Newsletters 📋 Events (2) Sign in (3) United States

LAW.COM PRO





(L-R)David Perez, the firmwide chair of Perkins Coie's business litigation practice, and Jake Dean And Aaron Ver, business litigation attorneys with the firm. Courtesy

EXPERT OPINION

3 Keys to Successfully Litigating Alter Ego Claims

David Perez, Aaron Ver and Jake Dean of Perkins Coie write that when it comes to establishing or piercing the corporate veil, it's best to be a storyteller rather than a box-

August 15, 2023 at 07:30 AM

@ 10 minute read

By David Perez, Aaron Ver and Jake Dean I August 15, 2023 at 07:30 AM

establishing or piercing a corporate veil works much the same. A corporation or limited liability company (LLC) is ordinarily regarded as a legal entity separate

Few things are as American as apple pie, baseball, or creating a corporate subsidiary to limit liability and risk. Just as pies and baseball are governed by recipes and rules, respectively,

and distinct from its owners and members. Entire industries-including finance and real estaterely on a shared understanding that both sides in any given transaction will be represented by their respective corporate avatars: special-purpose entities created for the sole purpose of insulating the parent company from the risks associated with a particular deal, investment or agreement. In commercial real estate, for instance, it is often the case that both the landlord and the tenant listed on a lease are shell entities, the upshot being that if (or when) something goes wrong, neither parent entity will be on the hook. Until, of course, something does go wrong. Faced with the possibility of suing a judgment-proof

shell entity, a plaintiff may instead seek to hold the parent liable—also known as "piercing the corporate veil" or an alter ego claim. Most attempts to pierce the corporate veil will fail at the pleadings stage—often because the

plaintiff fails to plead the right facts. But a colorable veil piercing claim presents a high-risk, highreward scenario for both plaintiffs and defendants. What follows are the three key issues that any litigant should keep in mind when prosecuting or defending against an alter ego claim. Identify the Standard and Weaponize the Leading Cases

The standards governing alter ego claims can be messy and differ somewhat from state to state. Universally, however, veil-piercing claims must meet a high bar, since society recognizes the

benefits of allowing persons and organizations to limit their business risks through incorporation. In the jurisdictions with the lowest bar, a plaintiff must show that piercing the corporate veil is necessary to prevent an inequitable result. In stricter jurisdictions, the plaintiff must show actual fraud (e.g., for a claim related to a contract in Texas) or wrongdoing (New York). Most jurisdictions analyze the relationship between the two entities—for example, whether the owner completely dominates the corporation or whether separate corporate personalities exist—either as a separate element a plaintiff must prove (New York) or as part of the analysis of the equities (Massachusetts and California). But no state has a simple, formulaic "box-checking" standard to prove an alter ego claim. That's why it is so important to identify the standard (however murky) for piercing the corporate veil in

the jurisdiction where your client finds itself. From there, identify the two or three leading cases where a court pierced the veil, or declined to do so-and understand why. Most jurisdictions outside of Delaware and New York will have relatively few leading cases on the subject. For both sides, but particularly if you are the defendant, take any perceived weaknesses with your facts or in the case law seriously. Even if most factors cut in your favor, your opponent may

find an opening because alter ego cases often involve contradicting standards and rarely provide clear rules. That's why you must attempt to understand the legal standard and identify your weaknesses before the other side does. Early and Often, Home In on the Parent/Subsidiary Distinctions No matter your jurisdiction, the cleanest way to prosecute an alter ego claim will be to show a

disregard for the corporate formalities separating the parent entity from its subsidiary. Most

jurisdictions call this a "unity of interest" test, and often the factors include the parent's degree of ownership of the subsidiary, overlap in leadership, commingling of funds, keeping of separate records (e.g., minutes), proper documentation of financial transactions between the parent and of ownership of the subsidiary, overlap in leadership, commingling of funds, keeping of separate records (e.g., minutes), proper documentation of financial transactions between the parent and the subsidiary, and the amount of control the parent exercises over the subsidiary's daily affairs. This is one area where plaintiffs often trip up at the pleadings stage, failing to allege that the corporate formalities were not

motion should identify as many of these factors as possible in the complaint—even if it is on "information and belief." After all, the real facts underlying these issues can only be learned through discovery. But the defendant need not wait for discovery to find out whether its parent and subsidiary were sharing bank accounts, properly documenting loans, or maintaining separate minutes books. If the alter ego claim survives the pleadings stage, the key

followed or failing to explain how the defendant fell short. A plaintiff who wants its alter ego claim to survive a Rule 12

corporate formalities, and what "cleanup" might need to take place. Perfection is not the standard; courts won't pierce the veil based on a series of nitpicky formalities that weren't Often, particularly in real estate or finance, the parent entity has a constellation of special purpose entities created to minimize risk across a sprawling portfolio of investments. Without a team dedicated to keeping track of necessary filings and notices, the parent entity may simply set up an LLC but forget to manage it properly. Such mismanagement is precisely the opening a

plaintiff can weaponize to pursue an alter ego claim.

breach?

for defense counsel is to immediately dig in to understand the "level of hygiene" with respect to

Because these issues are so fact-intensive, the plaintiff's discovery requests, and the defendants' (both parent and subsidiary) discovery responses, are critical. The plaintiff should ask for corporate documents separating the two entities and find out all it can about financial transactions between the parent and subsidiary. What office space did the subsidiary have? What employees did the entities share? Were the subsidiary's documents properly filed and renewed with the secretary of state? Are the same people signing the discovery responses for both the parent and the subsidiary?

More to the point, the plaintiff should home in on the parent entity's relative level of involvement

in the facts underlying your dispute. Did the parent direct the subsidiary to breach its obligations? Did the parent strip resources from the subsidiary's coffers in advance of the

Getting a handle on the relative state of affairs between the parent and the subsidiary is not just important as an element of this claim but also key to the story underlying an alter ego claim. After all, if a parent doesn't respect the corporate distinctions between itself and its subsidiary, then why should a court? By contrast, a defendant who can show clear distinctions between the

parent and the subsidiary will have a strong argument that those distinctions should be Win the Equities by Being a Storyteller, Not a Box-Checker For a plaintiff trying to pierce the corporate veil, showing that the defendants disregarded their

corporate formalities is necessary but insufficient. In almost all other jurisdictions there is a second component: the equities, A disregard for corporate formalities is often strong evidence

that the corporate structure was manipulated to the plaintiff's detriment.

But the key is for the plaintiff to show why, as a matter of fairness, the corporate form ought to be disregarded to prevent the plaintiff's loss. In some jurisdictions, the subsidiary's relative level of capitalization becomes relevant. For instance, if the subsidiary took on a significant legal obligation but the parent deliberately starved the subsidiary of capital, then the plaintiff has a

strong argument that the corporate forms were manipulated in a manner that will cause the plaintiff significant harm. Deliberately creating a judgment-proof entity is never a good look, especially if there is evidence that the parent entity directed the subsidiary to breach its legal obligations. How the equities shake out depends on the case and on any extenuating circumstances such as fraud or financial improprieties. A plaintiff should try to uncover any and all misrepresentations and misstatements during the negotiations or the course of the deal itself. If the plaintiff can show that the defendant somehow misrepresented the subsidiary's capital, or its ability to fulfill the legal obligations, then the plaintiff will have a strong equities argument.

wants to push. Identifying favorable factors without a cohesive narrative is not enough; the judge or jury should understand that piercing the corporate veil is the only just outcome. After all, it is often the case that the plaintiff knew it was dealing with a subsidiary without the resources to pay a large judgment. But if the parent used the subsidiary as nothing more than a marionette, pantomiming the subsidiary as a separate entity while pulling all the strings, the

But a plaintiff should approach the equities with caution and choose carefully which theme(s) it

plaintiff is better situated to pierce the veil. For the defense, a powerful line of attack will involve showing that the plaintiff understood the risks and still proceeded with the deal. For instance, turning back to the real estate context, landlords routinely sign deals with tenants who are nothing more than special nurpose entities landlords routinely sign deals with tenants who are nothing more than special purpose entities, with no real assets of their own. The landlords are often special-purpose entities too. Recognizing that both sides have the equivalent of a shell entity signing the lease, the landlord will often ask for a "security package" from the tenant (e.g., a letter of credit) and/or a guaranty

from the tenant's parent entity up to a certain amount. That way, if the tenant breaches the lease, then at least the landlord has some recovery, although never the full value of the lease. And that is how a defendant is well positioned to win the equities argument: by showing that in this deal the parties knew what they were doing. The plaintiff, for instance, knew it was dealing with a subsidiary and chose to proceed; the plaintiff could have, for instance, refused to sign unless the defendant's parent entity was made a party to the agreement.

In cases where the plaintiff knew its exposure going in, and even negotiated provisions to account for that exposure (e.g., a security package), that plaintiff will have a very difficult time proving that it would be inequitable to maintain the corporate distinctions. After all, there is

nothing inequitable about holding two parties to the agreement they struck.

To win an equities argument, a plaintiff should focus on showing how the defendant's "fast and loose" actions between the parent and the subsidiary demonstrate bad faith. By contrast, a party defending against an alter ego claim should highlight what the plaintiff knew and how the plaintiff understood the risks attendant to the agreement.

Often, if the plaintiff is considering or actively pursuing an alter ego claim, it is because the plaintiff understands that the recovery against the subsidiary will be limited. So the incentive is strong to at least try to pierce the corporate veil.

In many cases, early resolution of the alter ego claim will be unattainable. Whether prosecuting or defending against such claims, it is critical to develop an encyclopedic understanding of how your jurisdiction has adjudicated such claims. From there, master the facts associated with the parent's and subsidiary's respective distinctions and formalities. And develop a compelling

theme for why the equities should tilt in your client's favor. Be a storyteller, not a box-checker. David A. Perez, is the firmwide chair of the business litigation practice at Perkins Coie. He is based in Seattle. Aaron J. Ver and Jake Dean are both counsel in the practice. They are based

Reprinted with permission from the "August 15th, 2023 edition of the "Am Law Litigation Daily" © 2023 ALM Global Properties, LLC. All rights reserved. Further duplication without permission is prohibited, contact 877-256-2472 or asset-and-logo-licensing@alm.com."

in San Francisco and Los Angeles, respectively.