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Courts can 'pierce the corporate veil' to assign corporate liability to shareholders

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Corporations have been created under the law as a means of limiting the liability of the people who invest their capital in them. Typically, when a plaintiff successfully sues a corporation for wrongdoing, damages can be recovered only from the corporation itself, and not from the corporation's shareholders. Shielding shareholders from liability for the corporation's debts encourages investment and business activity.

In some situations, however, the courts will "pierce the corporate veil" and hold shareholders liable to the plaintiff for wrongdoing by the corporation. There is no hard and fast rule for determining when a court will pierce the veil and hold the shareholders liable. However, there are general guidelines the courts consider when determining liability:

- Use of the corporate form as a fraud or subterfuge to facilitate wrongdoing by shareholders (this is always a requirement for veil-piercing)
- Gross undercapitalization of the corporation
- Failure to observe corporate formalities such as directors and shareholders meetings
- Failure to pay dividends
- Siphoning of funds from the corporation by a dominant stockholder
- Non-functioning officers
- Absence of corporate records

Although it is always difficult to pierce the corporate veil, it is important for executives to observe corporate formalities and for the corporation to maintain a separate economic existence from its shareholders. The temptation to ignore these requirements is particularly great when the corporation has only one or a few shareholders. Such corporations often dismiss these requirements as unnecessary technicalities.

The risk here, of course, is that a court will hold a shareholder liable for payment of a judgment recovered against the corporation itself. This can lead to large payments and unplanned liability for individuals.

Plunkett & Cooney's transactional and real estate attorneys are very familiar with establishing and maintaining corporations and similar entities in a manner that maximizes the ability of shareholders to avoid personal liability. Observing corporate formalities in today's litigious society often illustrates the maxim that "an ounce of prevention is worth a pound of cure."

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