REV. 1321, 1326-42 (2003) (examining applicability of agency law generally in connection with limited liability, as well as specifically with respect to parent-subsidiary structures).

[232] *See* RESTATEMENT (THIRD) OF AGENCY § 1.01 (2005) ("Agency is the fiduciary relationship that arises when one person (a 'principal') manifests assent to another person (an 'agent') that the agent shall act on the principal's behalf and subject to the principal's control, and the agent manifests assent or otherwise consents so to act."); *cf.* Mendelson, *supra* note 49, at 1206 (proposing a variant of agency-based analysis whereby "a shareholder with the capacity to control would be fully responsible for corporate torts or statutory violations" when the amount of vicariously generated liability exceeds corporate assets).

[233] *See* RESTATEMENT (THIRD) OF AGENCY § 2.03 ("Apparent authority is the power held by an agent or other actor to affect a principal's legal relations with third parties when a

agency principles tend to be merely "metaphorical or rhetorical [devices] . . . relied upon simply to justify a conclusion that, for some other reason, liability should follow from shareholder control."[234]

Instead the constructive trust shifts the focus from liability to benefit. The contours of agency law conform to the least-cost-avoider formula, of which orthodox loss-allocation analysis is a mere variant.[235] In this vein, veil-piercing involves an attempt to specify objective bases for imposing personal liability on a shareholder. But, as evidenced by current judicial efforts, properly defining these bases is a notoriously difficult fact-intensive inquiry that makes veil-piercing ill-suited to summary judgment.[236] Rather than trying to determine what attributes should expose a shareholder to liability, the constructive trust focuses on whether the ultimate holder should retain the proceeds flowing from title to a misappropriated asset.

That holder is converted into a constructive trustee upon proof that the retention constitutes unjustified enrichment. Unlike liability and its implicit deterrence framework, benefit-oriented analysis concerns explicit validity. In essence, the custodian of a misappropriated asset must articulate a principled reason against disgorgement.[237] The universe of invalid reasons for enrichment ranges from participatory grounds, such as nullity, terminability, and voidability,[238] to non-participatory grounds, such as wrongful benefits received either absolutely involuntarily or knowingly.[239] In contrast to veil-piercing,

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third party reasonably believes the actor has authority to act on behalf of the principal and that belief is traceable to the principal's manifestations."); *cf.* Krendl & Krendl, *supra* note 6, at 3 n.9 (embracing Judge Learned Hand's position that "express agency would not provide a remedy because the consensual element would be lacking and . . . implied agency would be inappropriate because that would mean that the veil would be pierced in every situation" (citing Kingston Dry Dock Co. v. Lake Champlain Transp. Co., 31 F.2d 265 (2d Cir. 1929))).

[234] Millon, *supra* note 10, at 1332.

[235] *See supra* notes 116-21 and accompanying text.

[236] *See, e.g.*, Am. Mgmt. Corp. v. Dunlap, 784 F. Supp. 1245, 1248 (N.D. Miss. 1992) ("Whether it is a defendant who seeks to preserve a corporate shield over him, or a plaintiff who is attempting to pierce the corporate veil, corporate disregard often raises genuine issues of material fact, thus making summary judgment inappropriate.").

[237] *See* BIRKS, *supra* note 129, at 43 ("There is a limited range of recognized explanations. If the putative explanation is invalid or if there never was even a putative explanation, the enrichment is *sine causa*, it lacks the required explanatory basis and must be given up.").

[238] *Id.* at 126 ("[T]he enrichment cannot be unjust until the other has brought the contract to an end. . . . Subject to that caveat, nullity, termination, terminability, and voidability all suffice to show that an enrichment has no valid basis. Mere unenforceability does not."); *see also id.* at 142-54 (examining inadequate participatory bases within contract, trust, and gift contexts).

[239] *Id.* at 155 ("In general, an absolutely involuntary enrichment will have no explanatory basis at all."); *id.* at 157 ("In the absence of a cogent explanation to the contrary, to insist on fault is to disapply the law of unjust enrichment in favour of the law of wrongs. The

then, the "unjust" component to enrichment is not some amorphous set of principles,[240] but rather "a reason for restitution which is not a manifestation of consent and not a wrong."[241]

To see the merits of this approach, return to the mass-risk scenario. Subsidiaries that externalize tortious harm generate strong incentives for their parents to maintain formalities and segregate operations; as a result, victims must pursue corporate agents with typically inadequate means,[242] or nervously hope that public pressure somehow will impel the parent to assume financial responsibility.[243] Rather than taking these diversionary courses, the constructive-trust inquiry goes straight to whether the parent has benefited from the subsidiary's tortious conduct; to the extent that the underlying benefit has been knowingly received by the parent, it must proffer a valid justification for retaining those proceeds or else disgorge them. And, unlike veil-piercing, this burden is imposed on the parent not by virtue of its status as a (controlling) shareholder, but as the current holder of misappropriated assets. Accordingly, if some of those assets have been distributed to shareholders or transferred to another entity, they will be subject to judicial scrutiny and possible disgorgement.[244]

The constructive trust thus can do what veil-piercing is supposed to. Virtually everyone agrees that the justifications for limited liability do not extend to the mass-risk scenario.[245] Further, under the orthodox approach, no one seriously questions that shareholder liability should protect involuntary and tort creditors,[246] who are the most compelling candidates for equitable relief.[247] And the need for such relief is most pronounced against corporate

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equitable wrong is 'knowing receipt.'").

[240] *See* BIRKS, *supra* note 34, at 18-19 ("[T]he word 'unjust' . . . invite[s judicial] appeals to abstract conceptions of justice from whatever moral and political values might best suit a party's case. . . . In the phrase 'unjust enrichment' the word 'unjust' might, with a different throw of the dice, have been 'disapproved' or, more neutrally, 'reversible'. . . .").

[241] BIRKS, *supra* note 129, at 13.

[242] *See supra* notes 67-68 and accompanying text.

[243] *See* LoPucki, *supra* note 67, at 52-53 (describing how Exxon Corporation would have evaded liability for the Valdez oil spill but for political backlash, and observing that "[a]ttempting to predict whether cultural and political constraints will dissipate is a highly speculative undertaking").

[244] Bona fide recipients without notice of an adverse claim, however, would be exempt. *See supra* note 166 and accompanying text. Accordingly, the constructive trust would not reach into the personal assets of most shareholders, only those who elect to profit from the morally hazardous conduct after the remedy has been applied. Corporate agents thus would be exposed to personal liability, but only to the extent they are and continue to be shareholders.

[245] *See supra* notes 49, 68 and accompanying text.

[246] *See supra* note 101 and accompanying text.

[247] *Cf.* DAGAN, *supra* note 195, at 298 ("[T]his preference reflects a strong intuition that does survive normative scrutiny, namely: the idea that involuntary creditors should not be

groups, which utilize judgment-proofing strategies on the largest scale. But even when presented with these favorably stacked concerns, veil-piercing cannot match the constructive trust.

C. *Three+ Dimensions*

The ultimate litmus test for any corporate disregard theory, though, is the corporate enterprise. Fragmenting a business into a network of corporate affiliates or siblings is an extremely effective prophylactic for veil-piercing.[248] As with parent-subsidiary structures, the "alter ego" or "instrumentality" inquiry can be thwarted by creating multiple corporations, each of which adheres to corporate formalities and conducts distinct operations.[249] Moreover, because veil-piercing is designed to hold only a shareholder personally liable, the remedy affords no relief for assets transferred from a corporation through a parent to a third firm or party.[250]

The difficulties posed by enterprises form part of veil-piercing lore. In *Walkovszky v. Carlton*,[251] a pedestrian struck by a taxicab attempted to reach through a controlling shareholder to access his nine other separately incorporated taxicab companies and their insurance reserves.[252] The suit was dismissed on the basis that its veil-piercing theory did not seek derivative relief from the shareholder.[253] In rejecting that theory, the court observed that "it cannot reasonably or logically be inferred . . . that the business . . . carried on by a larger corporate entity composed of many corporations . . . would be liable to each other's creditors in contract and in tort."[254] As a result, the

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pooled together with voluntary ones.").

[248] ARTHUR R. PINTO & DOUGLAS M. BRANSON, UNDERSTANDING CORPORATE LAW § 3.08, at 63 (1999) ("Under existing law, the segmentation strategy, as in isolating riskier portions of a business in separate subsidiaries, is a viable strategy frequently utilized."); *see also* Lynn M. LoPucki, *The Essential Structure of Judgment Proofing*, 51 STAN. L. REV. 147, 149 (1998) (demonstrating how judgment-proofing can be obtained by splitting a business structure into multiple limited liability entities).

[249] *See supra* notes 228-29 and accompanying text.

[250] *Cf.* Berle, *supra* note 207, at 354 ("Whenever 'corporate entity' is challenged, the court looks at the enterprise. . . . This is, in essence, not so much a 'disregard of the corporate fiction' as it is a holding that the economic enterprise . . . is illegal, or criminal, or in violation of public policy, or fraudulent, or otherwise objectionable, as the case may be.").

[251] 223 N.E.2d 6 (N.Y. 1966).

[252] *Id.* at 7.

[253] *Id.* at 8 ("[I]t is one thing to assert that a corporation is a fragment of a larger corporate combine which actually conducts the business. It is quite another to claim that the corporation is a 'dummy' for its individual stockholders . . . ." (citation omitted)).

[254] *Id.* at 10. This precursor to enterprise liability was couched by the *Walkovszky* court in terms of agency principles. *Id.* at 7-8 ("In determining whether liability should be extended to reach assets beyond those belonging to the corporation, we are guided, as Judge Cardozo noted, by 'general rules of agency.'" (quoting Berkey v. Third Ave. Ry. Co., 155 N.E. 58,

plaintiff was forced to amend the complaint to seek relief against only the controlling shareholder in his individual capacity, whose presumably inadequate personal assets had prompted the initial attempt to reach the sibling companies.[255]

These shortcomings of veil-piercing have inspired what is known as enterprise liability.[256] More of a theory than an accepted doctrine,[257] the strategy is to demonstrate that a failure to treat various corporate entities as a collective whole would promote injustice.[258] As should be apparent, enterprise liability borrows heavily from traditional veil-piercing;[259] and, not surprisingly, they can be confused for the same purpose.[260]

Some, however, maintain that enterprise liability is worth the stretch. Indeed, Phillip Blumberg has advocated for the wholesale replacement of liability for entities with that for enterprises.[261] To accomplish this, the

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61 (N.Y. 1926))).

[255] Walkovszky v. Carlton, 287 N.Y.S.2d 546, 547 (App. Div. 1968) ("[T]he amended complaint sufficiently alleges a cause of action against appellant, i.e., that he and the other individual defendants were conducting the business of the taxicab fleet in their individual capacities."), *aff'd*, 244 N.E.2d 55, 55 (N.Y. 1968); *see also* Bainbridge, *supra* note 12, at 484 (speculating that the action eventually settled).

[256] *Cf.* Bainbridge, *supra* note 12, at 526 ("Properly understood, veil-piercing is a vertical form of liability . . . . Enterprise liability provides a horizontal form of liability . . . ."). A related doctrine, which resides within bankruptcy, is substantive consolidation. *See, e.g.*, *In re* Bonham, 226 B.R. 56, 77 (Bankr. D. Alaska 1998) (rejecting an analogy to veil-piercing as "misplaced" and instead concluding that "substantive consolidation is more like the corporate law notion of enterprise liability"); *see also supra* notes 174-176 and accompanying text.

[257] *Cf., e.g.*, Browning-Ferris Indus. of Ill., Inc. v. Ter Maat, 195 F.3d 953, 959-60 (7th Cir. 1999) (noting the "general rule . . . that a shareholder qua shareholder, and a parent, subsidiary, or other affiliate, qua affiliate, is not liable for a corporation's debts," and observing that the prospect of requiring enterprises "to maintain a sufficient capital cushion to be answerable" for externalized risk "has not carried the day in any jurisdiction that we are aware of").

[258] *Cf., e.g.*, Gartner v. Snyder, 607 F.2d 582, 587 (2d Cir. 1979) (requiring plaintiff to prove defendant shareholder's use of "the larger combine, to conduct his purely personal business").

[259] PINTO & BRANSON, *supra* note 248, § 3.08, at 63 (observing that, to impose enterprise liability, "it is necessary to focus on the grounds used to pierce the corporate veil"); *see also supra* note 5 and accompanying text.

[260] Bainbridge, *supra* note 12, at 528 ("[W]hile the remedies are conceptually distinct, in practice the line between them tends to blur. In many cases, much the same set of facts could be invoked to justify either or both remedies.").

[261] PHILLIP I. BLUMBERG, THE LAW OF CORPORATE GROUPS: PROBLEMS IN THE BANKRUPTCY OR REORGANIZATION OF PARENT AND SUBSIDIARY CORPORATIONS, INCLUDING THE LAW OF CORPORATE GUARANTIES § 18.02, at 699-704 (1985); *see also* Robert B. Thompson, *Unpacking Limited Liability: Direct and Vicarious Liability of Corporate Participants for Torts of the Enterprise*, 47 VAND. L. REV. 1, 35-40 (1994) (advocating

boundaries between different entities would be assessed based on the "degree of economic integration between the formally separate but commonly controlled components of the corporate group."[262] Although the natural question would seem to be what constitutes "economic integration," Blumberg never provides an answer,[263] much less indicates how this approach could yield principled or predictable results.[264]

The reason may be that enterprise liability ultimately cannot achieve anything superior than its conceptual fountainhead, veil-piercing. This is because both schemes are designed conventionally around liability rules. While the justifications for limited liability clearly do not extend to enterprises,[265] defining them is hardly a sure proposition. The diverse array of potential corporate groups, either in parent-subsidiary or enterprise form, virtually ensures a contextual, fact-intensive inquiry.[266]

The benefits of enterprise liability, however, can be approximated by the constructive trust. The real challenge with affiliate, parent-subsidiary, or sibling structures is not sorting out their exact relationships, but rather preventing misappropriated assets from being divided among or transferred to multiple corporations. All too often, by the time a complex corporate structure can be dissected, the money already is gone. Imposition of a constructive trust, however, results in the application of tracing rules that operate independent of the form or type of corporate structure.[267] This is because any ultimate holder can be designated a constructive trustee, provided the misappropriated assets can be identified;[268] and even when those assets have been intermixed with

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enterprise liability).

[262] BLUMBERG, *supra* note 8, § 22.03.2, at 431.

[263] Blumberg does identify four "very rough types of complex corporate enterprises," but acknowledges that they are "imprecise" and that "[i]t obviously is not possible to fit all industrial structures conveniently into any arbitrary system of classification." *Id.* § 22.03.3, at 432, 437.

[264] *See* LoPucki, *supra* note 67, at 67 (criticizing Blumberg's proposal as "vague and uncertain," and likely to "produce intolerable uncertainty for other system participants as well").

[265] *See* Phillip I. Blumberg, *Limited Liability and Corporate Groups*, 11 J. CORP. L. 573, 630 (1986) ("If a subsidiary corporation constitutes only one of a number of components of a corporate group collectively conducting a fragmented unitary business, the very basis for the establishment of limited liability as a matter of general legal policy disappears." (footnote omitted)). *But see* Kashfi v. Phibro-Salomon, Inc., 628 F. Supp. 727, 732-33 (S.D.N.Y. 1986) ("Courts are reluctant to disregard the separate existence of related corporations by piercing . . . and have consistently given substantial weight to the 'presumption of separateness.'").

[266] *See supra* note 229 and accompanying text.

[267] *See supra* notes 165-67 and accompanying text.

[268] *See supra* note 244 and accompanying text.

legitimate ones, a myriad of tracing methods are available for courts to disgorge funds in an equitable fashion.[269]

Corporate affiliates or siblings thus present no unusual challenge. When a judgment cannot be enforced against a particular corporate defendant, a court simply follows the trail of any assets linked to the underlying harm into the hands of any shareholder, related company, or third party.[270] If these assets have been appropriated wrongfully, the current holder must proffer a valid explanation for retaining title.[271] Absent any justification or defense, that holder is designated a constructive trustee and the assets subject to proprietary claims.[272] The plaintiff-beneficiary then elects its preferred remedy.[273]

But this analysis would not have altered the outcome in *Walkovszky*. Although that case nicely illustrates the (limited) mechanics of veil-piercing within the corporate-enterprise scenario, the siblings correctly were shielded from joint and several liability; as the court noted, the fact that all of these corporations had complied with the minimum statutory insurance requirements negated any possible finding of fraudulent or illicit conduct.[274] To uphold limited liability, therefore, would be a justified result.[275] In contrast, a constructive trust inquiry for *Walkovszky* would not have focused on whether the defendant corporation had inadequate capital or committed a wrong, but whether assets may have been "shuttling" among the different entities and shareholders in an unjustified manner.[276] Because no such evidence was present,[277] equity would have concluded that a constructive trust was unjustified.

Nor would the outcome perforce differ if such evidence did exist. Imagine the same facts in *Walkovszky*, but with one slight wrinkle: after the plaintiff's suit has been instigated, the defendant corporation distributes enough cash to cover all damages in the form of a preferred dividend to a minority (affiliate or sibling) shareholder.[278] Due to a lack of requisite control or domination,

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[269] *See supra* note 165 and accompanying text.

[270] *See supra* note 244 and accompanying text.

[271] *See supra* notes 237-41 and accompanying text.

[272] *See supra* notes 189-96 and accompanying text.

[273] *See supra* note 189 and accompanying text.

[274] Walkovszky v. Carlton, 223 N.E.2d 6, 10 (N.Y. 1966) ("If it is not fraudulent for the owner-operator of a single cab corporation to take out only the minimum required liability insurance, the enterprise does not become either illicit or fraudulent merely because it consists of many such corporations.").

[275] *See supra* notes 53-54, 207, 210, 219 and accompanying text.

[276] *Walkovszky*, 223 N.E.2d at 10.

[277] *Id.* (finding the complaint lacked sufficiently particularized allegations that the defendants were "shuttling their personal funds in and out of the corporations").

[278] *Walkovszky* actually involved three individual stockholder defendants, Walkovszky v. Carlton, 262 N.Y.S.2d 334, 335-36 (App. Div. 1965), one of whom was Carlton, the controlling shareholder, *Walkovszky*, 223 N.E.2d at 9. The other two were never identified and presumably held only a minority interest. *See Walkovszky*, 262 N.Y.S.2d at 336.

traditional veil-piercing would not provide any relief.[279] The only way to make this plaintiff whole would be to impose a constructive trust, on the basis that the dividend was wrongfully received and would be retained unjustifiably by the shareholder.[280] Nevertheless, a court ultimately might decide *not* to order disgorgement.

The reason would be an undesirable balance of competing interests. On the one hand, restoring unjustified benefits represents ex post compensation that would be justified under corrective-justice principles generally and economic analysis specifically for involuntary creditors.[281] On the other hand, upholding limited liability reflects an ex ante bargain that shareholders would demand to protect their distributions and ensure their participation within capital markets.[282] A quite plausible conclusion might be that restoring the plaintiff in this hypothetical case would incur a much larger expense to shareholder welfare across all corporations, and thus be a poor trade-off. Or a court might conclude otherwise.

The point is that this calculus is impossible under orthodox analysis. When limited liability is worth preserving, veil-piercing cannot be an option. Even when limited liability is worth compromising for the benefit of certain types of creditors, veil-piercing cannot deliver any relief from the corporate enterprise. But where veil-piercing fails miserably, the constructive trust can succeed. This is because the constructive trust is detached from the underlying claim, and thus operates independent of limited liability and its rationales; as a result, courts do not face a fork in the road, but instead have equitable discretion to weigh the competing merits of pursuing ex ante goals or awarding ex post relief.[283] Although only one final course of action will be taken, it will flow

[279] *Cf. supra* notes 228-229 and accompanying text.

[280] *See supra* notes 237-41 and accompanying text. Fraudulent transfer law also would be unable to void what is an entirely permissible distribution, provided the defendant corporation remained solvent along with its mandatory insurance coverage. *See supra* notes 184-86 and accompanying text. Had the cash or some equivalent value instead been transferred to a third-party non-shareholder, fraudulent transfer law would not yield a materially different result than a constructive trust, because the receipt would be with notice of an adverse claim. *See supra* note 166.

[281] *Cf.* Ernest J. Weinrib, *Correctively Unjust Enrichment*, *in* PHILOSOPHICAL FOUNDATIONS OF THE LAW OF UNJUST ENRICHMENT 31, 31-33, 52-53 (Robert Chambers et al. eds., 2009).

[282] *See supra* notes 50-54 and accompanying text.

[283] *See* Puckett v. Richard, 418 So. 2d 838, 839 (Ala. 1982) ("In the exercise of its equity jurisdiction, a . . . court is entirely justified in molding a decree which adjusts the equities of all the parties."); Duggan, *supra* note 141, at 219 ("The remedy is discretionary in the sense that, even if the case satisfies all three elements of the test, the court will still not necessarily impose the trust. The court may refuse to impose the trust on the ground that there are other remedies available . . . which make the declaration of the constructive trust unnecessary or inappropriate." (internal quotation marks omitted)).

from a more principled and predictable reasoning process that can yield efficient and equitable results.[284]

CONCLUSION

Veil-piercing has been called "Our Lady of the Common Law."[285] Over the years, though, she has been dragged through the mud and pilloried, withstanding attempts at expulsion from corporate law.[286] All the while the culprit quietly has stood in our midst. We have been so enamored with the virtues of limited liability that using it to orient our view of veil-piercing seems like a natural and reasoned path.

The problem is that "[l]imited liability is the rule, not the exception."[287] Orthodox loss-allocation analysis frames limited and unlimited liability as mutually exclusive choices. Only when the rationales for limited liability have reached their limits is veil-piercing qua unlimited liability charged with filling the remaining gaps.

The resulting doctrine is not just "rare, severe and unprincipled,"[288] but inadequate, incomplete, and incorrect. No one seriously defends limited liability within mass-risk or enterprise scenarios; yet veil-piercing proper is unable to occupy that void. While everyone agrees that limited liability should not apply in tort, empirical studies uniformly find otherwise. Furthermore, those studies, along with courts and commentators, neglect veil-piercing claims grounded in property and unjust enrichment.[289] Despite veil-piercing's origins as a provisional procedural device forged from equity, courts continue to look the other way and insist that veil-piercing is a partially legal remedy that entails a triable right.[290]

To ignore the past of veil-piercing condemns it to an ineluctable fate. The conclusion from our early corporate history is that *un*limited shareholder

[284] Whether resort to the constructive trust would diminish the volume of veil-piercing requests is difficult to predict. One variable is how courts would conduct a remedial hearing, which some, but not all, courts correctly conduct for veil-piercing; the specifics of that procedure would affect the ultimate incentives of parties to settle. Moreover, the constructive trust arguably might open the door to some claims, such as enterprise liability, that otherwise are foreclosed under the current approach. Certainly, though, the constructive trust can handle what pure veil-piercing is designed to redress, and in a more principled fashion that would benefit not only litigants but entrepreneurs attempting to assess their liability risk.

[285] WORMSER, *supra* note 27, at 40.

[286] *See supra* note 13 and accompanying text.

[287] Anderson v. Abbott, 321 U.S. 349, 362 (1944)

[288] Easterbrook & Fischel, *supra* note 21, at 89.

[289] *See supra* Part I.B.

[290] *See, e.g.*, William Passalacqua Builders, Inc. v. Resnick Developers S., Inc., 933 F.2d 131, 136 (2d Cir. 1991) ("[T]he action for piercing the corporate veil appears to have its roots in both law and equity.").

liability was the default rule applied when a corporation was judgment-proof.[291] Following the lead of English chancery courts, American legislatures fashioned an incidental equitable remedy. The nature, function, and scope of what later became veil-piercing thus were independent of limited liability. Nothing that has transpired since, not even the shift from democratic to economic rationales for limited liability, amounts to an intervening cause that would justify abandoning this original conceptual scheme.

We not only have denied the past, but also cannot see a better future. Almost a century ago, Justice Cardozo stumbled upon the noble conscience of equity,[292] the constructive trust, yet failed to realize its relevance for veil-piercing. He is not alone. Although ubiquitous within non-corporate contexts, the constructive trust has never been considered as an alternative that maps onto veil-piercing and can produce superior results. Instead, corporate law stubbornly focuses on proposals to repackage or tweak veil-piercing as currently conceived.[293]

Veil-piercing cannot be salvaged so simply; it must be re-conceived. Classic scenarios that reveal the limits of veil-piercing are handled quite capably by the constructive trust. Further, insolvency provides a setting where the constructive trust shines, presenting a choice of remedies that enables a plaintiff to optimize equitable relief while veil-piercing claims are pooled with general unsecured creditors. Indeed, when also compared against equitable subordination and fraudulent transfer law, the constructive trust represents the most satisfying means to solve the persistent challenge of how to make judgment-proof corporations and shareholders accountable for malfeasance.

Lady Justice has waited long enough for her integrity to be restored. Courts already possess and routinely exercise the equitable discretion to impose and fashion constructive trusts sua sponte.[294] Instead of having to conjure up metaphorical proof to beat the metaphorical veil of limited liability,[295] entrepreneurs and litigants deserve a predictable and principled approach to determining their ultimate exposure. By balancing the interests of claimants, corporations, shareholders, and third parties, courts finally can produce efficient and equitable results in one of the most dysfunctional and important areas of corporate law.

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[291] *See supra* note 44 and accompanying text.

[292] *See supra* note 30 and accompanying text.

[293] *See supra* note 27 and accompanying text.

[294] *See supra* notes 145-46 and accompanying text; *see also* Pfohl Bros. Landfill Site Steering Comm. v. Allied Waste Sys., Inc., 255 F. Supp. 2d 134, 141 (W.D.N.Y. 2003) (imposing a constructive trust but denying a request for veil-piercing); Graham v. Mimms, 444 N.E.2d 549, 556-57, 560-61 (Ill. App. Ct. 1982) (same).

[295] *Cf.* Fred S. McChesney, *Contractarianism Without Contracts? Yet Another Critique of Eisenberg*, 90 COLUM. L. REV. 1332, 1336 (1990) ("[I]t takes a model to beat a model." (citing GEORGE J. STIGLER, THE THEORY OF PRICE 7 (4th ed. 1987))).