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***427 THEORIES OF THE CORPORATION AND THE LIMITED LIABILITY COMPANY: HOW SHOULD COURTS AND LEGISLATURES ARTICULATE RULES FOR PIERCING THE VEIL, FIDUCIARY RESPONSIBILITY AND SECURITIES REGULATION FOR THE LIMITED LIABILITY COMPANY?**

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***428 I. Introduction**

The history of the corporation in America reflects the opposing attitudes Americans have toward the wealthy. On the one hand, Americans tend to be tolerant of and even to celebrate the hard worker who succeeds; on the other hand Americans are suspicious of large and powerful organizations. Thus while the corporation was heralded as a way for people of modest means to improve their station by lessening risks in new business pursuits, Americans never overcame their early and strong suspicion of corporations as hard-to-control entities that were dangerous to the republic. From the beginning of the corporation's history in America, its defenders and its critics have described it in a way that conformed to their prejudices about the rights of citizens to contract freely between themselves or the duties owed by citizens to the state and to other citizens. While one understanding of the corporation might have become dominant at a particular historical juncture, the tensions underlying American attitudes toward corporations were never completely eliminated.

The discussion so far has centered on corporations, but in truth it applies to all business entities that have limited liability, recognized by the state, for some or all of its participants. For it is limited liability that sets a corporation apart from regular business partnerships and which provokes the greatest ire in its critics and praise in its defenders.

In some situations, the state will find the creators, participants, and members of the entity liable for the actions of the entity. This will allow a plaintiff to "pierce the entity's veil." In this area of law differences between the varying understandings of state chartered business entities are most apparent. One who strongly believes in freedom of contract and freedom from state intrusion in private ordering will argue that piercing should be rare. This is so because, as the proponents of freedom of

contract argue, the entity with limited liability would exist even without government *429 recognition; the "market" would have demanded it. On the other hand, one who believes that business entities with limited liability exist at the sufferance of the state will argue for a less stringent piercing standard. Piercing the veil, therefore, is a useful prism through which to view over time the contrasting attitudes toward entities with limited liability. The inability of any one understanding of limited liability entities to obtain complete dominance is perhaps a reason that the law of piercing the veil is the most litigated issue in corporate law and remains a predominantly common law doctrine, uncodified by statute in most states.

A. The Importance of the LLC: Delaware, a Case in Point

The past seven years have seen an explosion in the kinds of new entities with limited liability. Prominent among these new entities is the Limited Liability Company (LLC). This article will argue that the LLC is of great importance to the debate over the nature of entities with limited liability for a number of reasons. First, the LLC has the potential to replace both the C and the S corporation as the entity of choice for organization (at least in Delaware). Second, the LLC is much more explicitly a creature of contract than the corporation. Indeed, the Delaware LLC statute explicitly recognizes and protects the freedom to contract. One way this freedom is manifested is in the ability of LLC members to contract around many if not most of the fiduciary obligations that people involved in corporations owe each other. Third, the traditional piercing doctrines are very hard to apply to LLCs and some statutes, notably Delaware's, make it almost impossible to pierce an LLC's veil for anything short of outright fraud. It would seem that the LLC's potential to replace the corporation is empirical proof of the efficiency of a contractarian or minimalist approach to business entity regulation. Nevertheless, this article will argue that, at least as far as piercing the veil in Delaware is concerned, the pendulum has swung too far toward the extreme contractarian position, and that the Delaware courts will soon feel great pressure to find a way to pierce the veils of LLCs. This is true even if the courts have to invent a common law of LLC piercing or apply contractual doctrines.

This article is confident in making the above assertion for three reasons. First, the contractarians have underestimated the strength of the regulatory impulse (for better or for worse) in American law. Indeed, courts in most jurisdictions have allowed piercings even when most state statutes make no exception to a corporation's limited liability. Second, corporate piercing has recently become much easier in Delaware, a trend which this article will argue will ultimately affect the LLC. Finally, economic analysis demonstrates that the efficiency of limited liability increases with the size of the entity. The larger the entity, the greater the gains in market efficiency if it has limited liability. It is perhaps for this reason that the only piercings that have been successful have been for entities with nine or fewer shareholders. Perhaps this principle can also explain why most small entities with limited liability are pressured by their creditors to contract away their right to limited liability. Since LLCs are much smaller entities than C corporations, and will continue to be for some time, it would seem to be a sub-optimal result for LLCs to be harder to pierce than C corporations.

*430 B. Description of Contents

Part II of this article will outline the nature and history of business entities with limited liability, relating how the various theories of the firm have dealt with the issue of freedom of contract and state regulation. The history of the firm illustrates the tension between the conflicting goals that American society set for corporations. On the one hand, Americans wished to promote efficient wealth maximization by as broad a range of people as possible. On the other, Americans wanted to regulate the firm in order to protect those who lost out on that wealth creation. This part will argue that at no time in American history was a successful balance between these two goals reached. Indeed, every theory of the firm propounded contains, to some extent, the tensions inherent in the broader debate over what firms are for. This fact has made the thinking about the firm and its regulation quite schizophrenic, and the history of corporate law see-saws between a paternalistic and free market approach. This see-sawing becomes most prominent when examining the limits of limited liability, i.e., when to pierce a firm's veil of limited liability.

As an illustration, Part II will outline the basic theories behind piercing the veil. The instability of the piercing law has led proponents of both views of the firm (those who view it as a nexus of contracts and those who view it as a concession of the state) to conclude that the legal doctrines used by judges when determining whether or not to pierce the veil are irrelevant and confused. What really matters is how the case at hand relates to the wider and deeper policy goals of limited liability - economic efficiency, democracy, and (depending on whom one asks) concern for the common weal.

Part III will discuss the LLC and provide a short history, describe its main attributes, and offer possible reasons for its phenomenal popularity. This part will then highlight three areas in which LLCs differ from corporations - piercing the veil,

fiduciary duties, and classification as a security - in order to explain more fully the LLC's attractiveness to charter writers. The LLC, as this part will highlight, is free of many of the regulations, both statutory and judge made, that plague corporate law. One of the conclusions of this part is that partnership taxation is not the only reason behind the LLC's increased popularity. Rather, the "waivability" of many corporate laws that impose high transaction costs is luring would be entrepreneurs to use the LLC form. Indeed, it is quite possible that the LLC will soon be traded on the secondary markets and will supersede the corporation as the entity of choice for all firms. Another conclusion of this part is that while the LLC's displacement of the corporation might speak to the declining relevance of limited liability, what it really shows is that Bernard Black was right when he claimed that much if not most of current corporate law is trivial. [FN1] Finally, this part sounds a cautionary note for all contractarians. The speed with which LLCs came to be considered securities, despite vigorous opposition by the leading LLC commentators, points to the continuing power of the communitarian critique of the contractarian position and the inherent instability *431 of any one victory in the endless debate between the various, conflicting goals of American business law.

Part IV will examine the Delaware LLC statute in detail. This article has chosen to concentrate on Delaware because of its tremendous importance as a state of choice for incorporation and because its LLC statute is so explicitly contractarian. This part will then outline and compare the Delaware law for piercing the veil of LLCs, corporations, limited partnerships, limited liability partnerships, and business trusts. Finally, this article will conclude with the speculation (there have been no LLC piercing cases in Delaware yet) that the courts in Delaware will find it hard to pierce an LLC's veil, and will be forced to disregard the obvious differences between corporations and LLCs as well as the intent of the LLC statute. The courts will need to apply traditional piercing theories to the LLC, or fashion a new doctrine based on a mixture of contract and common law principles.

II. The Politics of Business Regulation: Attitude and Values

The conflicting values that underpin differing approaches to business regulation are reflected in how individual legal actors approach specific cases. While such a conclusion would have been heretical thinking not long ago, an increasingly uncontested position is to argue that a legal actor's (i.e., a judge's or legislator's) responses to a new law or legal scenario will follow a pattern and that pattern will reflect the actor's value judgments about the perceived consequences of his responses. [FN2] Furthermore, even when the actor is unable to articulate the likely consequence of a particular response, his responses will follow a pattern because he has internalized value judgments which cause him to prefer instinctively one response to another. [FN3] However, rare is the culture that has a monolithic position about how people should order their affairs. Isaiah Berlin has argued that Western Civilization contains many incommensurate goals and ideas in constant tension, and no single idea has or will be able to gain complete dominance. [FN4]

*432 Modern America is no exception. American attitudes toward commerce and centralized accumulations of wealth have evolved over the years, but at no time has there been a single overarching attitude toward them. Historians have long recognized that American political culture contains a number of differing political and social traditions (e.g., liberalism, civic republicanism, dissenting Protestantism) that have been woven together in the documents and ideas that make up our common culture. However, historians have also realized that no one of these traditions has ever been completely dominant. The history of American attitudes toward state chartered business organization reflects the tension between these various traditions. [FN5] As the state chartered business entity in the form of the corporation became more widespread, various theories emerged to explain what the corporation was, whether the state should regulate it, and why it should be regulated. These theories were often used to legitimize or criticize various corporate law doctrines. [FN6] Indeed, theories about the nature of the corporation are an excellent example of how law embodies beliefs about what is legitimate and how those beliefs influence the way people behave. The various theories about the nature of the corporation both reflected what their progenitors' beliefs led them to think the corporation was and what it was for, and later shaped what possible directions the development of corporate law could take. In other words, the legal theory of the corporation shaped social practice (in the form of corporate law doctrines), and practice informed theory (in the form of how the corporation was used) at the same time. [FN7]

*433 Legal concepts as verbal and abstract constructs contain a broad range of interpretive potential, sometimes capable of sustaining strongly subversive normative arguments. [FN8] The meaning of legal concepts that came about as a response to one particular situation, when confronted with a new situation can often be twisted to mean something entirely different. [FN9] Thus the idea that the corporation is a natural entity that arises independently of the government and is purely a private arrangement between parties wherein the government's purpose is merely to act in a fashion similar to a register of land titles, can be manipulated into an argument for a greater governmental role. As a natural entity, the corporation is a

citizen like any other and has certain obligations and duties.

The history of the corporation evidences a tension between the impulse to let people contract freely, and a concern for those harmed by such contracts. Every attempt by advocates of absolute freedom of contract to create a doctrine of the business entity that will brook no government intervention has met, for better or for worse, with resistance and has been twisted in some way to allow some wiggle room for state intervention. The LLC in many ways represents the latest and perhaps most audacious attempt by contractarians [\[FN10\]](#) to remove from commerce the "shackles" of the state. Delaware, for example, enshrines protection of the freedom of contract in its LLC law, thus making it very hard for the state to intervene - whether by imposing fiduciary duties on unwilling members or by holding members liable for actions of the LLC. [\[FN11\]](#) As will be argued below, the values that underpin the resistance to absolute freedom of contract in America are too strong to be done away with through legislative fiat. American fears of concentrated wealth will not be placated by the legislature defining an LLC as a contract between two private parties. Indeed, if history is any guide, the very arguments and theories of the contractarians can be twisted to require government supervision. The courts in Delaware, though generally very receptive to the interests ^{*434} of commerce and free contracting, will be under tremendous pressure for both political and economic reasons to permit easier piercings of LLC veils than the law currently seems to allow.

A. The Nature and History of Business Entities

The debate over the doctrines of freedom of contract and limited liability is the core jurisprudential issue in business entity law. [\[FN12\]](#) The issues that separate most commentators on business law are as follows: (1) the degree to which people have the right to order freely their relationships by contract; (2) the extent of the state's obligation to enforce that contract; (3) whether the state's grant of limited liability confers upon the entity certain duties toward third parties; and (4) whether the violation of those duties gives third parties the right to avoid the limited liability of the entities. [\[FN13\]](#) Most state laws and most judges' rulings reflect a particular position on this debate.

The history of the business corporation also reflects the tension between these various attitudes towards the corporation. It is a matter of historiographical debate (1) whether the corporation was initially conceived as a concession granted by the state and only later was thought of as a nexus of contracts; (2) whether both views of the corporation (corporation as a state concession and as a nexus of contracts) ^{*435} existed from the outset and have always struggled for dominance; or (3) whether the corporation was always thought of as a nexus of contracts, and only later, would be regulators claimed that the corporation was a state concession. [\[FN14\]](#)

1. Two Views of the Evolution of the Corporation

Gregory Mark argues that the corporation was initially personified as a fictive entity and was later personified first as a partnership and then as a naturally occurring entity. [\[FN15\]](#) These different personifications of firms were used by their proponents to argue for or against government intervention. The first theory propounded to explain the corporation, the fictive entity theory, described the corporation as a concession of the government, therefore subject to government regulation. [\[FN16\]](#) What the state gives, went the thinking, the state can take away. The partnership and the natural entity theories of the corporation arose in opposition to the fictive entity conception of the firm. The proponents of both later understandings argued that since the firm was a product of normal contractual relations, the government had no special right to interfere in their workings and impose regulations. [\[FN17\]](#) For a time the view of the firm as a natural entity was the dominant one. However, the growing size of firms and the recognition of the separation of ownership and control in firms resulted in commentators arguing that firms were somehow independent of their owners. [\[FN18\]](#) This argument - that firms were the natural product of individual private contracts and not dependent on the state, but that firms when created were unique individuals separate from their human creators - led to the belief that the firm was a citizen and owed duties to the state analogous to those duties owed by human citizens. [\[FN19\]](#)

Thus, while the natural person theory of the firm was designed to prevent government regulation, it led to a reimposition of government regulation. [\[FN20\]](#) In order to avoid this return of government regulation, Mark argues that corporate theorists created the "management as trustee" theory of the firm. [\[FN21\]](#) The theorists claimed that ^{*436} the firm was not an entity independent of its owners but was merely the aggregate of the interests of its shareholders; the management was the trustee of the shareholders. This theory posited that the firm had no obligation beyond those to its shareholders. [\[FN22\]](#) Yet, as Mark notes, while lessening the power of doctrinal arguments for imposing governmental regulation on firm conduct, the "aggregate interest" theory of the firm was not a full defense against government regulation. The proponents of government

regulation argued that since firm management had so much power over individual shareholders, the government had to impose various duties on management that would hold them accountable to shareholders who were too "weak" to impose these duties themselves. [\[FN23\]](#) The latest personification of the firm, the "New Economic Theory" of the corporation, claims the corporation is merely a "nexus of contracts." According to Mark, this is a "sophisticated version of the aggregate conception of the corporation that has dominated corporate law discourse since the 1930s." [\[FN24\]](#) As such it is unlikely to result in the abolition of government regulation because of the conflicting nature of the goals that Americans have for corporate law. [\[FN25\]](#)

William W. Bratton, while not disagreeing with Mark's thesis of theoretical evolution, disputes the extent to which any particular theory of the corporation was dominant at any one time. Bratton's thesis, the "doctrinal conception" of the corporation, posits that a strong consistency in theories of the corporation exists throughout history. [\[FN26\]](#) All conceptions of the firm contain common elements. Each theory conceives "of the corporation as a reification, finding reality in the actions of individual participants. Each simultaneously recognizes entity and aggregate characteristics, concession and contractual origins, and public and private aspects." [\[FN27\]](#) Bratton finds the tensions Mark locates among theories of the firm to be inherent within each theory. Each theory, in differing degrees and ways, is schizophrenic about what ultimately the firm is. What is novel about the "nexus of contracts" approach is its "single minded" contractualism and anti-regulatory and anti-public aspect approach. [\[FN28\]](#) Since the schizophrenic nature of theories of the firm merely reflects the differing goals Americans have for corporate law, Bratton predicts that the forcibly separated aspects of the theories of the firm will merge. [\[FN29\]](#) Any move "to foreclose wider discussion by the assertion that contract should govern as a function of the intrinsic nature of the corporation will fail." [\[FN30\]](#)

*437 2. Law and Economics and the Evolution of the Corporation

Gary M. Anderson and Robert D. Tollison, two law and economics scholars, argue that limited liability entities existed, functioned, and were respected as such by the business community even when the state refused to recognize them. [\[FN31\]](#) Only after these entities became ubiquitous and unstoppable did the government decide to do away with the laws that prevented their official recognition. [\[FN32\]](#) Such a history of the firm is quite controversial. [\[FN33\]](#) Furthermore, in light of public choice theory - a theory closely related to law and economics scholarship - which posits that the law making process is a forum for self-interested factions seeking to capture the state in their own interests, it seems difficult to reconcile a purely private, contractarian model of the firm with a vision of the state as acting in the private sphere in order to advance the interests of particular groups. [\[FN34\]](#) Any history of the corporation that ignores the strong interest of the state in the development of corporate law will necessarily be incomplete. Indeed, Thomas Lee Hazen and Rutherford Campbell argue along with Mark and Bratton that contractarians ignore the fact that economic efficiency is not, and has not been, the only value that American citizens have historically wanted the state to promote. [\[FN35\]](#) Even today, despite our society's increased interest in economic efficiency, Americans are still concerned about society's "losers." [\[FN36\]](#) However, Henry N. Butler and Larry E. Ribstein argue that even conceding that the corporation was at one time a concession of the state and Americans are concerned about the disadvantaged, these facts in themselves fail to disprove the contractarian understanding of the firm. [\[FN37\]](#) *438 They state that "blind adherence to an outmoded theory does not, however, provide a normative argument against the contractarian view." [\[FN38\]](#) Nevertheless, a casual glance at the history of the firm in the United States reveals that Americans are unwilling to relinquish either understanding of business entities, believing that they can both promote economic good and cause distress to the less fortunate. These positions are hard to balance, and history has shown how theories of the firm have vacillated between society's emphasis on one or the other concern. The debate between the value and danger of limited liability - perhaps the most important economic aspect of business law - highlights these conflicting concerns. This debate over the breadth of limited liability based on its alleged utility and dangers will be discussed below.

B. Limited Liability: Advantages and Limits

Two reasons are generally advanced for limited liability. First, it promotes economic efficiency; second, it allows access by people of lesser means to risk taking and money making. The former reason is usually proffered by law and economics scholars; the latter is usually noted by historians and is called the democratic argument. While acceptance of either reason does not necessarily lead to unqualified acceptance, the proponents of each advance slightly different approaches to the limits of limited liability.

Frank Easterbrook and Daniel Fischel in their classic work of law and economic scholarship, *The Economic Structure of*

Corporate Law, argue that limited liability reduces transaction costs and enhances the efficient and smooth running of the securities markets. [FN39] This in turn lowers the costs of capital, which in turn increases economic output and the public welfare. [FN40] They advance six reasons: (1) Limited liability reduces the entity's and its shareholders' need to monitor its agents, which makes passive investing and diversification a more rational strategy, reducing the costs of operating the entity. [FN41] (2) Limited liability reduces the need to monitor *439 other shareholders to see whether they can properly bear the risks that the entity plans or is undertaking. [FN42] (3) Limited liability promotes the free transfer of shares, which creates incentives for managers to act efficiently since the results of their inefficient actions will be punished by the market. [FN43] (4) Limited liability makes shares homogenous commodities that reflect all the information publicly available about the entity. In a situation of unlimited liability, not all shareholders would be able to access relevant risk information, and would thus value the share price differently. When all investors can trade on the same terms, investors will know the price reflects all available information. [FN44] (5) Limited liability allows for more efficient diversification of one's assets. In a regime of unlimited liability, the rational strategy would be to minimize one's holdings since any one holding could explode and force one into bankruptcy. Diversification is desirable since it is a much safer strategy and will induce investors to put more capital into the markets; investors will be able to balance better their risks. [FN45] (6) Limited liability prevents managers from becoming unduly risk averse. [FN46]

Easterbrook and Fischel cap their defense of limited liability with a naturalist argument. They see the issue as whether it is better "to allow losses to lie where they fall or to try to shift those losses" to someone else. [FN47] They see this as an empirical question, and conclude that the "market's answer is partial risk shifting. . . . the risk of all investors is limited to the amount they contribute at the outset. . . . If greater risk shifting were beneficial, we would have seen it evolve in the market." [FN48] Some law and economics scholars, as we saw above, have even argued that state incorporation is a mere formality. [FN49] Limited liability is so efficient that had the state not recognized it, market forces would have created somewhat similar entities through the process of free contracting. [FN50] Therefore, these scholars argue, the corporation's veil of limited liability should be pierced only when it is clear that something in the original contractual understanding has gone wrong. [FN51] Easterbrook and Fischel, on the other hand, recognize that limited liability creates the risk of moral hazard; the managers of the firm, knowing that the burden of the risk will fall *440 elsewhere, will engage in over-risky endeavors. [FN52] However, while conceding this is a problem with involuntary creditors (e.g., tort claimants against the firm), they claim this is a non-issue with respect to voluntary creditors since voluntary creditors (e.g., contract claimants) factor in the riskiness of dealing with limited liability firms ex ante when they give their credit terms. [FN53]

1. Limited Liability for Close Corporations and Subsidiaries

When discussing the limits of limited liability, Easterbrook and Fischel also differentiate between smaller and larger firms, and parent and subsidiary firms. [FN54] They claim that in smaller firms (usually called "close corporations") there is much less separation between management and risk bearing. Since the suppliers of capital for small firms also tend to be involved in decision making, limited liability does not reduce monitoring costs as much. Additionally, since close corporation shares are not generally freely tradable, the other benefits of limited liability such as facilitating efficient risk bearing and monitoring by the secondary markets are absent. Finally, managers in close corporations have greater incentives to engage in overly risky projects than managers of public corporations since they have less to lose. [FN55] Subsidiary firms, like close corporations, have a greater moral hazard problem than public corporations. [FN56] This is the case because allowing creditors to reach the assets of a parent does not create unlimited liability for any investor. Easterbrook and Fischel argue that this extra liability defense creates an incentive for subsidiary managers to engage in overly risky endeavors, or to engage in risks greater than they would if the subsidiary were an independent organization. [FN57] As a result of the above differences they find a stronger justification for limited liability in large public corporations than in small firms or subsidiaries.

Easterbrook and Fischel conclude their analysis of the limits of liability with the observation that the moral hazard inherent in limited liability will sometimes lead courts to set aside the protections of limited liability. [FN58] They argue that the traditional doctrines advanced for piercing the corporate veil are "obscure," *441 "arbitrar[y]," and "singularly unhelpful." [FN59] In this case, the courts are really trying to allow creditors to reach the assets of shareholders where limited liability "provides minimal gains from improved liquidity and diversification while creating a high probability that a firm will engage in a socially excessive level of risk taking." [FN60] They imply that the traditional piercing doctrines are merely a cover for the court to rectify inefficient (and unjust?) burdens of risk. They assert that courts will be more willing to pierce the veil of close corporations and subsidiaries when there are tort creditors and when the firm is undercapitalized. [FN61] Courts will pierce the veil of an entity when the burden of the risk has fallen on those who could not negotiate with the firm or with whom the firm negotiated in bad faith. [FN62] This is why courts will pierce the veil for tort claims and when there has been

fraud or misrepresentation. [\[FN63\]](#) When a firm is undercapitalized, the courts will pierce the veil because the lower the amount of capital, the greater the incentive for managers to engage in risky behavior. [\[FN64\]](#)

2. The Empirical Reality of Piercing the Veil

Robert Thompson, in his monumental study of piercing cases, uses empirical evidence to confirm some and contradict other claims made by law and economics scholars. [\[FN65\]](#) Thompson discovered that there have been no successful piercings of firms with more than nine shareholders. [\[FN66\]](#) Thompson concludes, based on extensive evidence, that Easterbrook and Fischel were correct that the doctrines used to justify piercing are "indeterminate" and "conclusory." [\[FN67\]](#) He also concludes that the justification for limited liability - that it facilitates the public market for shares - is strong enough to overcome any argument for piercing. [\[FN68\]](#) Furthermore, in a close corporation setting, the only setting in which piercing occurs, the primary concern of the courts is the bargain between the parties. The courts, according to both Thompson and law and economics scholars, find the presumption for limited liability to be the strongest when all the parties are fully aware of the risks in creating a contract. [\[FN69\]](#) Thompson, Easterbrook, Fischel, and other law and ^{*442} economics scholars differ in that Thompson found that the courts are less likely to pierce in cases of involuntary creditors. [\[FN70\]](#) Thompson does not offer any normative justification for this result; indeed, he believes that this is the wrong result and advocates legislation or the use of noncorporate doctrines to remedy it. [\[FN71\]](#) However, this result does point to a flaw in the predictive power of the economic model - that perhaps other forces are at work other than a concern for economic efficiency. [\[FN72\]](#) However, Stephen Presser, author of a treatise on piercing the veil, asserts that in the years after the Thompson study finished, tort creditors indeed became more susceptible to piercing than voluntary creditors. [\[FN73\]](#)

3. The Inefficiency of Unlimited Liability and the Democratic Argument for Limited Liability

Law and economics scholars have tried to demonstrate that limited liability is more efficient than unlimited liability. [\[FN74\]](#) One of the more important contributions of these scholars was to give explanations of why courts might depart from the rule under certain circumstances. [\[FN75\]](#) The problem with the law and economics scholars is that they fail to show that no other regime can provide the same benefits as a regime of limited liability. [\[FN76\]](#) Furthermore, not all law and economics commentators agree with Easterbrook and Fischel that limited liability is efficient. [\[FN77\]](#) Many argue that a more efficient method of encouraging the risk taking that leads to economic growth would be a pro rata system of unlimited liability accompanied by an insurance system to protect against losses. [\[FN78\]](#) The problem with the arguments of ^{*443} the proponents of pro rata liability is that they ignore the power that insurance companies will have over start-up firms. In a regime of pro rata liability people will have to have very good credit ratings to be able to go into business. Insurance firms will be loath to grant coverage to unknown business people. This reluctance will recreate the pre-limited liability situation in which the only people able to engage in risk taking are the very wealthy or the foolhardy. [\[FN79\]](#)

While the various alternatives to limited liability that have been proposed have been falsified, the proponents of limited liability have failed to prove that there is no equally efficient alternative. [\[FN80\]](#) The efficiency argument is therefore necessary but not sufficient to prove that limited liability is the optimal regime. Presser, while not disagreeing with the efficiency argument, claims that limited liability was designed, historically, as a means of "encouraging the small scale entrepreneur, and of keeping entry into business markets competitive and democratic." [\[FN81\]](#) Prior to wide-spread adoption of the corporate form, most people believed that only the very wealthy could have the privilege of investing in corporations. [\[FN82\]](#) Presser argues that the "democratic" argument for limited liability serves as a complement to the efficiency argument. [\[FN83\]](#) If one accepts the premises of the democratic argument, then it is no longer sufficient to argue that limited liability is inefficient. One must also argue that limited liability is not as democratic, in that it opens up risk taking opportunities to as wide a group of citizens as any other proposed alternative. Therefore, limited liability need not be the most efficient regime, so long as there is no more democratic way to spread access to wealth-making opportunities. [\[FN84\]](#) Yet both the efficiency and democratic arguments are ultimately open to empirical ^{*444} challenge. Presser concludes, however, that despite assertions to the contrary, [\[FN85\]](#) the "historical data seems, in the final analysis, to lend support both to the economic and to the democratic arguments for limited liability." [\[FN86\]](#)

The democratic argument for limited liability would place even greater barriers to piercing the veil than the efficiency argument since the primary benefactor of limited liability laws is supposed to be the small firm. [\[FN87\]](#) Presser argues that, therefore, protection for smaller firms should be greater than for larger firms and that it would be unfair not to extend this strong protection to small firms which are subsidiaries of larger corporations. [\[FN88\]](#) However, Presser acknowledges that non-efficiency arguments are potentially dangerous since they allow for what Presser calls "arguments from policy." By

broadening the range of acceptable debate from only economic concerns to political and policy concerns, the democratic argument - which at its heart favors a broad rule of limited liability - legitimizes consideration of the classic arguments for a narrow rule, the concession or communitarian theory of the limited liability entity. [\[FN89\]](#)

4. The Concession Theory of the Firm and the Lessons of History

The concession theory of the firm (sometimes called the regulatory, communitarian or anti-contractualist approach) views the corporation as a privilege granted by the state creating an artificial entity. [\[FN90\]](#) Under this understanding, limited liability entities have a responsibility to operate in the public interest. Under the concession/communitarian view, the "corporateness" of the artificial entity should be disregarded when the entity is being operated in a manner that runs counter to the spirit of the grant of privilege, i.e., when the public weal is damaged, rather than enhanced, by the operation of the corporation. One of the earliest and most frequently cited piercing case seems to reflect this point of view. [\[FN91\]](#) Judge Cardozo's opinion in *Berkey v. Third Avenue Railroad Co.*, [\[FN92\]](#) while refusing to pierce the veil, mentioned in dicta that the corporate form was a "privilege" that could be "perverted" by "fraud" and possibly other activities that go unmentioned. [\[FN93\]](#) Cardozo recognized the difficulty of determining what these exact perversions might be. In the most frequently quoted language on the subject, he stated that "[t]he whole problem of the relation between parent and subsidiary corporations is one that is still enveloped in the mists of metaphor." [\[FN94\]](#) Cardozo's reluctance to pierce in *445 *Berkey* led to a flurry of commentary on general and broad principles to use in piercing the veil of corporations. [\[FN95\]](#)

Maurice Wormser, the first person to popularize the term "piercing the veil," argued for the concession theory. [\[FN96\]](#) He claimed that the state's sufferance of the corporate form carried with it strong responsibilities, the shirking of which ought to result in the denial of corporate privilege. [\[FN97\]](#) He wrote:

[A] corporate entity will not be ignored at law and equity simply because the number of stockholders is few, or even one, unless the circumstances are such that would warrant the same disregard of the entity were there ten thousand shareholders. . . . When the conception of corporate entity is employed to defraud creditors, to evade an existing obligation, to circumvent a statute, or advertise or perpetuate a monopoly, or to protect knavery or crime, the courts will draw aside the web of entity, will regard the corporate company as an association of live, up-and-doing, men and woman shareholders, and will do justice between real persons. [\[FN98\]](#)

Wormser believed that the corporate form should be ignored only when a corporation was very obviously used as a means to perpetuate an injustice; thus piercing law had to be kept purposefully vague. If it were made clear, people intent on committing injustices could merely factor their actions around the law. [\[FN99\]](#) The danger of Wormser's approach was that it relied very much on the discretion of individual judges, creating too much uncertainty for third parties.

Frederick Powell rejected Wormser's broad intuitive approach in favor of three general tests: (1) the alter ego or mere instrumentality test, requiring that the subsidiary be completely under the control and domination of the parent; (2) the fraud or wrong or injustice test, requiring that the defendant parent's conduct in using the subsidiary be somehow unjust, fraudulent or wrongful toward the plaintiff; and (3) the unjust loss or injury test, requiring that the plaintiff actually have suffered some harm as a result of the conduct of the defendant parent. [\[FN100\]](#) Powell created a laundry list of factors, and importantly did not require actual fraud for piercing. [\[FN101\]](#) Many courts adopted Powell's approach since it offered bright line tests in lieu of the "mists of metaphor" that existed in the broader approaches. [\[FN102\]](#)

*446 Oddly enough, the concession theory and the efficiency theory of the firm are very similar in one important way: they both reject the applicability and relevance (or even legitimacy) of judicial rules for piercing the veil in favor of a case-by-case analysis. The law and economics approach is efficiency-based while the concession/communitarian is fairness-based. [\[FN103\]](#) Perhaps this resistance to formal rules by proponents of both schools of thought is behind the confusion inherent in piercing law. American society has conflicting goals for corporate law. On the one hand society wants to promote free ordering in the belief that in so doing they are increasing the general welfare; on the other hand, society wants to restrict private ordering for paternalistic reasons and out of concern for the less fortunate or those less able to look after their own interests. [\[FN104\]](#) Society has never come to a satisfactory conclusion about the proper balance between these two interests.

Consequently, the law on the subject swings back and forth. The law moves from a feeling that artificial entities have too much leeway and that their creators must be held responsible for their actions, to the feeling that too much regulation and risk-avoiding incentives are placed upon entrepreneurs; consequently, artificial entities must be given stronger forms of limited liability. Eventually, the abuses of limited liability that gave rise to the initial feeling for greater liability for the

entity's creators will return with greater force, and new ways to pierce the veil of the new entities will be found. It is perhaps for this reason that, "In an age dominated by statutes, piercing the veil remains a vital and robust common-law doctrine." [\[FN105\]](#) Indeed, there is no one solution to the problem of piercing the corporate veil since there are probably as "many solutions to the piercing problem as there are theories of, or individual attitudes toward the corporation." [\[FN106\]](#) In other words, how one views the nature of the corporation will directly affect how one understands the limits of the corporation's liability and the duties of the corporation and its constituents to each other and to third parties. [\[FN107\]](#)

***447** It can be safely predicted, however, that both Presser and the law and economics scholars view the expansion of avenues for increasing limited liability favorably. However, communitarian theorists would be skeptical of any further expansion of limited liability since it would only increase opportunities for individual citizens to ignore the public interest. Regarding the LLC, Presser and law and economics scholars might part company. The LLC has been and will continue to be for some time an alternate form of the close corporation. As discussed above, the efficiency argument for limited liability would allow easier piercing for smaller entities like the LLC. However, Presser's democratic argument for limited liability seems to favor greater limited liability for LLCs than for corporations because LLCs tend to be created by small investors, the intended and primary benefactors of limited liability laws. The next part will show that the formal rules for piercing the veil fit the LLC rather poorly.

Additionally, Part III will note that many commentators argue that the whole purpose of LLCs is to avoid the common law and statutory regulations (such as piercing the veil and fiduciary duties) that have been attached by the courts over the years to corporations. These two facts make LLCs difficult to pierce, even more so than C corporations. While many might laud this outcome, the efficiency predictions of law and economics scholars and the communitarian analysis of the concession theorists would view this as a suboptimal result. Part IV will address this conundrum as it relates to Delaware, the most popular state for business entity registration.

III. The Limited Liability Company and Its Development

The LLC has spread like wildfire throughout the country. [\[FN108\]](#) The LLC is an entity that combines a partnership-like structure with corporate-like limited liability. Originally, the LLC was taxed at the federal level as a corporation. [\[FN109\]](#) For the first ten years of its existence, interest in the new entity was limited to two states. [\[FN110\]](#) Indeed, it was only after the Internal Revenue Service (IRS) ruled that the LLC would, in certain circumstances, be taxed as a partnership and not a corporation [\[FN111\]](#) ***448** that the LLC spread from two jurisdictions to all 50 states and the District of Columbia. [\[FN112\]](#) The rate of growth of LLCs is phenomenal: from 1990-1995 LLCs have increased in number by over 120% a year. [\[FN113\]](#) While LLC expansion appears to have slowed somewhat in recent years, its growth rate still far exceeds that of any other business entity. [\[FN114\]](#) In 1997 the favorable IRS treatment given to LLCs was expanded. [\[FN115\]](#) As a result of the new "check the box" regulations, all LLCs can ***449** elect to be treated as pass-through entities unless their shares are traded on the secondary markets. [\[FN116\]](#) This change in IRS treatment has made the LLC even more popular and increased its rate of growth.

A. Why the LLC?

There is considerable debate over why the LLC is so popular. Some commentators argue that the LLC's popularity stems merely from its tax status and that the whole purpose of the LLC is to avoid taxes. [\[FN117\]](#) Indeed, the IRS has given no official reason for its change in policy toward the LLC, leading some to believe that it decided to forgo this source of revenue because of intense lobbying from business interests. [\[FN118\]](#) Most commentators, however, laud the emergence of the LLC and claim that very little tax revenue was actually lost. [\[FN119\]](#) Susan Pace Hamill argues that the primary motivation behind the new rules was to level the playing field between large closely held companies that were able to circumvent higher taxes and smaller less sophisticated businesses (echoes of Presser's democratic theory?). [\[FN120\]](#) Other commentators, including Richard Booth, argue that while leveling the playing field is an important part of the LLC story, a more important reason for the IRS's ***450** change of heart is the decline of the relevance of limited liability in business dealings and the increased importance of the ability to trade on secondary markets in differentiating between companies. As a result of this relative decline in importance, Booth claims that the goal of tax neutrality is better served by taxing public companies rather than those merely with limited liability. [\[FN121\]](#)

There are a small number of dissenters from the LLC bandwagon. These commentators consider the manner in which partnership taxation for LLCs developed - ad hoc legislation by the states, with the states dictating federal tax policy - as dangerous and potentially harmful to the cause of rational business taxation reform. [\[FN122\]](#) Others are troubled by the loss

of tax revenue and not *451 comforted by Hamill's reassurances. [\[FN123\]](#) Still others view the LLC as a dangerous means of circumventing hard-earned rights for minority shareholders, [\[FN124\]](#) or as a way of avoiding proper disclosure under the securities laws. [\[FN125\]](#)

While it is undeniable that a major force behind the spread of LLCs is the partnership-like taxation afforded its members, [\[FN126\]](#) the LLC has other attributes that *452 make it a popular entity choice. Indeed, the reason the majority of commentators laud the emergence of the LLC is that they see it as a way to circumvent the complicated rules governing S corporations while still acquiring limited liability. [\[FN127\]](#) LLCs are popular because they are easy to create [\[FN128\]](#) and have few mandatory rules. [\[FN129\]](#) LLCs are hybrid entities in that they share many attributes of corporations and partnerships. As mentioned above, LLCs allow partnership taxation and limited liability protection for all members. However, unlike limited partnerships - which also enjoy a form of limited liability - all LLC members can participate in management and control of the company without subjecting themselves to personal liability for the LLC's debts and obligations. [\[FN130\]](#) Generally speaking, state LLC statutes do not grant continuity of life, but with the change in IRS regulations, state *453 laws might change to allow it. [\[FN131\]](#) LLCs, unlike S corporations, can be created by anyone - foreign residents and citizens. [\[FN132\]](#) Also, LLCs generally require a minimum of two members, unless state law allows single member LLCs, and have no maximum number of members; whereas S corps are limited to a maximum of seventy-five shareholders. [\[FN133\]](#) Additionally, LLCs permit multiple classes of ownership interests while S corporations permit only one class. [\[FN134\]](#) The formation of LLCs, like partnerships, is not a taxable event unless it is a disguised sale or a member is relieved from debt. [\[FN135\]](#) S and C corporations' formations, however, are taxable. [\[FN136\]](#) Unlike, C corporations, LLC members may deduct LLC losses to the extent of their tax basis in their LLC interest, which includes their allocable share of LLC debt. [\[FN137\]](#) Finally, unlike C corporations, cash distributions and liquidations are non-taxable events to the extent of a member's tax basis in his LLC interest. [\[FN138\]](#)

Despite the LLC's much vaunted flexibility, however, "true" freedom of choice in creating an LLC's management structure remains elusive. For example, an LLC's structure will influence its securities law treatment, the available methods of tax accounting, the calculation and imposition of self-employment taxes, and the deductibility of losses. [\[FN139\]](#) Another major stumbling block to "true" freedom of choice is that nearly all the laws and provisions regarding LLC structure are untested in the courts. Nevertheless, much of the appeal of the LLC stems not only from its tax status, but from its flexibility - specifically from its ability to avoid a host of corporate common law and statutory regulations that increase the transaction costs of doing business in the corporate form. It is to three such areas of regulation that this article will now turn.

*454 B. The Uncertain State of LLC Law: Piercing, Fiduciaries, Securities

While the newness of the LLC no longer prevents advisors from wholeheartedly recommending them, [\[FN140\]](#) one cannot be sure about how the courts will treat these new entities. It is difficult to tell how the courts will interpret the various LLC statutory provisions. It is even more difficult to figure out how the courts will apply various corporate common law doctrines and statutory regulations to LLCs. No one can say for certain whether the courts will treat LLCs like corporations for the purpose or fiduciary duties, piercing the veil, securities and other laws, or whether some other approach will dominate. This uncertainty is a result of the paucity of LLC case law. For example, there are fewer than ten cases that deal with the extent of liability within the LLC, [\[FN141\]](#) and only one of those cases has come down with a definitive ruling. [\[FN142\]](#)

*455 The lack of case law creates much discretion for judges to apply consequentialist thinking, tempered by their jurisprudential convictions, to the cases they decide. Based on commentators' celebration of the LLC's flexibility, it is plausible that avoiding corporate law understandings of piercing the veil, fiduciary duties, and securities laws is a major reason behind the popularity of LLCs. Furthermore, most state LLC statutes do not explicitly mention whether corporate common law piercing doctrines and corporate fiduciary duties apply to LLCs, nor do they mention whether LLC interests are securities. Consequently, it is in cases in these three areas that judges will have the most power to pass judgment on the value of LLCs in general, as well as the relationship of LLCs to greater jurisprudential issues of freedom of contract and the duties that come with limited liability. The lack of any formal doctrines in these areas provides much leeway for debate about the ultimate purposes of the firm, discussed in Part II, to guide judicial discussion. In order to understand how these wider issues will affect LLC law in these areas, this article will now outline the various approaches commentators have suggested on piercing the veil, fiduciary duties, and LLC membership interests as securities in an LLC.

1. Piercing the LLC Veil

Piercing the corporate veil is the most litigated yet least understood issue in corporate law. [\[FN143\]](#) Larry Ribstein and Robert B. Thompson both note that piercing doctrines are "gap filler" common law doctrines that "let the courts deal with the many cases that statutory rules effectively cannot resolve." [\[FN144\]](#) Consequently, "legislatures' attempts to 'clarify' the veil-piercing doctrine [for both corporations and LLCs] are doomed to failure." [\[FN145\]](#) The ability of courts to pierce a limited liability entity's veil is particularly relevant to LLCs since courts almost exclusively pierce the veils of close corporations and corporate groups, [\[FN146\]](#) and the investors that make up close corporations are precisely those most likely to form LLCs. While there is currently no uniformity on LLC piercing law, certain patterns exist. *456 Thompson divides LLC piercing laws into categories based on: (1) the breadth of insulation; (2) to whom the insulation is provided; and (3) the extent to which the statute explicitly incorporates corporate law principles. [\[FN147\]](#) While all LLC statutes list explicitly who is granted limited liability, most statutes are silent on how limited liability is avoided and how piercing doctrines apply to LLCs. This pattern also exists in corporate law. [\[FN148\]](#) Nevertheless, Thompson argues that the same principles that apply to corporate piercing will apply to LLC piercing. [\[FN149\]](#) He concludes that the "statutes do little, if anything, to change the long-standing and well-developed judicial exceptions to limited liability based on either piercing the corporate veil or direct liability for active participation." [\[FN150\]](#) However both Thompson and Ribstein realize that LLCs differ from corporations and that mechanically applying corporate piercing doctrine to LLCs will lead to absurd outcomes.

a) Determining Factors to Pierce the Veil

The general factors that courts claim to use when determining whether or not to pierce the veil of corporations include: (1) fraud, (2) inadequate capitalization, (3) failure to adhere to corporate formalities, and (4) abuse of the corporate entity that results in complete dominance by the shareholder or shareholders. [\[FN151\]](#) Disregard of corporate formalities is rarely sufficient in and of itself for piercing. [\[FN152\]](#) One possible reason is that evidence of the disregard of formalities is usually sought long after the transaction giving rise to the particular lawsuit took place, and a judgment based on activities unrelated to the plaintiff's claim is seen as an unjustified windfall. [\[FN153\]](#)

Applying the four general piercing factors to LLCs is not as easy as it might seem. The latter two factors, disregard of corporate formalities and dominance of the entity by shareholders, have no application to LLCs. LLC members, by the nature of the entity, will be inclined to organize and run LLCs in a very informal manner. [\[FN154\]](#) Indeed, LLC proponents always mention the LLC's flexibility - the facts that most statutes require very few corporate formalities, and that the LLC *457 may be formed and run without keeping any records whatsoever. [\[FN155\]](#) Thus, to allow piercing for disregarding LLC formalities and for dominance by narrow interests will make the promise of limited liability for LLCs empty by definition. [\[FN156\]](#) Commentators have suggested various solutions to this conundrum. Eric Fox and Debra Cohen-Whelan argue that the formalities and dominance doctrines make no sense when applied to LLCs and should be abolished, and that inadequate capitalization and fraud should be the sole bases for piercing an LLC's veil. [\[FN157\]](#) Fox realizes that this will make it much harder to pierce an LLC's veil, and argues that courts should add another factor to LLC piercing - fairness. Courts should be willing to let the unfairness of the situation force the piercing of the veil, even when there is no fraud or undercapitalization. [\[FN158\]](#) Fox does not, however, discuss how this "fairness" doctrine might be applied. In the tradition of the concession theory of limited liability entities, he seems inclined to leave appraisals of the unfairness of a particular situation entirely in the hands of a judge.

Karin Schwindt agrees with Fox's analysis for piercing actions arising from tort. However she argues that claims arising in contract disregard the separateness of the LLC (i.e., the alter ego/dominance doctrine) and that claims arising in fraud should be the primary bases for deciding whether or not to pierce the veil. [\[FN159\]](#) Schwindt notes that in contract, the plaintiff voluntarily dealt with the LLC and should have known whether or not it was undercapitalized, but there is no way for the plaintiff to know whether the LLC was being fraudulent. [\[FN160\]](#) While Schwindt's arguments about fraud make sense, she provides no reason that LLCs should be liable for alter ego/dominance violations. [\[FN161\]](#) Apparently, Schwindt believes that dominance of an LLC by its shareholders is fraudulent in some way. This is odd, because she recognizes the danger that LLCs will be by definition "piercable" since they are often alter egos of their individual members. [\[FN162\]](#) One possible explanation of Schwindt's stance is a feeling that close corporation and LLC members might use their entities to hide from their duties as citizens, which under the communitarian theory of limited liability would be valid grounds to discard the entity. [\[FN163\]](#)

*458 b) Piercing Adjusted to the LLC

Steven Bahls and Cohen-Whelan argue for a totality of the circumstances approach which adjusts the four factors mentioned

above to the realities of LLCs. [\[FN164\]](#) Courts should examine the totality of the following circumstances: (1) whether members fail to comply with formalities required by statute, (2) whether one member manages the LLC without consultation with the other members, (3) whether members and managers fail to keep business funds and accounts separate from funds and accounts of members, (4) whether members fail to keep their personal books and financial accounts and records separate from the LLC books, (5) whether the LLC was originally grossly undercapitalized to meet the reasonably anticipated capital requirements, as determined at the date of organization, (6) whether members of the LLC fail to hold the business out as a separate legal entity, (7) whether the members make corporate decisions, usurping the power of the managers, if the articles of organization require decision making by managers, (8) whether the managers of the LLC consist of directors, officers, or managers of the other entity, if the LLC is owned by another business entity, and (9) whether members of the LLC fail to respect the separate legal entity of the LLC by, for example, using the LLC's credit to secure loans to members, distributing earnings to member through non-authorized means, or whether members use LLC property as if it were their own. [\[FN165\]](#)

Bahls' approach is the best of those mentioned above in that it recognizes that the applicability of each of the four factors of traditional piercing doctrine depends to a large extent on the original charter of the individual LLC. It also takes into account the efficiency arguments made by economists, differentiating between firms with many agents and those with few agents. For example, the dominance doctrine might make sense when the LLC is manager controlled, but not when it is member controlled. Nevertheless, in large part Bahls' approach amounts to a restatement of the concession theory, i.e., that piercing occurs when the members show no respect for the privilege of limited liability granted to them by the state, and the members abuse that privilege. While this policy may be satisfying to some, it does not in and of itself provide much comfort for business planners who wish to structure their dealings efficiently and know, with some degree of certainty, whether they or their firm will be held liable in any particular situation. [\[FN166\]](#)

*459 Part IV will explore, based on past applications to other entities, possible ways the Delaware courts might apply Bahls' and other flexible approaches to concrete situations. Part IV will also explore the tension between the justification for Bahls' approach - that limited liability is a privilege granted by the state that comes with certain duties - and the overwhelmingly contractualist approach taken by the Delaware legislature when fashioning its LLC statute.

2. Fiduciary Duties in an LLC

Fiduciary duty, like piercing the veil, is another common law doctrine - albeit one that is more directly addressed by state statutes - that has spurred much litigation. It is in this area that LLC statutes have had their most innovative impact. A number of state statutes have attempted to create an entity that is entirely a creature of contract and not bound by any mandatory fiduciary duties whatsoever. [\[FN167\]](#) Some commentators argue that the abolition of mandatory fiduciary duties will make LLCs the entity of choice among business forms, including closely held and publicly traded companies. [\[FN168\]](#) Indeed, Delaware has paved the way for this eventuality by removing any obstacles for trading LLCs on the secondary markets and by explicitly basing its LLC laws on the contractarian model of the corporation. [\[FN169\]](#)

As with piercing the veil, there is very little case law concerning fiduciary duties in the LLC context. [\[FN170\]](#) A number of state statutes, however, address this issue. These statutes require LLC managers to perform their duties in good faith, in a manner they think is in the LLC's best interest, and with the care of an ordinary prudent person under the circumstances. [\[FN171\]](#) Generally speaking, managers under state LLC statutes are subject to a duty of loyalty and must avoid self-dealing. [\[FN172\]](#) Managers usually have the obligation of disclosure upon demand, and members have the right to inspect the books and records of the LLC subject to reasonable *460 restrictions. [\[FN173\]](#) Many statutes also require that managers act in good faith, so managers acting negligently or in bad faith cannot avoid liability. [\[FN174\]](#) However, the exact duties a manager may have in any particular situation depend on the contractual relationship at issue because "fiduciary and good faith duties are both gap-filling rules that the courts apply to deal with matters that the parties cannot easily cover in their agreements." [\[FN175\]](#) Since LLCs tend to be small and often are member managed, it is useful to split the duties into those owed by managers and those owed by members.

Manager related duties in manager managed LLCs are fiduciary in that managers as agents have a duty not to act selfishly. The statutes deal with two duties: the duty of care and the duty of loyalty. Most LLC statutes impose for managers, like corporate directors, a duty of care - the obligation to refrain from wilful or reckless conduct. The statutes also require managers to act as prudent persons in similar circumstances with the right of reasonable reliance on the reports of others. [\[FN176\]](#) LLC statutes also impose on managers a duty of loyalty. The duty of loyalty in the LLC context is similar to the duty of loyalty in other business associations, and includes obligations such as the duty to avoid self-dealing. [\[FN177\]](#)

Under most LLC statutes, members also have a duty of loyalty and care irrespective of whether the firm is member or manager managed. [\[FN178\]](#) However, it is not clear, even in the context of a member managed LLC, where all members have the authority to bind the LLC, which LLC members will be treated as managers with full fiduciary duties and which members will be treated as members in manager managed firms with no managerial fiduciary duties. [\[FN179\]](#) Indeed, most statutes are not clear as to what the duties of non-managing members in a member managed LLC really are. [\[FN180\]](#) Ribstein concludes that most state legislatures that tried to deal with this problem were not sure of what they were doing, resulting in statutes that are confusing. It will be up to the courts to clean up the mess. [\[FN181\]](#) Finally, curiously absent from discussions of fiduciary duties in an LLC context is how the duty to avoid oppression applies to LLCs. [\[FN182\]](#)

As a gap-filling doctrine, fiduciary duties give judges much latitude in trying to fashion the standards of loyalty and care owed in any particular situation. In the LLC context, where there is no precedent upon which to base loyalty and care standards, one of the central questions among commentators is which business ^{*461} association to take as a starting point for discussion: Should LLC duties be based on corporate or partnership duties? Ribstein argues that the majority of states' and commentators' reliance on corporate law doctrines instead of partnership law is misguided because LLCs are not tradable on liquid securities markets, and members have a great deal of power over managers. They could require managers to repurchase members' shares; members could dissolve the company; also, because of the small size of most LLCs, members have more power to block actions by managers than corporate shareholders do. [\[FN183\]](#) However, Ribstein's argument does not address the question of what the duties of non-member managers should be if LLCs become publicly traded. A publicly traded LLC will create three categories of people, managers (members or agents), members who are not managers but have large blocks of shares, and members whose ownership interests are too small in and of themselves to have much of an influence on the LLC's management. Partnership law alone will have a difficult time addressing the concerns of this third category of members.

The most controversial aspect of fiduciary duties in the LLC context is that many statutes grant members the power to waive fiduciary duties in their entirety. [\[FN184\]](#) Some statutes, such as New Jersey's, have no express fiduciary standards but grant express authorization for contractual modifications of judge-made fiduciary doctrines. [\[FN185\]](#) Other state statutes have fiduciary standards proscribed as default provisions, allowing avoidance of those standards only if the avoidance is contracted for in the original LLC agreement.

The Delaware statute has perhaps the greatest emphasis on the freedom to contract around fiduciary duties; this statute explicitly warns the courts not to void these contracts. [\[FN186\]](#) As a partial response to this freewheeling attitude among some states, the Uniform Limited Liability Company Act (ULLCA) tries to set a minimum standard for fiduciary duties below which members cannot contract away. [\[FN187\]](#) To confuse matters further, a number of states do not expressly mention the issue of fiduciary duties in their statutes. [\[FN188\]](#) This lack of statutory discussion will force the issue on to the courts, creating a lot of room for contractarians to argue for basing duties on partnership laws and allowing maximum waivability, and non-contractarians to argue for imposing the same or stricter duties on LLCs as would be imposed on a corporation. [\[FN189\]](#)

***462 a) Trends in LLC Fiduciary Duties**

Delaware's lack of default rules is in sharp contrast to the ULLCA, which is heavily influenced by the Revised Uniform Partnership Act (RUPA). [\[FN190\]](#) There is an interesting irony, pointed out by Wayne Gazur, in the desire to allow LLC drafters, in the name of freedom of contract and efficiency, to contract around fiduciary duties. The duty of loyalty, difficult to explain precisely, has been previously defined through expensive litigation. [\[FN191\]](#) Now states are permitting the parties to agree by contract to the meaning of the duty, but are not allowing the elimination of that duty. [\[FN192\]](#) This seems contradictory. States trust the contracting process and assume equal bargaining and adequate information, but do not trust the process enough to eliminate the duty of loyalty. [\[FN193\]](#) This strange combination of trust and lack of trust will lead to more litigation to help determine the limits of contracting parties. The search for this limit will be made even more difficult by the contradictory signals the states are sending. Judges favoring freedom of contract will look at the remarkable trust the states have in individuals to look after their own interests. Paternalistic judges will note that the state does not trust people enough to eliminate fiduciary duties. The result will be to require the courts to reinvent a field of law that already exists. Bahls argues that there must be a more efficient way to protect member interests than reinventing the wheel in the courts. A good place to start, according to these commentators, is to look at the policy arguments advanced for fiduciary duties.

b) Three Views of Fiduciary Duties: Bahls, Ribstein, and Dickerson

A common policy argument for the duties of managers and owners of closely held businesses is that without such duties, inequitable and inefficient distributions of wealth would be the norm. [FN194] Proponents of fiduciary duties such as Bahls argue that managers who act in a socially unacceptable manner, or who take excessive risks, should bear the costs of their actions. The duty of care thus fills in gaps in bargains involving the degree of skill used in decision making, while the duty of loyalty fills in gaps in bargains relating to conflict of interest transactions. In other words, fiduciary duties level the playing field between contractors with unequal knowledge or bargaining power.

Since the purpose of fiduciary duties is to remedy unequal bargaining power, Bahls argues that when considering whether LLC members or managers should have fiduciary duties greater or lesser than those of corporations or partnerships, courts *463 must consider the decentralized management structure of the LLC. [FN195] The structure of most LLCs seems to be a result of equal bargaining power and therefore LLCs ought to require lesser fiduciary duties than corporations. [FN196] While the lack of a ready market for LLC interests might seem to be a good argument for greater duties, Bahls claims that the general diversification of many LLC members makes a negligence standard for the duty of care in the LLC context unnecessary. Instead, he argues that the standard of care should be recklessness. [FN197] However, Bahls argues that the duty of loyalty of members and managers in LLCs should follow modern partnership law because the corporate rules are too unwieldy and because they contemplate a centralized management structure. [FN198] As far as the duty to avoid oppression, the states that address the issue "do not typically authorize the courts to order equitable remedies less drastic than dissolution." [FN199] Bahls cautions courts against using their equitable powers to prevent oppression since dissolution causes high administrative costs and fails to maximize the value of the LLC's business. Also, any remedy to dissolution should always "maximize the ability of minority members to realize their reasonable expectations." [FN200] Ribstein, while agreeing for the most part with Bahls, would argue for the total waivability of fiduciary duties on policy (free-market) grounds. [FN201]

In opposition to Bahls, Claire Moore Dickerson argues that LLCs should not be able to reduce the duty of loyalty of members to each other to the minimal standard of RUPA. [FN202] She argues that the common law has implicitly recognized that the choice of the corporate form over partnership reduces the risks to shareholders. The potential for risk for partners is higher than the potential for corporate shareholders. As a result, under common law, the fiduciary duties of partners in a partnership are higher than those of shareholders in a corporation. [FN203] Like Bahls, Dickerson bases her arguments about fiduciary duties on the extent of risk to LLC members. However, unlike Bahls, Dickerson argues that most LLC members are not diversified; indeed, they are even less diversified than shareholders in close corporations. [FN204] Therefore, unless the LLC member is also a manager, he will be in a very weak bargaining position and in much greater risk. [FN205] Consequently, Dickerson argues, LLC members and managers must owe a duty greater than that *464 of good faith to one another. [FN206] Bahls' and Dickerson's approaches illustrate how the conflicting goals and ideas society has concerning the firm, freedom of contract, and the duty of government to protect people from bad bargains can influence people's decisions on what path LLC law should take. In order to figure out what LLC fiduciary law might be, both Bahls and Dickerson had to reach for policy arguments about the purpose of fiduciary duties in general and could not merely rely on the statutes themselves. Furthermore, the policies on which Bahls, Dickerson, and Ribstein rely are in a constant state of tension. It is highly likely that any court viewing such matters would be similarly inclined to argue from policy - whether the point of LLCs is to maximize the ability of people to contract for whatever bargain they choose, or whether the state always has the duty to protect people from bad bargains. The securities laws are another example of where the law is unclear as to how it applies to the LLC. The policy concerns of protection versus freedom from regulation are similar.

3. LLC Interests as Securities

One of the strongest "selling points" for LLCs aside from partnership taxation has been the LLC's relative freedom from state regulation, making LLCs cheaper and more efficient than the corporate form. However, the proponents of LLCs generally have failed to predict that the LLC might be considered a security by the SEC and be subject to the Securities Act of 1933 and the Exchange Act of 1934. The few commentators who have addressed the issue agree that it is highly likely that as a matter of positive law some LLC interests will be considered securities. [FN207] Indeed, by 1995 the SEC had filed complaints against defendants in at least six unrelated cases for violating securities laws for selling interests in LLCs. [FN208] Additionally, *465 over sixteen states have taken action under state securities laws for offering or selling LLC interests. [FN209]

Commentators agree that while most LLC interests will not be deemed securities per se; if those interests possess certain characteristics, they will be considered securities. [FN210] There is no agreement over whether this development is a good one. Some argue that LLC interests should be considered securities. They disapprove of private ordering to avoid SEC laws because of the danger of fraud aimed at unsuspecting investors. In short, while these commentators recognize that LLCs were created as a dynamic entity to avoid many of the bureaucratic and transactional costs associated with traditional business forms, they conclude that the protection to LLC investors that will be gained by considering LLCs securities outweighs the costs. [FN211] Other commentators argue that the reduced transaction costs of LLC interests not being considered securities outweigh the potential cost of fraud. [FN212] Nevertheless, all commentators agree that it is inevitable that certain LLC interests will be treated as securities, whether the members want them to be or not.

The Securities Act of 1933 defines a "security" as follows: "When used in this chapter, unless the context otherwise requires - (1) the term "security" means any note, stock, . . . certificate of interest or participation in any profit-sharing agreement, . . . [or] investment contract . . ." [FN213] The Supreme Court has three basic tests for analyzing securities: the Howey test for investment contracts, [FN214] the Landreth Timber test for stock, [FN215] and the Reves test for notes. [FN216] Most commentators argue that it is hard to categorize LLC interests as notes (the Reves test), but that one can make strong arguments for categorizing them as investment contracts or stock (the Howey and Landreth tests). [FN217]

*466 Ribstein and Robert Keatinge, in their treatise on LLCs, dispute the conclusion that LLC interests can be securities. [FN218] They base their arguments not on previous SEC and court practice but primarily on policy, and argue that LLC interests should not be treated as securities because LLCs have flexible management structures and members can exert control without jeopardizing their limited liability. LLC members have strong expectations that they will not be relying on the efforts of others. Ribstein believes that these expectations make the LLC fail the Howey test requirement that to be a security the owner of the instrument must rely solely on the efforts of others to get a return on his investment. [FN219] Ribstein also argues that securities law should emphasize form over substance when defining a security. Since the LLC is not defined as a security it should not be considered one. He bases his arguments on efficiency considerations, claiming that "[b]y facilitating contracting over disclosure rights, emphasizing the form of the transaction tends to produce an optimal amount of disclosure" - the whole point of the securities laws. [FN220] Ribstein's arguments have not been persuasive. Even student texts (which usually do not present unlitigated issues as law) are resigned to the fact that certain LLC interests will be considered securities. [FN221]

Park McGinty agrees with Ribstein and Keatinge that LLC interests should not be considered securities, at least when they are member managed. [FN222] McGinty finds four reasons why the benefits of imposing the securities laws on LLCs might be outweighed by the cost of doing so:

Four primary factors induce doubt that the securities laws' current benefits outweigh their costs. First, there is substantial scholarly dispute that securities regulation improves investors' well-being. Second, recent securities law developments, particularly the *Gustafson v. Alloyd* case, [[[[FN223] have decreased the incremental benefits to investors of having securities law protection. Third, even as protections against substantive misdisclosure have been dramatically reduced for investors in nonpublic firms, less substantive but no less vexing technical requirements about how offerings must be made create traps for the unwary and encourage investor opportunism. Finally, despite the declining utility of securities coverage, vague tests for determining LLC interests' securities status leave the question largely to judges' unpredictable policy preferences. [FN224]

*467 Another danger that will result from treating LLC interests as securities, according to McGinty, is the possibility of the securities laws being used to erode the limited liability of LLCs. Disgruntled investors will be able to use controlling person liability under the securities law as a means of piercing the LLC's veil. [FN225]

The prognosis does not look good for those who do not wish LLC interests to be considered securities. For example, the SEC has adopted an analogy between the LLC and a corporate stock. [FN226] Furthermore, it is increasingly probable that "expansionist courts and commentators are likely to see the lack of the name 'stock' as a formalistic fig leaf conferred by state legislators on organizers of LLCs in an attempt to win a new round in a 'race to the bottom.'" [FN227] Despite the fact that the Howey test may fail to convince the courts in cases of LLCs in which members have a substantial degree of control, "liberal courts" are very likely to categorize them as stock using the "family resemblance test" outlined in *Landreth Timber*. [FN228]

The question of whether an LLC interest is a security highlights the role that policy arguments play in applying old laws to

LLCs. Unlike piercing and fiduciary duty laws, security laws related to LLCs have been tested by the courts and arguments in favor of regulation have defeated arguments in favor of freedom of private ordering. Indeed, the speed with which LLC interests came to be considered securities (despite the vigorous arguments against it by the authors of the leading *468 treatise on the subject) [FN229] points to the strength of the regulatory impulse in American law. Whether that impulse comes from a crude capture of the legislative process by entrenched regulatory interests or from deeper cultural values, the impulse is not likely to go away soon. Nevertheless, all three areas of law illustrate the tension underlying the ultimate goals and purpose of the limited liability entity and that tension's ability to influence substantive law.

C. The Implications of LLCs as Substitutes for Corporations

The confusion over the LLC's possible future course through the courts is paralleled by confusion about the LLC's origin. Commentators disagree on where the idea for the LLC originated as well as its future direction. Unsurprisingly, commentators' understandings of the origins of LLCs are related to their positions on the importance of freedom of contract. Those who favor a private contract understanding of the firm trace the LLC's evolution from the joint stock company; those who favor a concession understanding of the firm trace the LLC to the *limitada* or *GmbH* (Latin American and German forms of the close corporation). [FN230] Commentators also disagree over how courts will approach the recent change in IRS rules. Before 1997, state LLC statutes were written in such a way as to ensure compliance with IRS regulations that required that entities be more like partnerships than corporations in order to receive pass-through status. [FN231] Now that the corporate *469 or partnership form is no longer a barrier to such status, it is possible that states will reform their LLC statutes to permit even greater discretion in forming LLC operating agreements. [FN232]

The impending liberalization of LLC laws coupled with the increasing likelihood that LLC interests will be treated as securities make it increasingly likely that a group of entrepreneurs will decide that the tax losses incurred will be outweighed by the greater freedom of organization, and will attempt to trade LLCs on the secondary markets. [FN233] Whether one views this possibility with glee or dread is again closely related to one's views on the value of unfettered freedom of contract. [FN234] Regardless, the LLC seems to be evolving into a substitute for the corporation. Yet, it should be noted that the LLC is not the only contender to replace the corporation. There now exists an alphabet soup of entities that offer limited liability and greater organizational freedom than the S or C corp. [FN235] Indeed, *470 it is barely possible to talk of the LLC as a uniform entity, because there is very little legal uniformity. Attempts to impose such uniformity are criticized from all sides. Predictably, those who favor freedom of contract are against uniformity, finding it inefficient and counter-productive. In contrast, those arguing for uniformity view limited liability and freedom of contract as privileges that require a certain degree of regulation. [FN236]

Some commentators have argued that the rapid spread of the LLC does not reflect a renewed legislative commitment to the principles of freedom of contract, but rather is proof of the declining relevance of limited liability. Booth argues that while in the public mind limited liability is still considered crucial to business, limited liability is in truth a "myth." It costs nothing for states and the IRS to encourage the proliferation of limited liability entities since in the end the entities' limited liability is a sham. [FN237] Booth argues that outside the context of a small company, limited liability means little because the principals have enough at stake *471 than to risk bankrupting the firm. [FN238] Furthermore, in small firms, the principals are often required by their creditors to negotiate personal liability for the liabilities of the firm, so in reality limited liability rarely exists. [FN239] Booth does not argue, however, that limited liability is worthless. The purpose of limited liability is to give small businessmen an added bargaining chip when trying to secure credit for risk taking. Were there no protection of limited liability for the actions of small firms, it would be even more difficult for those firms to raise capital. [FN240]

Perhaps the most intellectually satisfying way to view the rapid growth of LLCs and the possible replacement of C and S corporations by LLCs is to see the phenomenon as empirical proof of the triviality of much of corporate law and to laud the emergence of more efficient entities. [FN241] Bernard S. Black argues that state corporate law is trivial because firms can contract around most mandatory rules. [FN242] According to Black, the concepts of a "race to the top" or a "race to the bottom" are empty. The debate over enabling or mandatory laws is sterile. He argues further that the corporate laws that exist are either avoidable or have no bite. [FN243] The laws that are not avoidable are merely "market mimicking," meaning that in a system of perfect free ordering, most rational participants would have chosen those rules anyway. [FN244] Laws that are not market mimicking are for the most part avoidable, yet they have varying degrees of avoidance costs. [FN245] The higher the avoidance cost, the greater the degree of mandatoriness. For close corporations, avoidable rules, though market mimicking and costly, are of greater importance to prevent oppression or gross unfairness. [FN246] Nevertheless, even market mimicking rules are inefficient because they prevent experimentation with rules that might be even more efficient and

procedures that the market would have adopted had they known such a situation was possible. [\[FN247\]](#)

Furthermore, Black doubts the ability of laws to modify behavior, arguing that culture plays a much more influential role in corporate managers' self-restraint. [\[FN248\]](#) He sees little practical difference in managers' behavior if fiduciary duties, for example, were adopted by charter rather than by statute. [\[FN249\]](#) It is for this reason that Black argues that in situations in which respect for law is low, such as in post-communist Russia, the best strategy for designing a corporate charter is to develop a self-enforcing one. In other words, a firm should be designed so that it will be in ***472** the interest of everyone to follow various rules of corporate behavior and resort to legal authority as little as possible. [\[FN250\]](#)

Black acknowledges the difficulty in proving his triviality thesis and opts to point out a few instances of triviality instead of engaging in a difficult empirical study of all of state corporate law and discussing why it is either market mimicking or has no bite. [\[FN251\]](#) Yet, the emergence of LLCs might be the empirical proof that Black was unable to provide. This empirical proof is possible if one posits, first, that the vast majority of LLC law is market mimicking, since nearly all LLC laws can be waived and therefore the only LLC laws that remain are those which rational market actors would have wanted in the first place. Second, if one also accepts the assumption that LLCs can fulfill the vast majority of tasks that corporations were designed to fulfill, then it is plausible to argue that all corporate laws that LLCs do not have are waivable. In other words, if one were to subtract from corporate law all the laws that also apply to LLCs, all that would remain would be waivable, with no bite, with low avoidance costs, and hence trivial.

The LLC represents an attempt to create a contractarian business entity that avoids most of the regulatory temptations of corporations since LLCs do not share corporations' contentious history, and were created for the explicit purpose of avoiding corporate regulation. The problem this understanding of LLCs raises is that by ignoring the legitimate and powerful communitarian or regulatory concerns present in American understandings of the economic order, if history is any guide, the current private, free-ordering model of the LLC is inviting some sort of regulatory backlash. In other words, while much of corporate law is currently trivial, the fact of its triviality will be corrected by a movement to make it mandatory.

Delaware represents the boldest and most powerful push toward a private contractualist model of the firm. This article doubts that such an understanding will stand unchallenged for long. Indeed, the speed with which LLCs came to be seen as securities illustrates the instability of such a pure contractarian position. The Delaware LLC law seems ripe for a "correction" by communitarian influenced forces, and it is to the Delaware statute that this article will now turn.

IV. The Delaware LLC Statute - Its History, Meaning and Future

The paucity of litigation on LLCs makes it difficult to predict the future of the LLC and other limited liability entities. But developments in Delaware, a state long dominant in business entity law, [\[FN252\]](#) point to the increased strength of the LLC form ***473** and flexibility of its organization. A 1994 revision of the Delaware LLC code is likely to fan the flames of the ongoing dispute over whether a corporation is a nexus of contracts or a state privilege. [\[FN253\]](#) The statute says outright that the LLC is, above all, a contract. [\[FN254\]](#) The revision in full states:

***474** (a) The rule that statutes in derogation of the common law are to be strictly construed shall have no application to this chapter.

(b) It is the policy of this chapter to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements.

(c) To the extent that, at law or in equity, a member or manager or other person has duties (including fiduciary duties) and liabilities relating thereto to a limited liability company or to another member or manager:

(1) Any such member or manager or other person acting under a limited liability company agreement shall not be liable to the limited liability company or to any such other member or manager for the member's or manager's or other person's good faith reliance on the provisions of the limited liability company agreement; and

(2) The member's or manager's or other person's duties and liabilities may be expanded or restricted by provisions in a limited liability company agreement. [\[FN255\]](#)

The Delaware statute also states regarding third party liabilities that:

(a) Except as otherwise provided by this chapter, the debts, obligations and liabilities of a limited liability company, whether arising in contract, tort or otherwise, shall be solely the debts, obligations and liabilities of the limited liability company, and no member or manager of a limited liability company shall be obligated personally for any such debt, obligation or liability of the limited liability company solely by reason of being a member or acting as a manager of the limited liability company. [\[FN256\]](#)

The Delaware legislature wanted to grant LLC drafters the maximum ability to organize their entities as they see fit with minimal interference of the court, specifically granting a minimum level of fiduciary duty, "good faith." Furthermore, the legislature seemed to be directing the court not to make any analogies to corporate law or other equitable doctrines [\[FN257\]](#) and to respect the contracts of members. [\[FN258\]](#) It would seem that the Delaware legislature sided with the contractarians *475 and decided to experiment with a situation of greater freedom of contract. This part will examine the Delaware statute in greater detail, look at its literal meaning and legislative history, and examine some possible ways Delaware's law for piercing the LLC's veil may evolve.

A. The Delaware LLC Statute, Its Origin, and Plain Meaning

The Delaware Limited Liability Company Act was signed into law on July 22, 1992, with an effective date of October 1, 1992. [\[FN259\]](#) The long time (compared to the Western states) that Delaware took to pass LLC legislation is not indicative of how responsive Delaware usually is to most "pro-business" developments. [\[FN260\]](#) The Committee in charge of drafting LLC legislation began to do so in 1991, but did not decide to present its proposal to the legislature until 1992, after the nation-wide trend of recognizing the LLC was already well established. [\[FN261\]](#) Delaware does not usually keep or refer to its legislative history; however every bill contains a synopsis that is evidence of legislative intent. [\[FN262\]](#) In the synopsis of the original LLC act, the legislature recognized the race between the states for charters of business entities and argues that "[t]his proposed Limited Liability Company Act will permit Delaware to remain at the forefront as a jurisdiction of choice for formation of business organizations." [\[FN263\]](#)

The 1994 amendments, which added language declaring the LLC agreement to be like a contract, recognizes the race between the states even more explicitly when it states that "Delaware is frequently chosen as a forum in which to form a limited liability company. . . . This bill amends the Act to keep it current." [\[FN264\]](#) In section 35 of the synopsis of the 1994 Amendments, the bill states that the purpose of section 18-1101(c) is to "confirm that provisions found in a limited liability company agreement relating not only to the duties and liabilities of members and managers, but also to the duties and liabilities of other persons, are enforceable." [\[FN265\]](#) Finally, in 1997 the Delaware Legislature decided that LLCs shall have perpetual existence, clearing the way for trading LLCs on the secondary markets. [\[FN266\]](#) In sum, *476 the legislative intent behind Delaware's LLC act seems to be to maintain Delaware's competitiveness as a place to charter business entities and to stick closely to the contractarian approach to understanding business entities and their relationships with their creditors, managers, shareholders, and regulators (i.e., the state).

Nevertheless, as will be highlighted below, despite a very deferential attitude toward the legislature, recent developments in how Delaware courts understand the power of their moral authority in corporate law, combined with the uncompromising contractarian position of the legislature, might tempt the Delaware courts to soften the contractarian nature of the LLCs in Delaware. They might impose certain common law doctrines that seek to ameliorate some potential abuses, specifically relating to the extent of limited liability.

The LLC Act was modeled on Delaware's popular limited partnership (LP) statute. [\[FN267\]](#) A manager of an LLC is in many respects treated the way a general partner is treated under the LP statute, except that the LLC manager does not have general liability. [\[FN268\]](#) The fundamental principle underlying the LLC Act is freedom of contract. The Act's approach is to allow members the broadest possible discretion when drafting their agreements, and to furnish answers only in situations in which the members have not expressly made provisions in their LLC agreements. The Act gives members virtually "unfettered discretion to define contractually their business understanding." [\[FN269\]](#)

In contrast to a limited partner in an LP, the limitation of liability of an LLC member is not jeopardized, in fact or theory, when the member participates in the management or control of the business of a Delaware LLC. [\[FN270\]](#) The word "solely," used in section 18-303, indicates that a member or manager will not be liable for the LLC's debts or liabilities because that person was only a member or manager, but at the same time the member or manager might still be held liable. Logic dictates that there are two ways that a member may become liable: the member or manager can make himself contractually liable for something on behalf of the LLC, or such liability can be imposed by the common law. [\[FN271\]](#) However the statute does not state how that liability might be imposed.

The Act seems purposefully ambiguous about its relationship to the common law. On the one hand, the Act states that in the case of conflict between the statute and common law doctrines, the statute's understanding is preferred and should not be strictly construed. [\[FN272\]](#) The legislature seems to be warning the courts not to apply common law doctrines too broadly in

a way that would restrict the spirit of the *477 Act. [\[FN273\]](#) However, the Act invites the courts to incorporate common law (and law merchant) rules "[i]n any case not provided for in this chapter." [\[FN274\]](#) The legislature has given the courts a very strange mandate. On the one hand, the Act is directing the courts to ignore common law doctrines when they impinge on the principle of freedom of contract, even in cases in which such doctrines can be used in conjunction with a fair reading of the text of the statute. On the other hand, the Act is inviting the courts to incorporate common law doctrines in cases in which the Act is not clear. These would presumably include cases in which common law doctrines in conflict with the principle of freedom of contract can be imposed under a fair reading of the Act.

Generally speaking, Delaware courts, when interpreting Delaware General Corporation Law, are very deferential to the legislature. The courts read statutes formally and do not try to stretch the literal meaning of statutes. Chancellor Allen discusses in dicta the Delaware court's approach to statutory interpretation in *Uni-Marts, Inc. v. Stein*. [\[FN275\]](#) It is worth quoting his opinion at length.

[W]hen construing the compliance of a transaction with the applicable provisions of the Delaware General Corporation Law our law does not employ a "functional equivalency" type of analysis (in which the regulation applied to one form of transaction is applied to all forms of transaction that are its functional equivalent). Instead, when construing the reach and meaning of provisions of the Delaware General Corporation Law, our law is formal. Formality in the analysis of intellectual problems has been largely out of fashion for much of this century, and Delaware corporation law has sometimes been criticized for its reliance on formality. . . . Corporations come into existence and are accorded their characteristics, including most importantly limited liability, because of formal acts. Formality has significant utility for business planners and investors. While the essential fiduciary analysis component of corporation law is not formal but substantive, the utility offered by formality in the analysis of our statutes has been a central feature of Delaware corporation law. Most notably, the established doctrine of "independent legal significance" provides that a form of transaction valid under one section of the statute is not subject to attack because it reaches a functional result that would require other or additional steps under a different section of the statute. [\[FN276\]](#)

It would seem, based on the above dicta, that any analysis of the law of piercing the veil of an LLC must employ a narrow and literal understanding of the Act. *478 Under a narrow reading of the Act, it would be next to impossible to impose liability on an LLC member or manager for the liabilities of the LLC without the member or manager having made himself subject to such liability by previous contract. Furthermore, if the LLC charter specified that members and managers were not to be held liable for any liabilities of the LLC for which they did not contract, based on section 18-1101(c)(2) and the above analysis on imposing common law doctrines, it would be impossible to impose traditional corporate common law piercing doctrines to attach liability to the member or manager.

B. The "Moral Tone" of the Delaware Courts

There is another understanding emerging of how the Delaware courts approach cases that might bode well for those seeking ways to pierce the LLC veil. Two studies of recent Delaware cases [\[FN277\]](#) conclude that by focusing too much on the doctrines that the Delaware court decisions create and not enough on the narrative description of the events under suit, commentators have been missing out on an essential element of what the Delaware courts are doing. "[T]he Delaware courts generate in the first instance the legal standards of conduct (which influence the development of the social norms of directors, officers, and lawyers) largely through what can best be thought of as 'corporate law sermons.'" [\[FN278\]](#) The fact that the Delaware Supreme Court has influence on American business out of all natural proportion, argue these studies, [\[FN279\]](#) has spurred the courts to be concerned about their judicial legitimacy. This has caused the courts to speak, in all but 3% of their decisions, in unanimity, [\[FN280\]](#) and to speak in an "unmistakably moral tone." [\[FN281\]](#)

The Delaware court system does not merely produce legal rules - the rules that they produce tend to be vague elaborations on widely accepted rules - but also produces an "elaboration of norms of conduct appropriate" to the behavior at issue; each case tells the reader something individually significant about the norms governing the contested actions. [\[FN282\]](#) By examining the differences between *Paramount Communications v. Time, Inc.*, [\[FN283\]](#) and *Paramount Communications v. QVC Network, Inc.*, [\[FN284\]](#) these two commentators conclude that the doctrinal differences between the cases are negligible. In *Time* (also known as *Time Warner*), the court upheld the "just say no defense" and found no violation of the board of directors' fiduciary duties to reject a superior takeover offer if so doing would *479 preserve the target corporation's "culture," [\[FN285\]](#) despite the offer's potential to raise short-term shareholder value. [\[FN286\]](#) On the other hand, three years later in *QVC*, the court held it was a violation of a board's fiduciary duty to reject a higher offer that would have increased short-term shareholder value. [\[FN287\]](#) The commentators note that these two cases seem to apply the same laws to the same

facts and yet reach different conclusions. [\[FN288\]](#) The significant difference between the two cases is that "the manager and board behaved well in Time Warner and badly in QVC." [\[FN289\]](#) Edward Rock concludes from his study of Delaware law that the "process that leads to reasonably precise standards proceeds through the elaboration of the concepts of independence, good faith, and due care through richly detailed narratives of good and bad behavior, of positive and negative examples, that are not reducible to rules or algorithms." [\[FN290\]](#) It would seem, therefore, that even if Delaware law doctrinally might not allow the possibility of piercing the LLC veil, a way of doing so might be found where the court feels that the behavior of the members/managers of an LLC is so bad that to not pierce the veil might threaten the moral legitimacy of the court. [\[FN291\]](#)

Rock argues that Delaware courts, when confronted with a case of bad behavior by management, will try to use public shaming through the recitation of facts in the judicial opinion to right the wrong instead of changing the law. They are afraid of the effects of changing a legal rule on the basis of a single case - which might make matters even worse. [\[FN292\]](#) However, LLCs tend to be small organizations with the social mechanisms of public shaming having a much weaker effect. This fact might force the courts to exercise more power over "bad" managers/members because mere public shaming in the press will not suffice. [\[FN293\]](#) The suggestion that managers of close corporations and LLCs cannot be publicly shamed easily and that *480 therefore courts will be more inclined to direct actions, such as piercing the veil, is tied to the argument that courts will more likely pierce LLCs and close corporations because their insulation from the discipline of the secondary markets lowers the efficiency of those entities having limited liability in the first place. Rock's arguments about the Delaware courts therefore mirror the idea, discussed above, that efficiency analysis predicts that limited liability should be weaker for entities like the LLC and the close corporation because the controls preventing overly risky behavior that exist for public corporations are absent.

C. Piercing the Veil in Delaware

While Delaware is acknowledged as having the best-developed general corporate case law, comparatively speaking, its law for piercing the veil is underdeveloped. [\[FN294\]](#) Piercing law in Delaware was always considered relatively stringent. While it is arguably becoming easier to pierce the veil in Delaware, it is still likely that in order to pierce the veil "[f]raud or something like it is required." [\[FN295\]](#) The leading case on the subject referring to subsidiary and parent corporations stated:

There is, of course, no doubt that upon a proper showing corporate entities as between parent and subsidiary may be disregarded and the ultimate party in interest, the parent, be regarded in law and fact as the sole party in a particular transaction. This, however, may not be done in all cases. It may be done only in the interest of justice, when such matters as fraud, contravention of law or contract, public wrong, or where equitable consideration among members of the corporation require it, are involved. [\[FN296\]](#)

While some courts have interpreted this language to mean that fraud is not the only basis for piercing, it is rare for Delaware courts to spell out in detail what those other bases might be. [\[FN297\]](#) One reason for this ambiguity might be that in Delaware, *481 unlike many other states, piercing the veil is clearly an action taken in equity at the sole discretion of the Chancellor or vice-chancellor. [\[FN298\]](#)

Some commentators have noticed a re-evaluation by the chancery of its strict approach to veil piercing. [\[FN299\]](#) In a 1987 case, [\[FN300\]](#) the Delaware court noted that while the "use of the corporate form to perpetrate a fraud" is the "paradigm instance" for piercing the veil, "conduct short of the active intent to deceive required to establish fraud may . . . occasion the 'piercing of the corporate veil.'" [\[FN301\]](#) Some examples of when this might occur include when "those in control of the corporate enterprise have not treated it as a distinct legal entity - have ignored the 'corporateness' of the corporation and have themselves treated it as their 'instrumentality,'" [\[FN302\]](#) or even when a non-shareholder "who is in control of and has misused a corporate structure." [\[FN303\]](#) The chancellor was careful to point out that "[t]he legal test for determining when a corporate form should be ignored in equity cannot be reduced to a single formula that is neither over nor under inclusive." [\[FN304\]](#) Nevertheless, failure to follow the appropriate formalities makes "the legal fiction of corporateness become less 'real' in the everyday experience of those involved in the firm's operations, and any expectation that others would treat it as a distinct, liability-limiting entity becomes less reasonable." [\[FN305\]](#)

However, contrary to Chancellor Allen's broad assertion in *Uni-Marts*, the courts eschew being overly formal in their rule making in this area. Rather they "tend to evaluate the specific facts with a standard of 'fraud' or 'misuse' or some other general term of reproach in mind." [\[FN306\]](#) The broad language of *Uni-Marts* does not result in veil piercing in that case, but it perhaps signals a more liberal approach to the possibility of veil piercing. [\[FN307\]](#) Indeed, in *Harco National Insurance Co. v. Green Farms, Inc.*, [\[FN308\]](#) the chancellor conceded that trying to "persuad[e] a Delaware Court to disregard the

corporate entity is a difficult task." [\[FN309\]](#) While "[f]raud has traditionally been sufficient reason to pierce the corporate veil. . . . *482 [o]ther grounds also exist." [\[FN310\]](#) The chancellor seemed aware that Delaware courts have yet to adopt the "alter ego" theory, but notes that the District Court of Delaware did adopt that analysis in *United States v. Golden Acres, Inc.*, [\[FN311\]](#) where the court wrote:

[A]n alter ego analysis must start with an examination of factors which reveal how the corporation operates and the particular defendant's relationship to that corporation. These factors include whether the corporation was adequately capitalized for the corporate undertaking; whether the corporation was solvent; whether dividends were paid, corporate records kept, officers and directors functioned properly, and other corporate formalities were observed; whether the dominant shareholder siphoned corporate funds; and whether, in general, the corporation simply functioned as a facade for the dominant shareholder. [\[FN312\]](#)

If the Harco and Golden Acres approach prevails in Delaware, then the state's veil piercing law would resemble that of most other states. [\[FN313\]](#) Nevertheless, the standards of proof are high. The court in *Golden Acres* noted that, "[u]nder Delaware law fraud is never presumed. Rather it must be proven to the satisfaction of the finder of fact." [\[FN314\]](#) While fraud at common law has been defined by Delaware courts to require intent by the representing party, in equity the Chancery is willing to provide a remedy for negligent or innocent misrepresentation. [\[FN315\]](#) In both Harco and *Irwin & Leighton*, the vice-chancellor and Chancellor, respectively, cited and adopted the law set forth in the federal cases. Thus commentators speculated that "it does seem that the days of Delaware as a state where it was exceptionally difficult to pierce the corporate veil may be numbered." [\[FN316\]](#)

As discussed in Part II.B.1, it is not easy to apply mechanically corporate piercing doctrines to LLCs. The courts in Delaware seem willing to consider piercing when the shareholders "misuse" the "legal fiction" of the corporation, expanding the fraud exception to limited liability to include cases where the shareholder did something *483 reproachable, if not necessarily fraudulent. While a little broader than fraud, it is difficult to see how it can apply directly to LLCs. What is "reproachable" under the policy of corporation law might not be so under LLC law. If the policy of the LLC statute is to give "maximum effect to the freedom of contract," it is hard to see how any freely entered contract can be "reproachable" even if it allows ethically questionable behavior by the signatories. On the other hand, where there is no consent to the LLC contract (such as for tort creditors), perhaps ethically questionable behavior is "reproachable."

1. "Piercing" Limited Partnerships and LLPs

The corporation is not the only other entity that has limited liability in Delaware. The courts might look to these other entities for guidance when trying to pierce an LLC's veil. For example, limited partnerships, limited liability partnerships, and business trusts enjoy limited liability and are also hard to pierce. Under partnership law, partners are liable jointly and severally for all obligations of the partnership. [\[FN317\]](#) However, in a limited partnership there are two categories of partners, general and limited. A limited partner is not liable for the obligations of the partnership unless he participates in the control of the business. [\[FN318\]](#)

The Delaware Limited Partnership Act lists a number of activities that are not considered participation in the "control of the business." Most of the non-control activities involve participation in broad, general strategy decisions about the partnership and do not deal with its day-to-day functioning. [\[FN319\]](#) The general applicability of LP liability laws to LLCs is not very clear since the whole point of LLCs is to grant its members limited liability across the board. In LPs, however, someone other than the entity is always fully liable on behalf of the entity. Furthermore, LLCs were designed to allow full participation by its members in the control of the LLC's business. It would thus go entirely against the policy behind the creation of the LLC to apply LP liability laws. The limited liability partnership (LLP), on the other hand, is very much like an LLC in that all partners have limited liability for all "debts, obligations and liabilities of or chargeable to the partnership arising from negligence, wrongful acts or misconduct, whether characterized as tort, contract or otherwise, committed." [\[FN320\]](#) However, a partner in an LLP is still liable for "his own negligence, wrongful acts or misconduct" and for such actions by people under his "direct supervision and control." [\[FN321\]](#) Additionally, the statute *484 clarifies innocent partners' protection from indirect liability by specifying that they are not liable "either directly or indirectly, by way of indemnification, contribution, assessment or otherwise" for the otherwise protected misconduct. [\[FN322\]](#) LLP members, like LLC members, can be held liable under common law principles for participation in a wrongdoing, [\[FN323\]](#) or if someone under their "direct control" commits a wrongdoing. The main effect of this rule is to clarify that a partner is not individually liable when there is no reason to think the member could have done anything to prevent the loss. [\[FN324\]](#)

It is not easy to answer whether general corporate piercing factors apply to LLPs. As a partnership, it is hard to argue that inadequate capitalization is a reason to pierce - especially if the instance of undercapitalization is a partner withdrawing funds from the partnership (although failure to obtain insurance where required might be a good basis for piercing). [\[FN325\]](#) Another problem with applying corporate piercing factors to LLPs is that there are very few formalities to follow with LLPs; disregard of formalities as a justification for piercing might make LLPs pierceable by definition. [\[FN326\]](#) Applying LLP piercing law to the LLC is a questionable strategy. First, the LLP is even newer than the LLC and has nearly no commentary and no case law about piercing. Second, it seems that LLP piercing laws are far more permissive than LLC or corporation laws in that they allow piercing for negligence or misconduct. It would thus make little sense for Delaware courts to look to LLPs for guidance.

2. The Delaware Business Trust

A final entity that has limited liability in Delaware is the Delaware Business Trust (DBT). [\[FN327\]](#) The beneficial owners of DBTs have the "same limitation of personal liability extended to stockholders of private corporations" under Delaware law. [\[FN328\]](#) Trustees generally are only responsible to the trust "when acting in such capacity," and "shall not be personally liable to any person other than the business *485 trust or beneficial owner for any act, omission or obligation of the business trust or any trustee thereof." [\[FN329\]](#) Furthermore, no employee, manager, or officer shall be liable other than to the trust or beneficial owners "[f]or any act, omission or obligation of the business trust or any trustee thereof, . . . except to the extent otherwise provided in the governing instrument" of the trust. [\[FN330\]](#) Generally speaking, Delaware trust law applies to DBTs. [\[FN331\]](#) The business trust is a creature of contract; state filing is not necessary for its existence. [\[FN332\]](#) Furthermore, the Business Trust is the most common kind of trust; 80% of all money in trusts is in commercial trusts incident to business deals. [\[FN333\]](#) A number of mutual fund companies have advocated becoming DBTs because the law was specifically drafted to accommodate the unique needs of investment companies; its policy is to give maximum freedom of contract to trust instruments. [\[FN334\]](#) While trusts are like contracts, it seems almost impossible to hold a trustee liable when acting within his authority as a trustee for an action of DBT. [\[FN335\]](#)

John Langbein, in his writings on the contractarian nature of trusts, hints how liability might be imposed when he describes the trust as a "relational contract." [\[FN336\]](#) By viewing a trust as a relational contract, the court might use such concepts as good faith to take a stab at approximating the terms the parties would have negotiated had they foreseen the circumstances that have given rise to the current dispute. Perhaps the court would surmise that the parties would have felt that the trustee should be liable under the circumstances in the case at hand. [\[FN337\]](#) This *486 reasoning brings us to the most provocative way the courts might try to surmount the problem of piercing the veil of the LLC - by using common law contract doctrines. The past century has seen the whittling away of formal contract doctrines and the greater use of fairness in evaluating contract cases. A court might conclude that an LLC charter, a contract which limits liability in a particular circumstance, contains an unconscionable clause and will amend the LLC "contract" to provide liability in certain circumstances. The next subpart will explore that possibility in greater detail.

D. The LLC as a Contract

The health of contract law has been a major source of controversy for the past thirty years. Some have heralded the "death of contract" and its replacement by tort law while others continue to insist on contract's vitality. [\[FN338\]](#) Much of the debate over the nature of contract law mirrors the debate over the nature of the corporation; should the state involve itself in the private contracting between parties and by what right does it do so. [\[FN339\]](#) The general conclusion on both sides of the debate, *487 however, is that greater attention must be paid to the actual bargains parties strike. Even the defenders of freedom of contract recognize the importance of looking past formal rules which maximize the parties ability to contract freely, to moral rules or standards in the market place. [\[FN340\]](#) Additionally there is greater focus on the doctrine of unconscionability and good faith. [\[FN341\]](#) Much of current good faith analysis is very free-market oriented. The case law tries to protect the parties' justified expectations *488 arising from their agreement. [\[FN342\]](#) The current debate over the nature of contract has a number of implications for LLCs.

If the LLC is a contract, the contract is between the members who create the LLC. The contract limits the liability of the members to the amount of their investment in the LLC. Richard Craswell, in his analysis of unconscionability, argues that the first question courts must ask if they wish to determine the validity of a contract limiting liability is whether the parties involved in the case at hand consented to the contract. [\[FN343\]](#) It is plausible to argue that a voluntary creditor consented to the LLC's contract. If he did not favor the LLC's limitation of liability, he could have required the individual members to

guarantee the LLC's loans, or he could have factored the riskiness of his credit, ex ante, into his price. [\[FN344\]](#) However, it can hardly be argued that an involuntary creditor of an LLC consented to the creation of the LLC's contract. An involuntary creditor most likely did not even know of the LLC's existence, let alone its limitation of liability, before he was harmed by the LLC. Furthermore, while a voluntary creditor might have consented to the LLC contract, he consented only under certain conditions. That is, he consented because he assumed, or had the right to assume, that the representations of the LLC about itself were correct; meaning that the LLC bargained with the voluntary creditor in "good faith."

E. Unconscionability and Good Faith in the LLC Contract

This article does not argue that all involuntary creditors and voluntary creditors suffering from fraud or misrepresentation or bad faith dealing by the LLC can disregard the LLC's veil of limited liability. Such an approach would be insupportable, for even contract law does not disallow all unfair contracts. Generally speaking, the case law requires "naughtiness" in the bargaining process, and an unfair outcome for one party in order to find unconscionability. [\[FN345\]](#) The courts and commentators have struggled with the doctrine of unconscionability and good faith, recognizing on the one hand its necessity as a "safety valve to ensure a minimum level of fairness in contracting." [\[FN346\]](#) On the other hand, courts also recognize the danger of making the law unpredictable and giving themselves too much discretion to develop standards that cannot be defined clearly or consistently. [\[FN347\]](#) Thus any court that wishes to embark on the path of piercing the veil via unconscionability *489 doctrines runs the risk of making an already vague doctrine even more vague and causing a tremendous uncertainty regarding the strength of an LLC's protection of limited liability.

There are few cases in Delaware that touch on unconscionability doctrines. [\[FN348\]](#) Courts in Delaware do not find a contract unconscionable merely when there is superior bargaining power on the part of one of the parties. [\[FN349\]](#) Generally, there must also be an absence of meaningful choice at the time of the formation of the contract, [\[FN350\]](#) and the contract terms must be unreasonably favorable to one of the parties. [\[FN351\]](#) The court in *Tulowitzki v. Atlantic Richfield Co.* outlined three approaches or tests of unconscionability: (1) the deluded and fair man test; [\[FN352\]](#) (2) taking unfair advantage or oppression by one party of the other; [\[FN353\]](#) and (3) the business practices of the community test. [\[FN354\]](#) What all these approaches have in common is that they look to non-legal principles to correct suspicious contracts. [\[FN355\]](#) Whether one looks to communitarian values, autonomy values, or efficiency principles, the unconscionability doctrine ensures that some meta-theory of the law (justice?) can be used to make normative judgments about how the law applies in specific circumstances. The problem with this and all meta-theories is that there is little unanimity about their universal validity. For that reason it is impossible in today's society to advocate a single approach, and as a result judges are left with *490 much discretion. The question is, then, how much discretion to make such normative judgments should be left to judges. There is no one answer, but the traditional though muddled answer is usually some sort of laundry list approach that tries to balance all the policy goals at issue. [\[FN356\]](#) The next subpart makes a stab at devising such a list.

F. A Common law of LLC Piercing

Robert Thompson does not see any reason why, in general, the method for piercing LLCs will be too different from the method for piercing corporations. [\[FN357\]](#) He argues that the LLC statutes will do little to change courts' ability to pierce the veil. [\[FN358\]](#) However, as discussed in Part II.B.1 above, applying the traditional piercing doctrines to LLCs is not so simple. Additionally, the language of the Delaware statute, which explicitly limits liability of the members of the LLCs and requires courts to respect the LLC "contract," should cause courts to pause before simply reapplying the corporate doctrines. Nevertheless, even assuming that the LLC charter is a contract, pure and simple, courts should be able to create a method of piercing the veil.

Taking cues from arguments about the purpose behind limited liability - both efficiency and democratic arguments - and from corrective doctrines of unconscionability and good faith, the following is a proposed list of concerns courts should consider when trying to pierce an LLC's veil. [\[FN359\]](#)

The courts should take the following steps before deciding to pierce the veil of an LLC. First, courts should determine the size of the LLC, and whether it is traded on secondary markets. The greater the size of an LLC, and the more it is traded on secondary markets, the more limited liability contributes to the efficient running of the LLC (and markets in general). Second, courts should determine whether the creditor was voluntary or involuntary. An involuntary creditor will more than likely not have consented to his relationship with the LLC, whereas a voluntary creditor could have and should have factored in the risks of contracting with a limited *491 liability entity into their original bargain. Third, courts should determine

whether the LLC is member managed or managed by agents. The more use made of agents, the greater importance limited liability and the efficient running of secondary markets assumes in running the firm. Fourth, courts should inquire whether the case at hand involves fraud, misrepresentation, an omission or coercion. If it did, then the creditor probably consented under false pretenses and the LLC bargained in bad faith. Thus, the reasonable expectations of the creditor cannot be fulfilled, by definition. Fifth, courts should inquire whether the LLC was formed with the explicit intent of engaging in risky behavior and being undercapitalized for the likely liabilities. If an LLC was formed with such a purpose, this fact should be extra evidence of the unconscionable behavior of the firm toward involuntary creditors. However, such evidence should not be evidence of unconscionable behavior toward voluntary creditors unless the LLC's purpose was obscured or misrepresented. Sixth, courts should determine whether the members of the LLC failed to respect the separate entity of the LLC by using the LLC's credit to secure loans to members, by using LLC property as if it belonged to members, or by generally failing to hold the firm out as a separate entity. By engaging in such behavior, the LLC members are not fulfilling the promise of the democratic argument - increasing opportunities for risk-taking across a wide socio-economic spectrum - but are abusing a legal technology in order to mislead potential creditors about the member's personal wealth.

It is unlikely that the legislature or courts in Delaware, or elsewhere for that matter, will provide a step by step test for determining whether or not to pierce an LLC's veil. Such a test would encourage courts to pierce more than they otherwise would because the mere existence of a set procedure for determining whether or not to pierce will make piercing seem a natural thing to do. Also, such a test would encourage firms to adjust their actions in such a way as to still engage in "bad" behavior but simultaneously to avoid the "bright lines" that will result in piercing.

V. Conclusion

This article has argued that ultimate human values shape the law and that those ultimate values are often in a state of tension. This tension is often reflected in the contradictory tendencies of the law and its evolutionary see-sawing from one position to another on the same issue. American attitudes toward the extent or limits of limited liability are a telling example of this truism. Americans wish to spread the ability to create wealth efficiently to as wide a range of people as possible. There is widespread recognition (with increasing dissent) [\[FN360\]](#) that limited liability entities unrestrained by regulation are the best and most efficient vehicles by which to achieve this goal.

However, Americans also exhibit a profound fear of, and a desire to regulate, the power of the legal technologies that allow for rapid wealth creation, and exhibit a democratic (or paternalistic, depending on one's perspective) concern for the alleged *492 victims of this wealth creating activity. Most theories of the firm have tended to embody these two contradictory impulses; yet this has not prevented partisans of both impulses from using the theories to further their own ends. Currently, the trend in Delaware, at least, is toward less regulation. Perhaps this trend is an overdue correction for years of intense regulation of firm activity; indeed, the rapid emergence and quick acceptance of the LLC seems to provide proof of this. However, it seems that things in Delaware might have swung too far in the private contracting direction.

The policy for limited liability is very strong. Nevertheless, just as with corporations, an impervious business entity will not stand. The demands of justice and efficiency will require that in certain circumstances the members of LLCs be held liable for their own or their agents' actions. The speed with which LLCs came to be viewed as securities is testimony to the regulatory impulse in American life. [\[FN361\]](#) One can only hope that when courts encounter a situation which public shaming will not heal, and thus feel the need to pierce an LLC's veil, they will keep in mind both the economic and democratic arguments for limited liability in the first place.

*493 Appendix: Total LLC Filings

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

[\[FN1\]](#). Law Clerk to Chief Judge Gregory W. Carman, Court of International Trade. J.D. cum laude, 1998, Northwestern University School of Law; M.A. with distinction (Legal and Political Theory), 1995, University College, London; M. Phil. (History and Philosophy of Science), 1994, Churchill College, Cambridge; M.A. (History), 1993, B.A. (History of Science), 1992, Johns Hopkins University. The author would like to thank Professor Stephen Presser, Ben T. Cohen, Nicole Cohen, and Guy Seidman for their invaluable assistance.

[\[FN1\]](#). Bernard S. Black, Is [Corporate Law Trivial?: A Political and Economic Analysis](#), 84 Nw. U. L. Rev. 542 (1990).

[\[FN2\]](#). Frank B. Cross evaluates theories that emphasize the role of culture and ideology in predisposing judges to reach

certain decisions. Frank B. Cross, [Political Science and the New Legal Realism: A Case of Unfortunate Interdisciplinary Ignorance](#), 92 Nw. U. L. Rev. 251 (1997). What he calls the "attitudinal model" of political science theory informs us that judges are not completely dispassionate. In controversial or unsettled areas of law a judge's political beliefs are a very accurate predictor of his rulings. [Id. at 318-19](#). Cross does not dismiss the legal model (i.e. traditional doctrinal explanations of legal results), but he emphasizes the strength (at least in certain areas) of the attitudinal model and convincingly argues that both models need to be utilized together and verified empirically. [Id. at 325](#).

[FN3]. [Id. at 318-19](#).

[FN4]. The works of John Gray are perhaps the best introduction to Berlin's thesis of the incommensurability of ultimate values. See, e.g., John Gray, Isaiah Berlin (1997); John Gray, What is Living and What is Dead in Liberalism, in *Post-Liberalism: Studies in Political Thought* 283-328 (1993). Gray does not argue for cultural relativism, i.e., that ultimate values are unknowable, but rather that they are many, often in conflict, uncombinable, and there is no ultimate standard to arbitrate between them. [Id. at 285](#); see also John Gray, *Beyond the New Right: Markets, Government & the Common Environment* (1993); Claude J. Galipeau, *Isaiah Berlin's Liberalism* (1994). Gray's and Berlin's assertions are vigorously contested in Ryszard Legutko, *On Post-Modern Liberal Conservatism*, 8 *Critical Rev.* 1 (1994) and Loren E. Lomsky, *Liberal Obituary?*, 102 *Ethics* 140 (1991), who both dispute the notion that Western Civilization lacks ultimate values with which to arbitrate between lesser, incommensurable values. While recognizing the pertinence of Berlin's thesis for lesser goals and values, both critics disagree with Gray's broader conclusions about the bankruptcy of much of Western philosophy.

[FN5]. See, e.g., Note, [Incorporating the Republic: The Corporation in Antebellum Political Culture](#), 102 *Harv. L. Rev.* 1883 (1989) (arguing that different visions of republicanism and emerging liberalism defined and were defined by the emergence and triumph of the private business corporation) [hereinafter Note, *Incorporating the Republic*]; J.C.D. Clark, *The Language of Liberty, 1660-1832* (1994) (arguing for the equal importance of proto-liberal, republican and dissenting Protestant traditions in forming American political thought). But see Gregory A. Mark, *Some Observations on Writing the Legal History of the Corporation in the Age of Theory*, in *Progressive Corporate Law* 75 (Lawrence E. Mitchell ed., 1995) (arguing that scholars on both sides of the debate have not properly examined the history of the corporation in order to find empirical proof for the assertions of contemporary theory) ("[W]e lack even bad histories of many of the most important doctrines in basic corporate law.").

[FN6]. See David Millon, *Frontiers of Legal Thought I: Theories of the Corporation*, 1990 *Duke L.J.* 201, 241 (1990).

[FN7]. See [id. at 242](#). This argument has even been seconded by the normally (although increasingly less so) ahistorical law and economics movement. See, e.g., Frank H. Easterbrook & Daniel R. Fischel, *The Economic Structure of Corporate Law* 4 (1991) ("The view you take of corporations and corporate law is apt to depend on your assumptions about how investors, employees and other players come to be associated in a venture.") This article does not argue for cultural determinism, but rather posits that law-makers, whether they be legislators, judges, or actors in the marketplace (who probably should be called "norm-makers") very often will choose one solution to a legal problem over another because of the perceived consequences of the favored solution. It is very easy for arguments of this kind to degenerate into a crude legal realism. On the other hand, it is hard to deny that a judge when applying old law to new situations or trying to interpret a brand new law has a large amount of discretion to apply consequentialist approaches to the new situation or law.

[FN8]. See Millon *supra* note 6, at 247-50 (discussing whether legal theory is determinative of legal doctrine and concluding that it cannot be, because legal theory is often subject to more than one interpretation and therefore cannot be determinative of a single doctrine).

[FN9]. See generally J.G.A. Pocock, *Modes of Political and Historical Time in Early Eighteenth Century England*, in *Virtue, Commerce, and History* 91 (1985) (discussing how the doctrine of the "ancient constitution" was transformed from being an argument for an authoritarian state to an argument for limiting the power of the state and how Edmund Burke tried to reverse this trend).

[FN10]. Robert A. Hillman defines corporate contractarians as those who view the corporation as merely a consensual contract between private parties and who see the role of corporate law as providing "gap filling" provisions when the parties fail to contract. The contractarians conclude that the market protects investors, and whatever the costs of a contractarian legal outlook, it is superior to an interventionist one because lawmakers have fewer incentives than the parties and less information

about the parties' goals and thus are unable to create an optimal corporate law. Robert A. Hillman, *The Richness of Contract Law: Analysis and Critique of Contemporary Theories of Contract Law* 99, 103 (1997) [hereinafter Hillman, *Richness of Contract Law*]. Hillman concludes that the contractualist approach is missing something. Simply "to label a relation contractual does not end the inquiry, it initiates it." *Id.* at 109. In other words, just because a corporation is a contract does not mean that the state does not have an interest in ensuring that the true intentions of the parties who entered into the contract are being respected. Hillman's argument is yet another example of how a theory arguing against state intervention can be twisted into an argument in favor of it.

[FN11]. See discussion *infra* Part III.

[FN12]. See Easterbrook & Fischel, *supra* note 7, at 40 ("Limited liability is a distinguishing feature of corporate law - perhaps the distinguishing feature.").

[FN13]. In 1989 the Columbia University Law Review published a special issue that contains many of the more important articles on the nature of the corporation, more specifically on whether the corporation is a contract or something else, and whether mandatory rules are necessary or an impediment to the purpose of corporations. The issue included: Melvin Avon Eisenberg, *The Structure of Corporation Law*, 89 *Colum. L. Rev.* 1461, 1488, 1524-25 (1989); Robert C. Clark, *Contracts, Elites, and Traditions in the Making of Corporate Law*, 89 *Colum. L. Rev.* 1703 (1989); Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 *Colum. L. Rev.* 1416, 1444-45 (1989); John C. Coffee, Jr., *The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role*, 89 *Colum. L. Rev.* 1618, 1621 (1989); Oliver Hart, *An Economist's Perspective on the Theory of the Firm*, 89 *Colum. L. Rev.* 1757, 1764 (1989); Jeffery N. Gordon, *The Mandatory Structure of Corporate Law*, 89 *Colum. L. Rev.* 1549, 1592 (1989); Lewis A. Kornhauser, *The Nexus of Contracts Approach to Corporations: A Comment on Easterbrook and Fischel*, 89 *Colum. L. Rev.* 1449 (1989); Fred S. McChesney, *Economics, Law, and Science in the Corporate Field: A Critique of Eisenberg*, 89 *Colum. L. Rev.* 1530 (1989); Roberta Romano, *Answering the Wrong Questions: The Tenuous Case for Mandatory Corporate Laws*, 89 *Colum. L. Rev.* 1599 (1989); Lucian Arye Bebchuck, *The Debate on Contractual Freedom in Corporate Law*, 89 *Colum. L. Rev.* 1395 (1989).

For a survey and criticism of the contractualists' and communitarians' methods, see, e.g., Deborah A. DeMott, *Trust and Tension Within Corporations*, *Progressive Corporate Law*, 81 *Cornell L. Rev.* 1308 (1996) (edited by Lawrence E. Mitchell); Fred S. McChesney, *Positive Economics and All That - A Review of the Economic Structure of Corporate Law by Frank H. Easterbrook & Daniel R. Fischel*, 61 *Geo. Wash. L. Rev.* 272 (1992).

For more recent discussion of the issue, see, e.g., Mark J. Loewenstein, *A New Direction for State Corporate Codes*, 68 *U. Colo. L. Rev.* 453, 458- 66 (1997) (discussing the various positions, contractualist and communitarian, regarding mandatory laws); Michael Klausner, *Corporations Corporate Law, and Networks of Contracts*, 81 *Va. L. Rev.* 757, 813 (1995) (arguing that the more common a term or law becomes the more efficient it will be and the greater likelihood and more pressure for firms to adopt that term, even if it is suboptimal; also arguing that legislatures should enact menus of terms).

[FN14]. See Gregory A. Mark, *The Personification of the Business Corporation in American Law*, 54 *U. Chi. L. Rev.* 1441 (1987) (adopting the first view); William W. Bratton, *The New Economic Theory of the Firm: Critical Perspectives from History*, 41 *Stan. L. Rev.* 1471, 1504 (1989) (adopting the second view); Gary M. Anderson & Robert D. Tollison, *The Myth of the Corporation as a Creation of the State*, 3 *Int'l R. L. Econ.* 107 (1983) (adopting the third view).

[FN15]. See Mark, *supra* note 14. There is strong proof for the historical priority of the concession theory. For example, the Supreme Court in *Dartmouth College v. Woodward*, 17 *U.S.* 518 (1819), described the corporation as "an artificial being, invisible, intangible, and existing only in contemplation of [state] law." *Id.* at 636; see also Martin Lipton & Steven A. Rosenblum, *A New System of Corporate Governance: The Quinquennial Election of Directors*, 58 *U. Chi. L. Rev.* 187, 188 (1991).

[FN16]. See Mark, *supra* note 14, at 1453.

[FN17]. See *id.* at 1459, 1469.

[FN18]. See *id.* at 1475.

[FN19]. See *id.* at 1480.

[\[FN20\]](#). See Millon, *supra* note 6, at 220. Mark and Millon seem to differ over whether the realists adopted the natural entity view and transformed it into a corporate citizenship view (Millon's view) or whether the realists argued that what the corporation is is irrelevant; what is important is the power it wields and that it should be regulated. Mark, *supra* note 14, at 1480.

[\[FN21\]](#). Management was conceived as the agent of the shareholders whose sole responsibility was to maximize their profits. Millon, *supra* note 6, at 223-24.

[\[FN22\]](#). *Id.*

[\[FN23\]](#). See *id.* at 225.

[\[FN24\]](#). See *id.* at 231.

[\[FN25\]](#). *Id.*

[\[FN26\]](#). See Bratton, *supra* note 14, at 1506.

[\[FN27\]](#). *Id.* at 1505. Bratton is here discussing Chancellor Kent's, Chief Justice Marshall's, and Stewart Kyd's approaches, but he argues they apply to all subsequent approaches. *Id.*

[\[FN28\]](#). See *id.* at 1516-17.

[\[FN29\]](#). *Id.* at 1517.

[\[FN30\]](#). *Id.*

[\[FN31\]](#). See Anderson & Tollison, *supra* note 14, at 110.

[\[FN32\]](#). *Id.* at 116.

[\[FN33\]](#). See Mark, *supra* note 5, at 81.

[\[FN34\]](#). See *id.* at 82.

[\[FN35\]](#). Thomas Lee Hazen argues that the contractarians, by comparing a corporation to a contract and claiming that that will give corporations freedom to order privately as they will, ignore much of recent contract law history, i.e. the "death of contract," and the fact that "the rigidity of many contract doctrines has been ameliorated by developments in the law of promissory estoppel and restitution" and the focus on "meaningful" consent. Thomas Lee Hazen, [The Corporate Persona, Contract \(and Market\) Failure, and Moral Values](#), 69 N.C.L. Rev. 273, 301 (1991). More importantly, despite a renewed interest (due to the collapse of communism) in the values that

underlie and result from the pursuit of economic efficiency, we as a society [are] uncomfortable with the unfettered pursuit of economic efficiency as envisioned by the Contractarians. We are uneasy with the apparent greed and self-interest that seem to fuel the system and the lack of grace and kindness that the Contractarians are willing to accept. We are concerned about 'losers' and repulsed in extreme cases by the results of the allocation of resources solely to those who can pay the most for them.

Rutherford B. Campbell, Jr., [Corporate Fiduciary Principles for the Post-Contractarian Era](#), 23 Fla. St. U. L. Rev. 561, 563 (1996). Campbell argues that the contractarians are attracted to Kaldor-Hicks efficiencies and the regulators are attracted to Pareto concepts. Society, Campbell argues, strongly favors Pareto concepts, and that is why, while the contractarians will and have made important contributions to the understanding of corporations, they will never triumph. [Id.](#) at 571.

[\[FN36\]](#). Campbell, *supra* note 35, at 563.

[\[FN37\]](#). Henry N. Butler & Larry E. Ribstein, [Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians](#), 65

[Wash. L. Rev. 1, 7 \(1990\)](#) [hereinafter Butler & Ribstein, Opting Out].

[FN38]. *Id.* at 9. Butler and Ribstein argue that the anti-contractarians underappreciate the extent of private controls on managerial conduct; mischaracterize the role of liability rules as a limitation on, instead of a part of, corporate contracts; underestimate the power of market forces as a constraint on the development of optimal contracts; and fail to evaluate the inefficiencies of their regulatory approach. *Id.* at 71; see also Henry N. Butler & Larry E. Ribstein, *The Corporation and the Constitution* (1995). Michael E. DeBow and Dwight R. Lee argue that the communitarian position (another name for the concession theory) is both unlikely and foolish. It is unlikely because in order for it to work in the federal system, every state or the federal government would have to adopt community oriented corporate codes. Additionally, controls would have to exist to prevent Americans from incorporating abroad. Communitarian corporate law is foolish because it assumes that investors will cooperate and that they will have to cooperate. The authors argue that investors can always circumvent the state through grey market entities or other maneuvers. Finally, communitarian goals are contradictory in that they ultimately impose higher long run costs on the greater community to protect a smaller community. Michael E. DeBow & Dwight R. Lee, [Shareholders, Nonshareholders and Corporate Law: Communitarianism and Resource Allocation](#), 18 *Del. J. Corp. L.* 393, 411-15, 418 (1993).

[FN39]. See Easterbrook & Fischel, *supra* note 7, at 40-59.

[FN40]. *Id.*

[FN41]. See *id.* at 41-42.

[FN42]. See *id.* at 42.

[FN43]. See *id.* at 42-43.

[FN44]. See *id.* at 43.

[FN45]. See *id.*

[FN46]. See *id.* at 44.

[FN47]. See *id.* at 49. For a discussion of law and economics scholars' tendency to fall trap to the naturalist fallacy, see Anthony D'Amato, *The Future of Law and Economics: Post Revolutionary Law & Economics: A Forward to the Symposium*, 20 *Hofstra L. Rev.* 757, 762 n.17 (1992).

[FN48]. Easterbrook & Fischel, *supra* note 7, at 42.

[FN49]. Larry Ribstein, concurring with Anderson and Tollison, *supra* note 14, makes the same argument when he asserts that state filing is the last vestige of the concession theory of corporate law. It is this vestigial arrangement that causes people to think that the state has the right to regulate corporations. Ribstein argues, however, that restrictions on limited liability contracts are not justified, and instead should be treated as any contract would be. Larry E. Ribstein, [Limited Liability and Theories of the Corporation](#), 50 *Md. L. Rev.* 80, 86-87, 129 (1991).

[FN50]. Ribstein, *supra* note 49, at 86-87, 129.

[FN51]. *Id.*

[FN52]. See Easterbrook & Fischel, *supra* note 7, at 50.

[FN53]. See *id.* at 50-53 (suggesting that the problem with involuntary creditors is not as scary as many claim since there exist tremendous incentives for firms to insure). In this Easterbrook and Fischel are joined by the dean of the law and economics movement. Richard A. Posner, *The Rights of Creditors of Affiliated Corporations*, 43 *U. Chi. L. Rev.* 499 (1976).

[FN54]. Easterbrook & Fischel, *supra* note 7, at 55-56.

[FN55]. This is the case because closely held corporations have proportionately fewer assets than public firms, and with limited liability their losses are limited to their assets. *Id.*

[FN56]. See *id.* at 56.

[FN57]. See *id.*

[FN58]. See *id.* at 54-55. Easterbrook and Fischel seem to agree with the Legal Realist and the Critical Legal Studies movement that the application of legal principles by a judge will reflect that judges wider beliefs and prejudices. Whereas the Critics claim judges are influenced by their political opinions, the Law and Economic movement claims judges are influenced by the logic of the free market. Whether the "logic of the free market" is an objective test of a law's worth or itself reflects certain normative judgments is an open question. See Arthur Alan Leff, *Economic Analysis of the Law: Some Realism About Nominalism*, 60 *Va. L. Rev.* 451 (1974).

[FN59]. *Id.*

[FN60]. Easterbrook & Fischel, *supra* note 7, at 55.

[FN61]. See *id.* at 56-59.

[FN62]. See *id.* at 56, 58.

[FN63]. See *id.* The distinction between tort and contract breaks down in cases of fraud or misrepresentation because in such cases the voluntary creditors were unable to assess properly the risks and adjust the price of capital, *ex ante*, accordingly. *Id.* at 58.

[FN64]. See *id.* at 58. Easterbrook and Fischel argue that this reasoning applies mostly to tort creditors, but it can also apply to contract creditors since not all creditors are able to inquire fully into their clients, and it is sometimes economically efficient for them to assume that their clients are fully capitalized. *Id.* at 59.

[FN65]. See Robert B. Thompson, [Piercing the Corporate Veil: An Empirical Study](#), 76 *Cornell L. Rev.* 1036 (1991) [hereinafter Thompson, *Piercing the Corporate Veil*].

[FN66]. See [id. at 1055](#).

[FN67]. [Id. at 1037, 1063](#).

[FN68]. See [id. at 1070](#).

[FN69]. See [id. at 1071](#).

[FN70]. See [id. at 1072](#).

[FN71]. See [id. at 1073](#).

[FN72]. Thompson suggests that the discrepancy between the predictions of the economic model and the empirical reality is a result of the power of presumptions created by legal doctrines to force suboptimal results. See *id.*

[FN73]. See Stephen B. Presser, *Piercing the Corporate Veil* 1-37 n.2 (1997) [hereinafter Presser, *Corporate Veil*].

[FN74]. See *id.* at 1-36; see also Posner, *supra* note 53, at 503 (arguing that since voluntary creditors can easily investigate measures undertaken by those to whom they lend to reduce risk, they can adjust their rates accordingly and thus protect themselves against any increased risk they assume because of limited liability).

[FN75]. See Presser, Corporate Veil, supra note 73, at 1-39.

[FN76]. See id. at 1-45.

[FN77]. See, e.g., William W. Bratton & Joseph A. McCahery, An [Inquiry into the Efficiency of the Limited Liability Company: Of Theory of the Firm and Regulatory Competition](#), 54 Wash. & Lee L. Rev. 629 (1997); Henry Hansmann & Reinier Kraakam, [Toward Unlimited Shareholder Liability for Corporate Torts](#), 100 Yale L. J. 1879 (1991).

[FN78]. William W. Bratton and Joseph A. McCahery argue that while an LLC might be more efficient than an S corporation or other similar entities, they are unsure whether LLCs are more efficient than a regime of unlimited liability. See Bratton & McCahery, supra note 77, at 686. Bratton and McCahery based their doubts on the thesis of Henry Hansmann and Reinier Kraakman, who claimed that it is plausible to argue that a regime of unlimited pro rata shareholder liability and a system of widespread insurance for investors is more efficient than limited liability. See Hansmann & Kraakam, supra note 77, at 1879. For a discussion of justice and efficiency of granting tort creditors "super-priority," see Andrew Price, [Tort Creditor Superpriority and Other Proposed Solutions to Corporate Limited Liability and the Problem of Externalities](#), 2 Geo. Mason U. L. Rev. 439, 441 (1995) ("Th[e] combination of limited liability and bankruptcy frustrates the purposes of tort law by allowing firms to commit torts for which they will not bear the costs. Instead, these costs are forced onto individuals who have the least chance of avoiding or mitigating the damage from the torts. A scheme that places the burden on the party least able to avoid the injury is inefficient.").

[FN79]. For a sustained attack on the thesis of pro rata liability, see Michael P. Coffey, In [Defense of Limited Liability - A Reply to Hansmann and Kraakman](#), 1 Geo. Mason U. L. Rev. 59 (1994). For an investigation of these issues in a parent subsidiary context, especially as it relates to CERCLA, tort and other liabilities, see Robert B. Thompson, [Unpacking Limited Liability: Direct and Vicarious Liability of Corporate Participants for Torts of the Enterprise](#), 47 Vand. L. Rev. 1 (1994). For the classic law and economic discussion of alternative methods (aside from piercing) of eliminating the moral hazard problem of limited liability, see Frank H. Easterbrook & Daniel R. Fischel, [Limited Liability and the Corporation](#), 52 U. Chi. L. Rev. 89, 114- 17 (1985).

[FN80]. Easterbrook and Fischel seem to recognize the inconclusive nature of their argument when they discuss reasons that limited liability still matters despite the fact that firms can duplicate the effect of limited liability. See Easterbrook & Fischel, supra note 7, at 48.

[FN81]. Presser, Corporate Veil, supra note 73, at 1-14; see also Stephen B. Presser, [Thwarting the Killing of the Corporation: Limited Liability, Democracy and Economics](#), 87 Nw. U. L. Rev. 148 (1992) [hereinafter Presser, Limited Liability].

[FN82]. See Presser, Corporate Veil, supra note 73, at 1-15.

[FN83]. See id. at 1-66, 1-67. Indeed, some have argued that the corporation emerged more for political and philosophical reasons than because of any economic need. The democratic urge required easy access to corporate form before there was economic need for it. See, e.g., Note, Incorporating the Republic, supra note 5.

[FN84]. Presser, Corporate Veil, supra note 73, at 1-66 through 1-68.

[FN85]. See, 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](#) (1987).

[FN86]. Presser, Corporate Veil, supra note 73, at 1-19.

[FN87]. See Presser, Limited Liability, supra note 81, at 164.

[FN88]. See id. at 172-76.

[FN89]. See Presser, Corporate Veil, supra note 73, at 1-12.

[FN90]. Butler & Ribstein, Opting Out, *supra* note 37, at 8-10.

[FN91]. The case is also fairly representative of most piercing case scenarios. See Presser, Corporate Veil, *supra* note 73, at 1-21.

[FN92]. 155 N.E. 58 (N.Y. 1926).

[FN93]. See *id.* at 60.

[FN94]. *Id.* at 61.

[FN95]. See Presser, Corporate Veil, *supra* note 73, at 1-21.

[FN96]. *Id.* at 1-27.

[FN97]. See *id.*

[FN98]. I. Maurice Wormser, Piercing the Veil of Corporate Entity, 12 Colum. L. Rev. 496, 517 (1912).

[FN99]. See Presser, Corporate Veil, *supra* note 73, at 1-29.

[FN100]. See Frederick Powell, Parent and Subsidiary Corporations: Liability of a Parent Corporation for the Obligations of Its Subsidiary 4-6 (1931); see also Presser, Corporate Veil, *supra* note 73, at 1-31 to 1-33.

[FN101]. See Presser, Corporate Veil, *supra* note 73, at 1-32.

[FN102]. See *id.*

[FN103]. See, e.g., Richard A. Posner, Economic Analysis of Law 523-25 (4th ed. 1992) (arguing for the superior efficiency of judge made law). But see Leff, *supra* note 58, at 470-73 (discussing the amorality and circularity of the law and economics approach).

[FN104]. Proponents of the concession and economic theory of the firm ignore the problem "posed by American law's dual wish to aid entrepreneurs of modest means by offering limited liability, and at the same time avoid the burden of imposing unforeseen liability on corporate creditors, particularly involuntary ones." Presser, Corporate Veil, *supra* note 73, at 1-49.

[FN105]. *Id.* at 1-9.

[FN106]. *Id.*

[FN107]. However, one must be careful not to claim that any vision of corporate law completely mirrors (as opposed to borrows from) any particular philosophic viewpoint, classical liberal, communitarian, or the like. Paul N. Cox convincingly argues that most major strands of liberalism (represented by Kantian, Humean and Hobbesian variations) as well as most strands of communitarianism (including civic republicanism) can fit any of the many positions on the corporation and its obligation, or lack thereof, to the wider community. See Paul N. Cox, The [Public, the Private and the Corporation](#), 80 *Marq. L. Rev.* 391, 400 (1997). Although Cox argues that nearly all forms of political thought current in the United States today point to some form of legal minimization, whereby the state self-consciously adopts a certain "lack of ambition in law" because the "processes of articulate argument prized within contemporary conceptions of law, while unavoidable in moderation, are incomplete, feeble and very often perverse means of seeking to control [the] social state of being." *Id.* at 529.

[FN108]. Prior to September 1988 there were fewer than 100 LLCs in the two states that had LLC statutes (Wyoming and Florida). See Susan Pace Hamill, The [Limited Liability Company: A Catalyst Exposing the Corporate Integration Question](#), 95 *Mich. L. Rev.* 393, 402-03 n.46 (1996). By 1991 there were 1700 new LLCs filed to do business in the eight states with LLC acts. *Id.* at 440. In 1995 forty seven states accepted 115,000 new LLC filings. *Id.* at 445. By the end of 1995 some 210,000 businesses chose the LLC form since 1988, a growth from 1991 to 1995 of 122.5%. *Id.* at 446. By contrast, between

1988 and 1992 corporation filings with the IRS increased 8.6% and partnership filings decreased 9.2%. Statistics of Income Div., Internal Revenue Serv., Statistics of Income: 1992 Corporations Income Tax Returns; Statistics of Income Div., Internal Revenue Serv., Statistics of Income: 1988 Corporations Income Tax Returns.

[FN109]. Carol R. Goforth, The [Rise of the Limited Liability Company: Evidence of a Race Between the States, But Heading Where?](#), 45 *Syracuse L. Rev.* 1193, 1200 (1995) [hereinafter Goforth, Rise of the LLC].

[FN110]. Florida's statute, the Florida Limited Liability Company Act, was enacted in 1982. [Fla. Stat. Ann. § 608.401-608.514](#) (West 1992). Wyoming's statute, the Wyoming Limited Liability Company Act, was enacted in 1977. [Wyo. Stat. Ann. § 17-15-101](#) (Michie 1977).

[FN111]. IRS [Revenue Ruling 88-76 \(Wyoming LLC\)](#) classified the Wyoming LLC as a partnership for federal tax purposes. This was the first ruling on an LLC's tax status. J. William Callison & Maureen A. Sullivan, Limited Liability Companies, A State-By State-Guide to Law and Practice 85 (1994).

[Treasury regulation § 301.7701-2\(a\)\(1\)](#), based on the Supreme Court's ruling in [Morrissey v. Commissioner](#), 296 U.S. 344 (1935), and often called the "Kitner regulations" after a certain doctor who sought corporate status for his medical practice in the 1950s, Andrew Wecker, [O.R.C. Chapter 1705 - Ohio's New Statute on Limited Liability Companies](#), 56 *Ohio St. L.J.* 951, 962 (1995), listed six characteristics that determine an entity's classification as either a partnership or a corporation for tax purposes: (1) associates; (2) an objective to carry on business for joint profit; (3) continuity of life; (4) centralized management; (5) limited liability; (6) free transferability of interests. Attributes that are common to both partnerships and corporations (the first two in the above list) are irrelevant when determining corporate or partnership status. [Treas. Reg. § 301.7701-2\(a\)\(2\) \(1983\)](#). Therefore, an unincorporated entity would be classified as a corporation if it has three or more of the four remaining corporate characteristics. [Treas. Reg. § 301.7701-2\(a\)\(2\) \(1983\)](#). All four characteristics were equally weighted. [Larson v. Commissioner](#), 66 T.C. 159, 172 (1976) (classifying entity with centralized management and free transferability of interests but without continuity of life and limited liability as a partnership). Since LLCs by definition have limited liability, under the Kitner regulations, see Tassma A. Powers & Deby L. Forty, Comment, [Partnership Taxation & The Limited Liability Company: Check Out the Check-the-Box Entity Classification](#), 32 *Land & Water L. Rev.* 831, 839-46 (1997), an LLC would be classified as a partnership for tax purposes only if it lacked two of the remaining three corporate characteristics: continuity of life, free transferability of interests, and centralized management. In 1992 and 1993 the IRS ruled that it would classify LLCs as partnerships in [Colorado, Rev. Rul. 93-6, 1993-3 I.R.B. 8 \(Dec. 24, 1992\)](#); [Virginia, Rev. Rul. 93-5, 1993 I.R.B. 6 \(Dec. 24, 1992\)](#); [Delaware, Rev. Rul. 93-38, 1993-21 I.R.B. 4 \(May 24, 1993\)](#); and [Nevada, Rev. Rul. 93-30, 1993-16 I.R.B. 4 19, 1993](#). These rulings coincided with the rush to create LLC legislation nationwide. Between 1991 and 1993, 24 states legislated LLC statutes, and in 1994, 12 more states had LLC statutes. See Hamill, supra note 108, at 443-44.

[FN112]. See Callison & Sullivan, supra note 111, at 1 (Supp. 1997).

[FN113]. See supra note 108. The percentage increase in nationwide LLC filings is incredible. From 1991 to 1992 filings increased 411.76%; from 1992 to 1993 filings increased 328.57%; from 1993 to 1994 filings increased 278.26%; and from 1994 to 1995 filings increased from 179.69%. Hamill, supra note 108, at 440-46.

[FN114]. The growth rate of LLCs is probably lowering to a more natural rate after satisfying pent-up demand.

[FN115]. Effective January 1, 1997, the IRS replaced the Kitner regulations with a simplified scheme wherein business organizations can select their classification for tax purposes. Prop. [Treas. Reg. 301.7701-1 to 301.7701-3](#), 61 *Fed. Reg.* 244 (1996). Under the new rules, the first step is to determine whether the business is an entity separate from its owners. Callison & Sullivan, supra note 111, at 17 (Supp. 1997). The new rules also permit entities that have a single owner to choose whether they wish to be recognized as entities for federal tax purposes. Id. All separate entities, except trusts or other exempted entities, are treated as "business entities." Id. The following "business entities" will always be treated as corporations for tax purposes: (1) entities organized under state corporation laws, and (2) other specially listed entities (including joint stock companies, insurance companies, federally insured banks, state owned entities). Id. All other entities are eligible to be treated for tax purposes as either partnerships or corporations. Id. at 17-18. Nearly all publicly traded entities will continue to be treated as corporations for federal tax purposes. [I.R.C. § 7704 \(Supp. 1998\)](#). The impact of these regulations is to make many IRS entity classification rules redundant and to lower the transaction costs of tax filing under the complex and formalistic Kitner regulations. Kenneth H. Heller & Michael K. Carnevale, Check-the-Box Final Regulations Simplify Entity

Classification, 28 Tax Advisor 296, 296-97 (1997). Now the primary factor determining whether an entity will be treated for tax purposes as a corporation or a partnership is whether the entity is subject to the rules relating to public trading. Joint Committee on Taxation Staff Review of Selected Entity Classification and Partnership Tax Issues (JCS-6-97), Issued April 8, 1997, Daily Tax Rep. (BNA) (Apr. 9, 1997), available in Westlaw, 1997 DTR 68 d51 [hereinafter Joint Committee on Taxation Staff Review].

[\[FN116\]](#). See supra note 115.

[\[FN117\]](#). Hamill, supra note 108, at 396.

[\[FN118\]](#). William W. Bratton and Joseph A. McCahery argue that interest group politics was the dominant reason for the spread of the LLC and that regulatory competition can be accorded no more than a secondary role in LLC proliferation. See Bratton & McCahery, supra note 77, at 682-83. The LLC spread not because its form was more efficient, but because special interest groups wanted an entity that would provide them with lower taxes yet still provide limited liability. *Id.* at 683. While their paper discusses the spread of LLCs among the states, it would be very easy to extend their argument to the federal level and show how special interests pushed the IRS to extend partnership taxation in the way it did.

[\[FN119\]](#). Richard A. Booth has argued that a primary reason that the IRS decided to adopt the check-the-box regulations is that little revenue was lost. Richard A. Booth, [The Limited Liability Company and the Search for a Bright Line Between Corporations and Partnerships](#), 32 *Wake Forest L. Rev.* 79, 80 (1997) [hereinafter Booth, Search for a Bright Line]; see also Hamill, supra note 108, at 413.

[\[FN120\]](#). Hamill argues that LLCs are not an "unsanctioned backdoor to corporate integration." Hamill, supra note 108, at 398. Rather, after an in-depth look at IRS revenue figures she concludes that closely held corporations pay a negligible amount of tax, and that the IRS has been unable to prevent closely held corporations from avoiding the corporate tax base. *Id.* at 416. The increased use of LLCs, she argues, "improves the fairness of the business tax system" in that "it levels the playing field" between sophisticated, well-advised small businesses that previously were able to circumvent double taxation, and unsophisticated small businesses that previously were not able to. *Id.* at 430. Furthermore, because of the practical inability of larger businesses to use the LLC form, the new regulations will have practically no effect on the overall corporate tax collected. *Id.* at 436.

[\[FN121\]](#). Booth claims that limited liability is no longer a reliable means of distinguishing between corporations and other forms of business. "The public versus private distinction for taxation purposes is a more satisfying explanation that captures the functional distinction between the two [corporations and partnerships] and is - to a large extent - self-executing." Booth, Search for a Bright Line, supra note 119, at 81. William Klein and Eric Zolt also argue that the relationship between limited liability and corporate tax status is "unsound." William A. Klein & Eric M. Zolt, [Business Form, Limited Liability, and Tax Regimes: Lurching Toward a Coherent Outcome?](#), 66 *U. Colo. L. Rev.* 1001, 1007 (1995). Booth sees the corporate tax as a tax on access to public financing, and strongly implies that differentiating double versus pass through taxation based on whether the entity is publicly traded better serves the goal of tax neutrality (that, ideally, the tax structure should not affect business decisions) than does differentiating tax based on limited liability. Booth, Search for a Bright Line, supra note 119, at 89.

Booth suggests that the standard reasons given for going public - finding greater sources of capital, offering options plans to executives, funding a pension plan, or creating a reliable index for the continuous valuation of the company - are not terribly compelling. *Id.* at 90. Rather, one of the most convincing reasons for a company to go public is to gain access to a public market for shares so that shareholders may be able to cash out some portion of their holdings. *Id.* at 91. Booth concludes that the desire for diversification is a "very strong motivation for going public." *Id.* at 92. Nevertheless, Booth notes that it is still not very clear why companies go public. *Id.* at 94. Indeed, under current laws companies that raise large amount of capital as debt securities can escape corporate taxation while companies that issues stocks cannot. *Id.* at 96. This fact would seem to derail Booth's thesis. However, Booth suggests that one reason that publicly traded companies continue to be taxed twice is because corporations are somehow greater than the sum of their shareholders' interests.

[A] publicly traded corporation is a more discrete entity and is more separate from its owners than is often realized.

Publicly traded stock is different from privately held stock. Because rational shareholders diversify, they buy and sell stocks only as part of a portfolio. Thus, the value of a publicly traded stock is only partially tied to the fortunes of a company. . . . [T]he price of individual stocks may be affirmatively affected by much broader considerations than the prospects of the issuing company. Indeed, it is at least arguable that managers may be required to manage differently when

the stock of their company is publicly traded.

Id. at 98. While Booth is agnostic about whether corporate and partnership taxation should be integrated as a normative matter, *id.*, there are many others who argue for their integration. See, e.g., Patrick E. Hobbs, [Entity Classification: The One-Hundred Year Debate](#), 44 *Cath. U.L. Rev.* 437 (1995).

[FN122]. A number of commentators bemoan the fact that it was the state legislatures that forced the Treasury Department's hand, since this created a plethora of tax entities that are very complicated and confusing and that induce investors to adopt forms of organization that might be suboptimal for them. Klein & Zolt, *supra* note 121, at 1040. While the current situation might have forced the Treasury to come closer to the laudable goal of integration, the move as it was carried out by the states "carries with it consequences that Congress, had it addressed the matter, might well have found it unacceptable." *Id.*

[FN123]. James W. Wetzler, the New York State Commissioner, said of the LLC that "the Federal Government has opened up a candy store." 1992 *Tax Notes Today* 243-10; see also Rachel Maizes, Note, [Limited Liability Companies: A Critique](#), 70 *St. John's L. Rev.* 575, 576-77 (1996) (arguing that LLCs have effectively reduced federal taxation revenue without Congressional approval and little national debate); Goforth, *Rise of the LLC*, *supra* note 109, at 1272-88 (discussing the history of LLC legislation and noting the lack of opposition to it); Jim Oliphant, *Overtaxed and Underused; Limited Liability Companies Would Limit State's Tax Revenues; Critics Say Florida's Antiquated Laws Keep Companies From Using a Corporate Vehicle Popular Elsewhere*, *Broward Daily Bus. Rev.*, Sept. 18, 1997, at A1 (asserting that partnership taxation of LLCs in Florida would cause the state to lose tax revenue). Susan Pace Hamill vigorously denies these claims and argues that partnership taxation of LLCs will have no overall effect on the real corporate tax collected. See Hamill, *supra* note 108, at 436; see also Kelly Thompson, *State Studies Economics of Limited Liability Companies*, 12 *Nashville Bus. J.*, Sept. 30, 1996, at 1 (Tennessee created a commission to study the tax impact of LLCs).

[FN124]. Franklin A. Gevurtz believes that the choice to follow corporate law norms in designing LLCs places minority shareholders at risk from squeeze-outs and freeze-outs. Franklin A. Gevurtz, [Squeeze-Outs and Freeze-Outs in Limited Liability Companies](#), 73 *Wash. U. L.Q.* 497, 498 (1995). While not against LLCs in principle he worries about the potential for minority shareholder oppression, *id.* at 501, and advocates reform along the line of close corporation statutes. *Id.* at 537. For a comparative analysis with European laws on small business entities minority shareholder oppression, see Sandra K. Miller, [Minority Shareholder Oppression in the Private Company in the European Community: A Comparative Analysis of the German, United Kingdom & French "Close Corporation Problem."](#) 30 *Cornell Int'l L.J.* 381 (1997).

[FN125]. Elaine A. Welle argues that due to limited liability, LLC members have less incentive than general partners to investigate or participate actively in the management of the LLC and are therefore more likely to be "passive investors, less informed, less sophisticated, and more dependent on the efforts of others." Elaine A. Welle, [Limited Liability Company Interests as Securities: An Analysis of Federal and State Actions Against Limited Companies Under the Securities Laws](#), 73 *Denv. U. L. Rev.* 425, 459 (1996) [hereinafter Welle, *Analysis of Federal and State Actions*]. Consequently, LLC interests should, contrary to the view of Ribstein and other LLC apologists, be treated as securities. *Id.* at 470. Indeed, it is highly likely that they will be treated as such. *Id.* Welle further argues that the protection granted to investors by considering LLC interests as securities outweighs the costs of doing so. *Id.* at 494; see also Elaine A. Welle, [Limited Liability Company Interests as Securities: Planning and Drafting Strategies Related to Securities Law Considerations](#), 31 *Land & Water L. Rev.* 153 (1996) (explaining why an LLC interest is often a security). But see Larry E. Ribstein, [Form and Substance in the Definition of a "Security": The Case of Limited Liability Companies](#), 51 *Wash. & Lee L. Rev.* 807, 809-10, 828-29 (1994) (arguing that on theoretical grounds courts should strongly presume that LLC interests are not securities, and that on grounds of certainty the form of an investment, not its substance or economic reality, should govern whether it is a security) [hereinafter Ribstein, *Form and Substance*]; Park McGinty, [The Limited Liability Company: Opportunity for Selective Securities Law Deregulation](#), 64 *U. Cin. L. Rev.* 369 (1996) [hereinafter McGinty, *Opportunity*] (arguing that although LLCs will probably be treated as securities, they should not be).

[FN126]. Nearly all commentators agree on the central importance of tax law to the LLC's development. See, e.g., Richard A. Booth, [Profit-Seeking, Individual Liability, and the Idea of the Firm](#), 73 *Wash. U. L.Q.* 539, 562, 563 (1995) [hereinafter Booth, *Idea of the Firm*] (acknowledging the primacy of tax considerations in the spread of the LLC but arguing that the real reason behind the development of LLCs is the slow realization that the proper characteristic by which to distinguish partnership and corporate taxation is not limited liability - since limited liability is mostly illusory - but trading on the secondary markets); Wayne M. Gazur, [The Limited Liability Company Experiment: Unlimited Flexibility, Uncertain Role](#), 58 *Law & Contemp. Probs.* 135, 140, 141 (1995); Gevurtz, *supra* note 124, at 515 (arguing that tax considerations were the

principal motivating factor behind LLC legislation); David S. Hulse & Thomas R. Pope, The Effect of Income Taxes on the Preference of Organizational Forms for Small Businesses in the United States, *J. Small Bus. Mgmt.*, Jan. 1996, at 24 (arguing that taxation is a primary motivator in choice of business forms, including LLCs); Robert R. Keatinge, [Corporations, Unincorporated Organizations, and Unincorporations: Check-the-Box and the Balkanization of Business Organizations](#), 1 *J. Small & Emerging Bus. L.* 201 (1997); Larry E. Ribstein, The [Emergence of the Limited Liability Company](#), 51 *Bus. Law.* 1, 4 (1995) ("The history of the LLC . . . makes clear the importance of partnership tax classification to the LLC's development.") [hereinafter Ribstein, *Emergence*]; Karin Schwindt, Comment, [Limited Liability Companies: Issues in Member Liability](#), 44 *UCLA L. Rev.* 1541 (1997).

[FN127]. See Ribstein, *Emergence*, supra note 126, at 3 (stating the LLC is more straightforward than the S corp); Dale A. Oesterle, [Subcurrents in LLC Statutes: Limiting the Discretion of State Courts to Restructure the Affairs of Small Business](#), 66 *U. Colo. L. Rev.* 881, 883-84 (1995) (arguing that LLC statutes evolved in response to the judge-made doctrines that have prevented firm participants from ordering their firms' internal affairs). Some commentators still believe that the S corporation has some value to investors. First, an LLC might not meet the corporate charter requirement needed in many lines of business, the corporate form is much more familiar than the LLC, and subchapter S is less complicated and simpler than subchapter K. See Joint Committee on Taxation Staff Review, supra note 115, at *25. Additionally, conversion from the S to C corporate form is tax free whereas the conversion from LLC to corporate form is taxable, thus raising costs if an previously formed LLC wishes to trade shares on secondary markets. *Id.*

[FN128]. Filing fees and the amount of information that must be given to the state's filing office is generally less than for corporations. See Callison & Sullivan, supra note 111.

[FN129]. A main benefit of the LLC is its flexibility. See Matthew A. Melone, [Limited Liability Company vs. S Corporation](#), 57 *Tax'n for Acct.* 289, 300 (1996). LLCs generally provide great flexibility in allowing members to opt out of the default provisions in state statutes. See Ribstein, *Emergence*, supra note 126, at 10. Additionally, most state statutes are confused or ambiguous about the relationship between general agency law principles and LLC members allowing sophisticated counsel much room to experiment with redefining fiduciary duties. See Ribstein, *Emergence*, supra note 126, at 10. Ribstein argues that LLCs are so popular because they reduce the transaction costs of doing business. This attribute of LLCs combined with the natural competition among the states for charters led to an explosion of interest in making LLC laws. Larry E. Ribstein, [Statutory Forms for Closely Held Firms: Theories and Evidence From LLCs](#), 73 *Wash. U. L.Q.* 369, 372 (1995) [hereinafter Ribstein, *Closely Held Firms*].

[FN130]. See Callison & Sullivan, supra note 111, at 12.

[FN131]. See *id.* at 5 (Supp. 1997).

[FN132]. See *id.* at 6 (Supp. 1997).

[FN133]. See *id.*

[FN134]. See *id.*

[FN135]. *Id.*

[FN136]. The formations are taxable only if the transferors meet the 80% control test of IRS section 351 to the extent of debt relief. See *id.*

[FN137]. See *id.*

[FN138]. See *id.* For more on the differences between LLCs and other entities, see Jeanne Calderon, A New Breed of Company; Limited-Liability Companies and Partnerships, 12 *Fin. Executive* 49 (1996); Kay O. Wilburn & Frank E. Watkins, Jr., Educating Your Clients About LLCs, 41 *Nat'l Pub. Acct.* 21 (1996); Gover Cleveland et al., Is There a Limited Liability Company In Your Future?, 17 *St. John's U. Rev. Bus.* 26 (1996); Larry E. Ribstein, Limited Liability Companies: [Possible Futures for Unincorporated Firms](#), 64 *U. Cin. L. Rev.* 319 (1996) (comparing LLCs and LLPs) [hereinafter Ribstein, *Possible Futures*]; Mark A. Bonenfant & Chris H. Carlson, The Limited Liability Company - A Useful Alternative to Partnerships and

S Corporations, 17 L.A. Bus. J. 7 (1995) (arguing that LLCs offer simplicity and flexibility for small closely held business that the other entities cannot offer); Paul R. Erickson, Buddy J. Sanders, [Assessing LLCs v. LLPs](#), 28 *Tex. Tech L. Rev.* 1005 (1997) (comparing LLCs and LLPs). For a comparison with other entities available in Delaware, see Edward M. McNally & John H. Small, *Alternative Entities: The Multiple Choices Available in Delaware*, *Del. Law.*, Fall 1994, at 27. For a chart comparing the attributes of California, Delaware and New York LLCs, see Brian L. Schorr et al., [Analysis of the Limited Liability Company Acts of California, Delaware & New York](#), 937 *PLI/Corp* 291 (1996) (a comparison of the LLC acts in California, Delaware, and New York).

[FN139]. See Carol R. Goforth, [Continuing Obstacles to Freedom of Choice for Management Structure in LLCs](#), 1 *J. Small & Emerging Bus. L.* 165, 170 (1997).

[FN140]. See Melone, *supra* note 129, at 300; see, e.g., John M. Cunningham, *The Limited Liability Company: Entity of Choice for High-Tech Start-Ups?*, *Computer Law.*, Apr. 1996, at 11, 20, available in LEXIS, Legnew Library, Cplawr File ("For the organizers of many high tech start-ups, this unique combination of advantages will make the LLC form the best possible business organization form for their enterprise.").

[FN141]. There are fewer than 10 cases that deal with piercing the veil of limited liability of LLCs, and most of them are confused as to whether to apply corporate doctrines or to modify them to the special circumstances of LLCs. See, e.g., [Northern Tankers \(Cyprus\) Ltd., v. Backstrom](#), 967 *F. Supp.* 1391, 1418 (*D. Conn.* 1997) (in action to pierce the veil of many related entities including corporations, trusts, and LLCs, deciding to pierce the entities, but failing to mention the two LLCs by name when listing the over 30 defendant entities whose veil will be pierced); [Ditty v. Checkrite, Ltd. Inc.](#), 973 *F. Supp.* 1320, 1335 (*D. Utah* 1997) (stating court was not presented with enough facts to pierce the veil of an LLC and related entities as a matter of law under the alter ego doctrine, but noting in dicta that most commentators assume that corporate piercing doctrines apply to LLCs); [In re Multimedia Communications Group Wire Assocs. v. Webster](#), 212 *B.R.* 1006, 1010 (*Bankr. M.D. Fla.* 1997) (holding notwithstanding common management, business location, computer network, office equipment, and receptionists, and the absence of a corporate formality, an LLC and other entities related to chapter 7 debtor were not his alter ego because separate books were kept for each entity, funds from investors for each entity were deposited in separate accounts, and each entity was engaged in its own distinct business practice); [Abu-Nassar v. Elders Futures Inc., No. 88 Civ. 7906](#), 1991 *WL* 45062, at *14 (*S.D.N.Y.* 1991) (declining to dismiss summarily defendant's counterclaim to pierce the veil of plaintiff, a Lebanese LLC, because under both Lebanese and New York law it was a triable issue whether the LLC could be pierced, under the alter ego, undercapitalization, and failure to follow formalities doctrines; the court made no distinction between LLCs and corporations when applying piercing doctrine); [Water, Waste & Land, Inc. v. Lanham](#), 955 *P.2d* 997, 1001 (*Colo.* 1998) (holding when a party negotiating with a member or manager of an LLC has no notice that the member or manager is negotiating on behalf of an LLC, member or manager can be held personally liable); [Chaplake Holdings Ltd. v. Chrysler Corp., No. Civ. A. 94C-04-164](#), 1995 *WL* 653510, at 4 (*Del. Super. Ct.* 1995) (court unable to consider whether it would pierce the veil of defendant LLC because it lacks jurisdiction over the matter); [Page v. Roscoe, LLC](#), 497 *S.E.2d* 422, 428 (*N.C. Ct. App.* 1998) (holding it is improper to name an individual member of an LLC as a party defendant without any evidence to support it; so doing could justify rule 11 sanctions).

[FN142]. In [Gallinger v. North Star Hospital Mutual Assurance, Ltd.](#), 64 *F.3d* 422, 427-28 (*8th Cir.* 1995), the court summarily decided not to pierce the veil of an LLC because it did not find that it was sufficiently undercapitalized or that there was an injustice involved in not piercing the veil. Minnesota law requires (1) undercapitalization or lack of formalities and (2) a fundamental unfairness to the plaintiff. *Id.* This case is interesting in that it seems to recognize that LLCs are different from corporations and, perhaps as a result, the court argued that although the elements of the first requirement for piercing the veil exist, since the firm was created as an LLC the second prong is weakened to such a degree that no piercing can exist as a matter of law. The court states that there is no issue of fundamental fairness when "all of the exhibits show that the liability of the NSHMA members was limited from the start by the legislation authorizing the formation of the company in Bermuda." *Id.* at 428. Shaun M. Klein argues that the Gallinger decision has created unreasonably high barriers to piercing an LLC's veil in the Minnesota and the legislature should intervene to prevent a rash of fraudulent activity. Shawn M. Klein, Comment, [Piercing the Veil of the Limited Liability Company. From Sure Bet to Long Shot: Gallinger v. North Star Hospital Mutual Assurance, Ltd.](#), 22 *J. Corp. Law.* 131, 150 (1996). *Water, Waste & Land Inc.* does not count as a definite "piercing" ruling because the case does not really address the piercing issue but focuses on agency law and finds liability solely on that basis.

[FN143]. See Thompson, *Piercing the Corporate Veil*, *supra* note 65, at 1036. For a survey of piercing law and cases, see

Thomas J. Heiden, [The New Limits of Limited Liability: Differing Standards and Theories for Measuring a Parent/Shareholder's Responsibility for the Operations of its Subsidiary](#), 823 *PLI/Corp* 7 (1993).

[FN144]. See Ribstein, *Emergence*, supra note 106, at 9.

[FN145]. See *id.*

[FN146]. See Thompson, *Piercing the Corporate Veil*, supra note 65, at 1075.

[FN147]. See Robert B. Thompson, [The Limits of Liability in the New Limited Liability Entities](#), 32 *Wake Forest L. Rev.* 1, 14 (1997) [hereinafter Thompson, *Limits of Liability*].

[FN148]. See [id. at 21](#).

[FN149]. See [id. at 22](#).

[FN150]. See [id. at 21](#). Thompson does not say that figuring out the particulars of how it will all work will be easy. Debra Cohen-Whelan argues that the doctrinal confusion that will occur when trying to apply corporate piercing doctrines to LLCs will result in under-utilization of the ability to pierce the veil. See Debra Cohen-Whelan, [Individual Responsibility in the Wake of Limited Liability](#), 32 *U.S.F. L. Rev.* 335, 352 (1998).

[FN151]. Presser writes that "[t]he genius of the piercing the veil doctrine is that the doctrine is never likely to be pinned down to rigid particulars." Presser, *Corporate Veil*, supra note 73, at 1-9, 1-33. Generally speaking the categories mentioned in the text are empirically correct and were first promulgated by Powell. *Id.*

[FN152]. See Robert W. Hamilton, *The Corporate Entity*, 49 *Tex. L. Rev.* 979, 988-91 (1971).

[FN153]. See *id.* at 990.

[FN154]. See Steven C. Bahls, [Application of Corporate Common Law Doctrines to Limited Liability Companies](#), 55 *Mont. L. Rev.* 43, 62 (1994).

[FN155]. See Schwindt, supra note 126, at 1562; Cohen-Whelan, supra, note 150, at 358.

[FN156]. See Eric Fox, Note, [Piercing the Veil of Limited Liability Companies](#), 62 *Geo. Wash. L. Rev.* 1143, 1174 (1994); Cohen-Whelan, supra note 150, at 355.

[FN157]. See Fox, supra note 156, at 1177; Cohen-Whelan, supra note 150, at 354.

[FN158]. See Fox, supra note 156, at 1177; Cohen-Whelan, supra note 150, at 354.

[FN159]. See Schwindt, supra note 126, at 1564-65.

[FN160]. See *id.* at 1564.

[FN161]. See *id.* at 1565.

[FN162]. See *id.* at 1562.

[FN163]. Perhaps then, under the communitarian theory, the alter ego doctrine does represent a fraud, the fraud being the misrepresentation by the LLC member to the state that he will not use the rights he is granted to avoid his duties. The LLC member has certain duties as a citizen that cannot be avoided by contract. He asked the state to grant him certain rights under the condition that he would not avoid his duties as a normal citizen. But the whole purpose of asking for those rights was to gain protection so that he could avoid his duties. This is fraud and cannot be allowed.

[FN164]. See Bahls, *supra* note 154, at 63-65; Cohen-Whelan, *supra* note 150, at 362-63. Cohen-Whelan is not as specific in her recommendations as Bahls is.

[FN165]. See Bahls, *supra* note 154, at 63-65; Cohen-Whelan, *supra* note 150, at 362-63.

[FN166]. Another "spanner in the works" of certainty with regard to piercing the veil is CERCLA. CERCLA jurisprudence has increased the ability of the government to pierce the corporate veil of companies. Courts generally have been willing to find shareholder liability only in very narrow and specific sets of circumstances; however, courts are quite willing to find direct parent corporation liability for the CERCLA violations of their subsidiaries. See Cindy A. Schipani, [Infiltration of Enterprise Theory into Environmental Jurisprudence](#), 22 J. Corp. L. 599, 6113-14 (1997). Schipani argues that at least for CERCLA federal courts are moving from simple piercing analysis to Professor Blumberg's liability theory where a parent, who exerted significant control over their subsidiaries, would be held liable for their CERCLA violations, and those that did not would not. All other considerations would become irrelevant. *Id.* at 619. Another problem is the extent of corporate liability when the firm goes bankrupt or dissolves. See, e.g., Ann E. Conaway Stilson, [Reexamining the Fiduciary Paradigm: Defining Directors' Duties to Creditors](#), 20 Del. J. Corp. L. 1, 113-21 (1995).

[FN167]. Wayne M. Gazur claims that one of the unintended consequences of the rush to write LLC statutes will be the creation of an almost entirely contractual, publicly traded entity. See Gazur, *supra* note 126, at 185. Because of the newness and untested nature of the LLC, Gazur advocates a moratorium on LLC legal evolution until the consequences of such a strongly contractual entity can be determined. See *id.* On the other hand, Ribstein, echoing Easterbrook and Fischel, disagree with Gazur's assessment and argue that even in corporations fiduciary duties are merely a species of contract. Larry E. Ribstein, [Fiduciary Duty Contracts in Unincorporated Firms](#), 54 Wash. & Lee L. Rev. 537, 540 (1997) [hereinafter Ribstein, *Fiduciary Duty Contracts*].

[FN168]. See Gazur, *supra* note 126, at 146-65, 174-75.

[FN169]. See *id.* at 174, 175.

[FN170]. See Robert B. Thompson, [The Taming of Limited Liability Companies](#), 66 U. Colo. L. Rev. 921, 936 n.67 (1995) ("States differ on the extent to which they have provided for fiduciary duties in LLCs and as yet there are no judicial interpretations.").

[FN171]. See Callison & Sullivan, *supra* note 111, at 61.

[FN172]. See *id.*

[FN173]. See *id.* at 62.

[FN174]. See *id.*

[FN175]. Ribstein, *Emergence*, *supra* note 126, at 16.

[FN176]. See *id.* at 17.

[FN177]. See *id.* at 18. For an argument that the duty of loyalty is inevitably inadequate to protect shareholder interest because it itself imposes costs on shareholders and suggesting a dissolution right for minority shareholders in its stead, see Park McGinty, [The Twilight of Fiduciary Duties: On the Need for Shareholder Self-help in an Age of Formalistic Proceduralism](#), 46 Emory L.J. 163, 182-224 (1997).

[FN178]. See Ribstein, *Emergence*, *supra* note 126, at 19.

[FN179]. See *id.*

[FN180]. See *id.* at 19-21.

[\[FN181\]](#). See *id.* at 21.

[\[FN182\]](#). See Bahls, *supra* note 154, at 72.

[\[FN183\]](#). See Ribstein, *Emergence*, *supra* note 126, at 17-18.

[\[FN184\]](#). Ribstein finds this development exciting. See Ribstein, *Emergence*, *supra* note 126, at 21; Ribstein, *Fiduciary Duty Contracts*, *supra* note 167, at 570-94 (arguing that non-waivable fiduciary duties are inefficient and unjust). Wayne Gazur views it as potentially threatening. See Gazur, *supra* note 126, at 146-62.

[\[FN185\]](#). See Gazur, *supra* note 126, at 152; see also Richard A. Booth, [Fiduciary Duty, Contract, and Waiver in Partnerships and Limited Liability Companies](#), 1 *J. Small & Emerging Bus. L.* 55, 56-57 (1997) [hereinafter Booth, *Fiduciary Duty, Contract, and Waiver*] (arguing that the ULLCA approach is good because it allows fiduciary duties is waived provided notice of their waiver is given).

[\[FN186\]](#). See Gazur, *supra* note 126, at 152.

[\[FN187\]](#). See *id.* at 147-48; Unif. Limited Liability Co. Act, 6A U.L.A. 429 (1995).

[\[FN188\]](#). See Gazur, *supra* note 126, at 149.

[\[FN189\]](#). See *id.* at 151.

[\[FN190\]](#). See *id.* at 156; Rev. Unif. Partnership Act, 6 U.L.A. 8 (1995).

[\[FN191\]](#). See Gazur, *supra* note 126, at 162; see, e.g., [Perlman v. Feldmann](#), 219 F.2d 173 (2d Cir. 1955); [Zahn v. Transamerica Corp.](#), 162 F.2d 36 (3d Cir. 1947); [Guth v. Loft, Inc.](#), 5 A.2d 503 (Del. 1939); [Lincoln Stores v. Grant](#), 34 N.E.2d 704 (Mass. 1941); [Meinhard v. Salmon](#), 164 N.E. 545 (N.Y. 1928); [Globe Woolen Co. v. Utica Gas & Elec.](#), 121 N.E. 378 (N.Y. 1918).

[\[FN192\]](#). See Gazur, *supra* note 126, at 162-63.

[\[FN193\]](#). See *id.* at 163.

[\[FN194\]](#). See Bahls, *supra* note 154, at 73.

[\[FN195\]](#). See *id.* at 76.

[\[FN196\]](#). See *id.*

[\[FN197\]](#). See *id.* at 78-79.

[\[FN198\]](#). See *id.* at 80.

[\[FN199\]](#). *Id.* at 84-85.

[\[FN200\]](#). See *id.* at 90.

[\[FN201\]](#). See Ribstein, *Emergence*, *supra* note 126, at 21-22.

[\[FN202\]](#). See Claire Moore Dickerson, [Equilibrium Destabilized: Fiduciary Duties Under the Uniform Limited Liability Company Act](#), 25 *Stetson L. Rev.* 417, 419-20 (1995).

[\[FN203\]](#). See *id.* at 455-56. For a classic example of this standard, see [Meinhard v. Salmon](#), 164 N.E. 545, 546 (N.Y. 1928) ("Joint adventurers, like copartners, owe to one another, . . . the finest duty of loyalty. . . . Not honesty alone, but the punctilio

of an honor the most sensitive, is then the standard of behavior.")

[FN204]. See Dickerson, *supra* note 202, at 455.

[FN205]. See *id.*

[FN206]. See *id.* at 461. Dickerson bases her arguments on the permitted harm theory - the amount of harm society will allow one to inflict another. She concludes that in the case of LLCs the harm envisioned here would be too great. See *id.* at 455-56. Fiduciary duty in an LLC context is a complex issue that touches on many aspects of agency and other law. The question of what those duties might be has spurred a number of articles exploring that question in a variety of contexts. For a discussion of an attorney's liability in aiding and abetting a breach of fiduciary duty, see Robert R. Keatinge, *The Implications of Fiduciary Relationships in Representing Limited Liability Companies and Other Unincorporated Associations and Their Partners or Members*, 25 *Stetson L. Rev.* 389, 401-02 (1995). For a discussion of the ability of non-managing members to bind Alabama LLCs, see Mitchel Hampton Boles & Susan Pace Hamill, *Agency Powers and Fiduciary Duties Under the Alabama Limited Liability Company Act: Suggestions for Future Reform*, 48 *Ala. L. Rev.* 143, 153, 158-59 (1996).

[FN207]. See McGinty, *Opportunity*, *supra* note 125, at 371; Welle, *Analysis of Federal and State Actions*, *supra* note 125, at 426.

[FN208]. See Welle, *Analysis of Federal and State Actions*, *supra* note 125, at 428. These cases include: [SEC v. Irwin Harry Bloch](#), *Litigation Release No. 14511*, 59 *SEC Docket* 931, 1995 *WL* 317420 (SEC) (May 25, 1995); [SEC v. United Communications, Ltd.](#), *Litigation Release No. 144577*, 59 *SEC Docket* 424, 1995 *WL* 254714 (SEC) (Apr. 24, 1995); [SEC v. American Interactive Group, LLC](#), *Litigation Release No. 14462*, 59 *SEC Docket* 203, 1995 *WL* 229088 (SEC) (Apr. 10, 1995); [SEC v. Future Vision Direct Mktg., Inc.](#), *Litigation Release No. 14384*, 58 *SEC Docket* 1716, 1995 *WL* 25731 (SEC) (Jan. 18, 1995); [SEC v. Parkersburg Wireless Ltd. Liab. Co.](#), *Litigation Release No. 14085*, 56 *SEC Docket* 1974, 1994 *WL* 186833 (SEC) (May 16, 1994); *Commission Obtains TRO Against Knoxville, LLC*, *SEC News Dig.* 94-130-10, 1994 *WL* 328317 (SEC) (July 12, 1994).

[FN209]. Welles writes that:

Orders have been issued under the securities laws of Colorado, Georgia, Illinois, Indiana, Kansas, Minnesota, Missouri, North Dakota, Pennsylvania, South Dakota, Washington, and Wisconsin. Many are summary cease and desist orders. Some of these orders are available on either Westlaw or Lexis. Unfortunately, many trial and administrative decisions are unreported. For example, California and New York courts, as well as federal courts, frequently do not publish their securities opinions. Joseph C. Long, 12 *blue Sky Laws* xi (1995). As a result, there may be numerous orders relating to alleged violations of state securities laws for the offer and sale of LLC interests that are not reported. See Welle, *Analysis of Federal and State Actions*, *supra* note 125, at 429 n.13.

[FN210]. See *id.* at 430. Of course, if the LLC interest is traded on an exchange, it will be considered a security.

[FN211]. See *id.*

[FN212]. See McGinty, *Opportunity*, *supra* note 125, at 423.

[FN213]. Securities Act of 1933 § 2(1), [15 U.S.C. § 77b\(1\)](#) (1994 & *Supp. II* 1996).

[FN214]. See [SEC v. W.J. Howey Co.](#), 328 U.S. 293 (1946).

[FN215]. See [Landreth Timber Co. v. Landreth](#), 471 U.S. 681 (1985).

[FN216]. See [Reves v. Ernst & Young](#), 494 U.S. 56 (1990).

[FN217]. See McGinty, *Opportunity*, *supra* note 125, at 386; Goforth, *Rise of the LLC*, *supra* note 109, at 1253-70.

[FN218]. See 1 Larry E. Ribstein & Robert E. Keatinge, *Ribstein and Keatinge on Limited Liability Companies* § 14-5 (1992).

[FN219]. [Howey, 328 U.S. at 298-99](#) (stating that an investment contract for purposes of the Securities Act is a scheme "whereby a person is led to expect profits solely from the efforts of the promoter or a third party"); see Ribstein, Possible Futures, *supra* note 138, at 349.

[FN220]. See Ribstein, Form and Substance, *supra* note 125, at 824.

[FN221]. See, e.g., Marc I. Steinberg, *Understanding Securities Law* 28-29 (2d ed. 1996).

[FN222]. See McGinty, Opportunity, *supra* note 125, at 419.

[FN223]. [Gustafson v. Alloyd Co., 513 U.S. 561 \(1995\)](#).

[FN224]. See *id.* at 423.

[FN225]. For example, if the offering and sale of an LLC interest were made without a properly filed registration statement having been declared effective by the SEC (the members thinking that their LLC is not a security) and the LLC interests are indeed securities, unless the sale had a transaction exemption, the sale did not comply with the registration requirements of section 5 of the Securities Act of 1933 and is a violation of section 12(1) of the Act. [15 U.S.C. § 77e\(a\), 1\(1\) \(Supp. II 1996\)](#). As a result, the disgruntled purchasers of LLC interests will be able to recover, with interest, the money they paid for the interests. Under "controlling-person" liability under the Act "controlling persons shall be liable jointly and severally with and to the same extent as such controlled person." So if a seller of the LLC interest were insufficiently liquid to satisfy the liability, the plaintiff could go against the assets of the LLC and all its members. Additionally, because the violation concerns the manner of the offering and not the information disclosed, the pre-existing LLC members (the ones who were members before the sale and not necessarily involved in the sale) would surely be liable. See McGinty, Opportunity, *supra* note 125, at 428. What is disturbing about this potentiality is that no one can be sure in advance whether or not his LLC interests will be considered securities, and there is no case law or commentary on which to base a guess. This makes transactions involving LLC interests extremely risky, negating one of the great promises of the LLC, efficiency.

[FN226]. See [SEC v. Knowville, LLC, Litigation Release No. 14155](#), No. 941073B (RBB), 1994 SEC LEXIS 2099, at *17 (S.D. Cal. July 11, 1994).

[FN227]. See McGinty, Opportunity, *supra* note 125, at 388.

[FN228]. See *id.* The court in Landreth outlined a number of characteristic of stocks, including "(i) the right to receive dividends contingent on apportionment of profits; (ii) negotiability; (iii) the ability to be pledged or hypothecated; (iv) the conferring of voting rights in proportion to the number of shares owned; and (v) the capacity to appreciate in value." Landreth, 471 U.S. at 686. The only thing holding back the full-fledged application of the Landreth test to LLCs is the Court's avowed desire to look to the "plain meaning" of the Securities Acts of 1933 and 1934, and LLCs did not exist when the Act was enacted. *Id.* at 687. However, in *Reves* the Court, in the note context, decided to move beyond the "plain meaning approach" and develop a "family resemblance" test. [Reves, 494 U.S. at 65-67](#). It is thus possible, despite what various commentators mentioned in note 105 might think, that courts will consider LLCs securities under the *Reves* test. See Steinberg, *supra* note 221, at 29.

[FN229]. Larry Ribstein argues strenuously against treating LLC interests as securities. See Ribstein, Possible Futures, *supra* note 138. Ribstein also co-authored one of the leading (and largest) treatises on LLCs. See Ribstein & Keatinge, *supra* note 218.

[FN230]. There is a great deal of uncertainty over the nature of the LLC. The question of whether it should be regulated in a similar fashion to corporations or whether LLCs should be treated as purely a creature of contract depends to a large degree on one's stance toward the principle of freedom of contract. This debate is reflected in an historiographic debate over the LLC's history; did the LLC evolve from the civil law *limitada* or *GmbH*. See, e.g., Thomas E. Geu, [Understanding the Limited Liability Company: A Basic Comparative Primer \(Part One\)](#), 37 S.D. L. Rev. 44, 50 (1992) (stating the limited liability company "is rooted in the traditions of the partnership association (in the United States) and the *limitadas*"); Bahls, *supra* note 154, at 46 ("The concept of limited liability companies originated in Germany more than one hundred years

ago."). The GmbH has many mandatory rules. See Ingrid Lynn Lenhardt, [The Corporate and Tax Advantages of a Limited Liability Company: A German Perspective](#), 64 U. Cin. L. Rev. 551, 562-63 (1996) (detailing how GmbHs differ from LLCs in that LLCs allow more managerial flexibility). The joint stock company has traditionally had very few mandatory rules. See, e.g., William J. Carney, [Limited Liability Companies: Origins and Antecedents](#), 66 U. Colo. L. Rev. 855 (1995) (arguing that LLCs are based on English joint stock corporation law and not on statist civil limitada law, and claiming that the English contract based view of the corporation is far better than the civil law view and that the LLC heralds a return to the contract based view of business organization). For a general history of the close corporation, which unfortunately stops before the LLC began to gain acceptance, see Kelvin H. Dickinson, [Partners in a Corporate Cloak: The Emergence and Legitimacy of the Incorporated Partnership](#), 33 Am. U.L. Rev. 559 (1984).

[FN231]. Robert Thompson notes that LLC default provisions closely mirrored the Kitner regulations for obtaining pass-through tax treatment. Thompson, *Limits of Liability*, supra note 147, at 5. The check-the-box regulations allow a company to choose partnership or corporate taxation so long as it does not trade on the secondary market, irrespective of the company's internal structure. Thompson also notes the belief of a number of observers that this will free the states to change LLC statutes to allow members to make LLCs more corporate in their structure. *Id.*

[FN232]. Thompson argues that such reform is very likely, in light of the predicted competition from limited liability partnerships. LLCs will want to differentiate themselves by becoming more "corporate." *Id.* at 6. Ribstein also makes this prediction. See Larry E. Ribstein, [Changing Statutory Forms](#), 1 J. Small & Emerging Bus. L. 11, 19 (1997) [hereinafter Ribstein, *Forms*]. Indeed, Susan Kalinka has argued that Louisiana should amend its LLC statutes in light of the check the box regulations. LLCs should become more like corporations and less like partnerships, for example, they should allow continuity of life. See Susan Kalinka, [The Louisiana Limited Liability Company Law After "Check the Box,"](#) 57 La. L. Rev. 715, 720 (1997).

[FN233]. According to Wayne M. Gazur there is no theoretic impediment to a publicly traded Delaware or Arkansas LLC. See Gazur, supra note 126, at 174. With the strong likelihood of interstate recognition of the LLC, one state can become a national haven for publicly traded LLCs. P. John Kozyris, [The Limited Liability Company: Does It Exist Out of State? What Law Governs It?](#), 64 U. Cin. L. Rev. 565, 574 (1996) (arguing that there is "little doubt that the LLC personality will be recognized" by other states; however, when dealing with foreign LLCs, courts might apply local as opposed to state of incorporation law). In 1995 the Delaware legislature deleted a provision that stated that once an LLC was no longer treated as a partnership for tax purposes (a necessary consequence of trading on the secondary market) it could be dissolved by any member. Limited Liability Company Act, ch. 75, sec. 21, § 18-802, 1995 Del. Laws. ch. 75 (1995). Finally, in 1997, the Delaware legislature revised the statute to provide that in the absence of an agreement to the contrary, an LLC will have a perpetual existence. [Del. Code. Ann. tit. 6 § 18-801\(a\)\(1\) \(Supp. 1997\)](#); see also Bernard J. Kelley, 1997 Amendments to the Delaware Limited Liability Company Act and Delaware Revised Uniform Limited Partnership Act, *Insights*, Oct. 1997, at 22, 23.

[FN234]. The explosion of avenues for accessing limited liability has caused great consternation about the death of liability. See, e.g., Lynn M. Lopucki, [The Death of Liability](#), 106 Yale L.J. 1 (1996). Lopucki argues that liability, one of the foundations of the modern legal system, is under attack. Without liability civil law will have no enforcement power. Clever lawyering has allowed people and entities to avoid liability entirely, or to such a degree that collection of civil damages is almost impossible. Lopucki views this trend with alarm, although she posits that perhaps with the rapid spread of information technology, giving someone or something a "bad name" came be as damaging and as much an incentive to follow the law as the threat of civil liability. See [id. at 7](#); see, e.g., Clinton W. Francis, *Property Neurosis: Thinking About a Post-Property System for Representing Product 58* (n.d.) (unpublished manuscript written by Northwestern University of Law professor) (on file with author). Others see in the LLC an increased danger of corporate oppression and shady dealings. See, e.g., Gevurtz, supra note 124. Still other commentators see the emergence of the LLC as a vindication of the power of the market and the freedom of contracts, and an occasion for celebration. See, e.g., Oesterle, supra note 127.

[FN235]. There are now over nine entity forms a person can choose for his firm. For example, in Colorado there are general partnerships, limited liability partnerships (LLPs), limited partnerships (LPs), limited liability limited partnerships (LLLPs), limited liability companies (LLCs), limited partnership associations (LPAs), C and S corporations, professional corporations (PCs) and co-operatives. In addition to the above, in Wyoming there is a statutory business trust. See Dale A. Oesterle & Wayne M. Gazur, [What's In a Name?: An Argument for a Small Business "Limited Liability Entity" Statute \(with Three Subsets of Default Rules\)](#), 32 Wake Forest L. Rev. 215 (1997). In Missouri there are around 15 different legal entities

available. See Daniel Grebler, What Difference a Legal Entity Makes, Reuter Bus. Rep., Feb. 27, 1997, available in LEXIS, News Library, Rebus File. For a fascinating article on the development of the short term "virtual corporation," see Ann E. Conaway Stilson, The [Agile Virtual Corporation](#), 22 Del. J. Corp. L. 497 (1997).

[FN236]. Ribstein strongly opposes any attempts at imposing uniformity in LLC laws, instead preferring state experimentation. He believes that the current attempt at uniformity, the Uniform Limited Liability Company Act, is inefficient, and is simply a way of reimposing corporate transaction costs that LLCs tried to avoid. See, e.g., Larry E. Ribstein, [A Critique of the Uniform Limited Liability Company Act](#), 25 Stetson L. Rev. 311 (1995); Ribstein, Forms, supra note 232; Larry E. Ribstein & Bruce H. Kobayashi, [Uniform Laws, Model Laws and Limited Liability Companies](#), 66 U. Colo. L. Rev. 947 (1995). Ribstein argues that the competition among states created a "race to the top" - toward a less regulated and less taxed entity. See Ribstein, Closely Held Firms, supra note 129, at 432. For an analysis of how to preserve the benefits of changing to new entities and how to minimize the transaction costs of doing so (primarily by avoiding uniform laws), see Ribstein, Forms, supra note 232.

Dale A. Oesterle and Wayne M. Gazur, on the other hand, argue for a uniform limited liability entity statute that would be uniform across states. See Oesterle & Gazur, supra note 235. They believe that to avoid needless opportunities for error and confusion there should be a uniform entity statute that allows for three variations; one would be for when all investors are active in management, another for unsophisticated passive investors with exit rights, and a third for sophisticated passive investors. The first would be similar to an LLP, the second a corporation, and the third would be a blank slate, provided the investors were knowledgeable and sophisticated. See id. at 145-48; see also Booth, Fiduciary Duty, Contract, and Waiver, supra note 185, at 55 (arguing that RUPA's and ULLCA's approach is "eminently sound"); John H. Matheson & Brent A. Olson, [A Call for a Unified Business Organization Law](#), 65 Geo. Wash. L. Rev. 1, 4 (1996) (arguing for a standard business organization similar to Oesterle and Gazur's LLCs).

For an overview of the recent history of distinct statutory forms of business organizations and a prediction that they will continue to evolve in a contractual direction, see Robert R. Keatinge, [Universal Business Organization Legislation: Will It Happen? Why and When](#), 23 Del. J. Corp. L. 29 (1998).

[FN237]. See Booth, Idea of the Firm, supra note 126, at 549.

[FN238]. See id.

[FN239]. See id.

[FN240]. See id.

[FN241]. It is this author's contention that the rapid emergence of LLCs is proof of Bernard S. Black's thesis that much of corporate law is trivial. See Black, supra note 1.

[FN242]. See id. at 544.

[FN243]. See id. at 551.

[FN244]. See id. at 559.

[FN245]. See id. Federal rules such as securities laws, Black argues, have a high degree of mandatoriness and are therefore less trivial.

[FN246]. See id. at 573.

[FN247]. See id. at 580.

[FN248]. See id. at 573.

[FN249]. See id.

[FN250]. See Bernard Black & Reinier Kraakman, [A Self-Enforcing Model of Corporate Law](#), 109 Harv. L. Rev. 1911

[\(1996\).](#)

[\[FN251\]](#). See Black, *supra* note 1, at 544.

[\[FN252\]](#). There are a number of schools of thought as to why Delaware has been dominant in corporate law. One school, represented by William Cary, argues that it results from a "race to the bottom" in that Delaware allows corporate charters that favors managers over shareholders. See, e.g., William M. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 *Yale L.J.* 663 (1974). A second school, the "contractarian" or "race to the top" school argues that states compete by offering governance terms that are attractive to both managers and shareholders, and they do this by giving maximum effect to freedom of contract and market forces. See, e.g., Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 *Colum. L. Rev.* 1416 (1989). A third school looks neither at the enabling rules nor the history of corporate law, but at the remaining mandatory rules. This school tends to find efficient adaptation to a complex world. Delaware has succeeded in this view because it has adapted the best. See, e.g., John C. Coffee, Jr., *The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role*, 89 *Colum. L. Rev.* 1618 (1989); Melvin Eisenberg, *The Structure of Corporation Law*, 89 *Colum. L. Rev.* 1461 (1989). A fourth school views Delaware's prominence as a result of a political process neutral to efficient outcomes, and companies hesitate to move from state to state because of high transaction costs. See, e.g., Roberta Romano, *The Genius of American Corporate Law* (1993); Jonathan R. Macey & Geoffrey P. Miller, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 *Tex. L. Rev.* 469 (1987). For a review of Romano's seminal work, see Martin von Haller Groenbaek, *The Genius of American Corporate Law, by Roberta Romano*, 42 *Am. J. Comp. L.* 655 (1994) (book review). Finally, Black argues that there is really little difference between state corporate charters and that the transaction costs associated with moving states is not that high. See Black, *supra* note 1, at 588-91. Rather Black claims that Delaware's advantage stems from its small size and the expertise of its judges and corporate bar. See *id.* Furthermore, Delaware's courts are "quick." See *id.* Curtis Alva agrees with Black that Delaware leads because it reduces agency costs by its small, expert, and nondiverse judiciary, and streamlined and efficient legal process. See Curtis Alva, *Delaware and the Market for Corporate Charters: History and Agency*, 15 *Del. J. Corp. L.* 885, 917-18 (1990). Michael Klausner argues that Delaware has the lead because the abundance of firms there creates network externalities such that the terms used in the corporate charters are more clearly used there and understood. Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 *Va. L. Rev.* 757, 843 (1995).

For an account of how the Delaware courts became dominant in corporate law, especially in its triumph over an early competitor, New Jersey, see Stephen B. Presser & Richard E. Simpson, *Adjusting to the Managerial Revolution: The Law of Corporations in the Federal Courts of Delaware 1900-1941*, 23 *Wm. & Mary L. Rev.* 725 (1982). It is ironic that one of the many reasons for Delaware's dominance cited by Macey & Miller and others is the abundance and certainty of Delaware case law. See Macey & Miller, *supra* note 252, at 484. It will be interesting to see whether Delaware becomes dominant in the LLC arena when it is lacking any significant case law in the area as of writing.

[\[FN253\]](#). As mentioned many times above, how one answers this question is in many ways determinative of one's views on LLCs. For an informal and informative debate on the topic, see Robert W. Hamilton & Larry E. Ribstein, *Limited Liability and the Real World*, 54 *Wash. & Lee L. Rev.* 687 (1997). Hamilton, who believes in mandatory rules for corporations, argues that LLCs are a bad idea because of the dangers of fraud. Ribstein, who is a contractarian, thinks LLCs are great, and argues for something even more broad, a "limited liability thing" that anyone can get just by filing for it. See [id. at 712](#).

[\[FN254\]](#). *Del. Code Ann. tit. 6 § 18-1101 (Supp. 1996)*. For an oblique judicial concurrence with this view, see *Poore v. Fox Hollow Enterprises*, No. C.A. 93A-09-005, 1994 WL 150872 (*Del. Super. Ct. Mar. 29, 1994*). The court ruled that Delaware LLCs could not conduct business in a court without representation by Delaware counsel because an LLC was more like a corporation than a partnership in that it was an artificial entity with limited liability and it was "largely a creature of contract." See *id.* at *2.

For an analysis of the 1994 revision, see Paul M. Altman & James G. Leyden, Jr., *Amendments to the Delaware Limited Liability Company Act*, Insights, Oct. 1994, at 28.

[\[FN255\]](#). *Del. Code Ann. tit. 6 § 18-1101 (Supp. 1996)*.

[\[FN256\]](#). *Id.* § 18-303.

[\[FN257\]](#). Of course, the court would be free to discuss equitable doctrines relating to contract such as unconscionability. Such doctrines might then be expanded to fill in the "vacuum" created by the inability of courts to apply corporate equitable

doctrine. The statute states that "in any case not provided for in this chapter, the rules of law and equity, including the law merchant, shall govern." [Del. Code Ann. tit. 6, § 18-1104 \(1993\)](#). How this might create a contractual basis for the introduction of corporate common law to LLCs will be explored below. For a discussion of a possible relation of this strategy to fiduciary duties in corporations, see Victor Brudney, [Contract and Fiduciary Duty in Corporate Law, 38 B.C. L. Rev. 595, 597-600 \(1997\)](#).

[FN258]. Thompson notes that Delaware courts are fond of finding that legislative action has preempted judicial discretion, and he raises the possibility that they will hesitate to apply common law corporate principles for piercing the veil where the court decides that the limited liability form is being misused by the participants. See Thompson, Limits of Liability, *supra* note 147, at 20-21.

[FN259]. See [Del. Code Ann. tit. 6, § 18-101 to 18-1107 \(1993\)](#).

[FN260]. See Goforth, Rise of the LLC, *supra* note 109, at 1234.

[FN261]. See *id.* at 1235.

[FN262]. See Telephone Interview with Ruth Ann Melson, Librarian, Legislative Council Delaware (Apr. 30, 1998).

[FN263]. H.R. 608, 136th Gen. Assembly, 2d Sess. at synopsis (Del. 1992).

[FN264]. 1994 Del. Laws. 260.

[FN265]. *Id.*

[FN266]. The revision of [section 18-801\(a\)\(1\)](#) that became effective on August 1, 1997, provides that an LLC agreement is dissolved and its affairs shall be wound up upon the first to occur of the following: (1) At the time specified in a limited liability agreement, but if no such time is set forth in the limited liability company agreement, then the limited liability company shall have perpetual existence.

[Del. Code Ann. tit. 6, § 18-801\(a\)\(1\) \(Supp. 1997\)](#).

[FN267]. See Martin I. Lubaroff & Paul M. Altman, Delaware Limited Liability Companies, Insights, Nov. 1992, at 32, 32.

[FN268]. See *id.*

[FN269]. *Id.*

[FN270]. See *id.* at 34.

[FN271]. See *id.* For a sample Delaware LLC Agreement that notes that liability of members is incurred only contractually "pursuant to a separate document," see Thomas W. Van Dyke, Delaware Limited Liability Company Agreement, SB71 ALI-ABA 99, 117, § 7.1(a) (1997).

[FN272]. "The rule that statutes in derogation of the common law are to be strictly construed shall have no application to this chapter." [Del. Code Ann. tit. 6, § 18-1101\(a\) \(1993\)](#).

[FN273]. What the "spirit" of the Act is, is expressly stated in the next subsection. "It is the policy of this chapter to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements." [Id. § 18-1101\(b\)](#).

[FN274]. [Id. § 18-1104](#).

[FN275]. See Nos. 14893, 14713, 1996 Del. Ch. LEXIS 95 (Del. Ch. Aug. 9, 1996).

[FN276]. *Id.* at *28-*29. This notion is echoed by Thompson. See Thompson, Limits of Liability, *supra* note 147, at 20-21.

[FN277]. See David A. Skeel, Jr., [The Unanimity Norm in Delaware Corporate Law](#), 83 Va. L. Rev. 127 (1997); see also Edward B. Rock, [Saints and Sinners: How Does Delaware Corporate Law Work?](#), 44 UCLA L. Rev. 1009 (1997).

[FN278]. See Rock, *supra* note 277, at 1016. Rock writes, "My intuition is that we come much closer to understanding the role of courts in corporate law if we think of judges more as preachers than as policemen." *Id.*

[FN279]. See Skeel, *supra* note 277, at 170-71.

[FN280]. This is compared to 70% of California cases having dissenting opinions and 35% of Indiana cases. See *id.* at 132.

[FN281]. *Id.* at 169.

[FN282]. Rock, *supra* note 277, at 1097-98.

[FN283]. [571 A.2d 1140 \(Del. 1990\)](#).

[FN284]. [637 A.2d 34 \(Del. 1994\)](#).

[FN285]. [Time](#), 571 A.2d at 1152.

[FN286]. *Id.* at 1150.

[FN287]. [QVC](#), 637 A.2d at 51.

[FN288]. See Skeel, *supra* note 277, at 166; see also Rock, *supra* note 277, at 1080.

[FN289]. Rock, *supra* note 277, at 1086. Ellen Taylor comes to a similar conclusion but does not understand why the justices of the Supreme Court violated set doctrine just because they did not like the board in QVC; that the board of directors "'could have done more' is not a reasonable measure of gross negligence." Ellen Taylor, [New and Unjustified Restrictions on Delaware Director's Authority](#), 21 Del. J. Corp. L. 837, 892 (1996). See also her remark that "[t]he Paramount court's attempt to distinguish Paramount from Time and liken it to Revlon is unconvincing to this writer." *Id.* at 892 n.289. Taylor argues that QVC is unjustified under any doctrinal argument one might think of, from statute or precedent, whether unconscionability, good faith, violation of fiduciary duties, etc., and attacks it as promoting uncertainty and inefficiency. *Id.* at 891. Rock argues, however, that for all of its mushiness, Delaware law, "over time . . . yield[s] reasonably determinate guidelines." See Rock, *supra* note 277, at 1101, 1017.

[FN290]. Rock, *supra* note 277, at 1017.

[FN291]. Perhaps Fox's "fairness" doctrine, *supra* note 156, might have a hearing in the Delaware courts after all.

[FN292]. See Rock, *supra* note 277, at 1104. Public shaming of executives should not be discounted; it is a powerful tool. A bad "write-up" in the Wall Street Journal can send a firm's share prices plummeting. See *id.*

[FN293]. Rock mentions this possibility regarding close corporations. See *id.*

[FN294]. See Presser, *Corporate Veil*, *supra* note 73, at 2-63. For discussions of piercing the corporate veil in addition to the Presser treatise, see G. Michael Epperson & Joan M. Canny, [The Capital Shareholder's Ultimate Calamity: Pierced Corporate Veils and Shareholder Liability in the District of Columbia, Maryland, and Virginia](#), 37 Cath. U. L. Rev. 605 (1988); Dana M. Muir & Cindy A. Schipani, [The Intersection of State Corporation Law and Employee Compensation Programs: Is it Curtains for Veil Piercing?](#), 96 U. Ill. L. Rev. 1059 (1996); William Hoffman Pincus, [Piercing the Corporate Veil in Maritime Cases](#), 28 J. Mar. L. & Com. 341 (1997); Boycle L. Graham, Comment, [Navigating the Mists of Metaphor: An Examination of the Doctrine of Piercing the Corporate Veil](#), 56 J. Air L. & Com. 1135 (1991); Note, [Piercing the Corporate Law Veil: The Alter Ego Doctrine Under Federal Common Law](#), 95 Harv. L. Rev. 853 (1982). For piercing in a European context, see Eran Aharon Lev, [European Community Competition Law: Is the Corporate Veil Lifted Too Often?](#), 2 J.

Transnat'l & Pol'y 199 (1993).

[FN295]. [Mobil Oil Corp. v. Linear Films, Inc.](#), 718 F. Supp. 260, 268 (D. Del. 1989).

[FN296]. [Pauley Petroleum, Inc. v. Continental Oil Co.](#), 239 A.2d 629, 633 (Del. 1968).

[FN297]. See Presser, Corporate Veil, supra note 73, at 2-65; see also [Mabon, Nugent & Co. v. Texas Am. Energy Corp.](#), Civ. A. 8578, 1988 WL 5492, at *3 (Del. Ch. Jan. 27, 1988) ("Fraud is frequently cited as a basis on which to pierce the corporate veil, but it is not the only one.").

[FN298]. See, e.g., [Sonne v. Sacks](#), 314 A.2d 194, 197 (Del. Super. Ct. 1973). The court stated, "In our opinion, piercing the corporate veil may be done only in the Court of Chancery, when the purpose of the action is to obtain a judgement against individual stockholders or officers, or against other corporations which have received assets without consideration." Id. The court went on to say that Delaware continued to make a distinction between law and equity and that as a consequence "[d]ecisions of courts in other states on this point are accordingly of little help to us." Id. This is still the rule. See, e.g., [Chaplake Holdings Ltd. v. Chrysler](#), No. Civ. A. 94C-04-164, 1995 WL 653510, at *4 (Del Super. Ct. Aug. 11, 1995).

[FN299]. See Presser, Corporate Veil, supra note 73, at 2-65.

[FN300]. See [Irwin & Leighton, Inc. v. W.M. Anderson Co.](#), 532 A.2d 983 (Del. Ch. 1987).

[FN301]. Id. at 987.

[FN302]. Id. To see how this might work in the context of trade secret misappropriation, see [Miles, Inc. v. Cookson America, Inc.](#), No. Civ. A. 12,310, 1994 WL 676761 (Del. Ch. Nov. 15, 1994).

[FN303]. [Irwin & Leighton](#), 532 A.2d at 987.

[FN304]. Id. at 989.

[FN305]. Id.

[FN306]. Id. (emphasis added).

[FN307]. See Presser, Corporate Veil, supra note 73, at 2-69.

[FN308]. No. Civ. A. 1131, 1989 WL 110537 (Del. Ch. Sept. 19, 1989).

[FN309]. Id. at *4.

[FN310]. Id. But see [Geyer v. Ingersoll Publications Co.](#), 621 A.2d 784 (Del. Ch. 1992) (seeming rejection of alter ego theory).

[FN311]. 702 F. Supp 1097, 1104 (D. Del. 1988). For another federal case that adopts the alter ego theory for Delaware, see [Phoenix Canada Oil Co., Ltd. v. Texaco, Inc.](#), 658 F. Supp. 1061 (D. Del. 1987).

[FN312]. [Golden Acres](#), 702 F. Supp. at 1104.

[FN313]. See Presser, Corporate Veil, supra note 73, at 2-70.1

[FN314]. [Harco](#), 1989 WL 110537, at *5.

[FN315]. See Presser, Corporate Veil, supra note 73, at 2-70.3.

[FN316]. Id. at 2-70.3. The federal courts have already reached that conclusion, or something close to it. See, e.g., [In re](#)

[Phillips Petroleum, Securities Litig., 738 F. Supp. 825, 838 \(D. Del. 1990\)](#) ("Delaware courts have also stated, although not held, that the corporate veil may be pierced where a subsidiary is in fact a mere instrumentality or alter ego of its parent."); [Harper v. Delaware Valley Broadcasters, Inc., 743 F. Supp. 1076, 1085 \(D. Del. 1990\)](#) ("Although the United States District Court of the District of Delaware has recognized the alter ego doctrine for some time . . . , application of the alter ego theory is something of a new development in the Delaware courts.").

[FN317]. See, e.g., Revised [Unif. Partnership Act § 306\(a\)](#), 6 U.L.A. 8 (1995). For a discussion of RUPA's attitude toward limited liability of partners, see Robert W. Hillman et al., *General and Limited Liability Partnerships Under the Revised Uniform Partnership Act 107-08*, 312-14 (1996).

[FN318]. See [Del. Code Ann. tit. 6, § 17-303 \(1997\)](#).

[FN319]. See [id. § 17-303\(b\)](#).

[FN320]. *Id.* § 1515(b). It is difficult to speculate on the true advantages of an LLP vs. an LLC aside from vague cultural issues of being a partner versus a shareholder. See Robert W. Wood, *Limited Liability Partnerships* 26 (1997). Yet there definitely seems to be some advantage, since the rate of growth of new LLCs is much greater than that of new LLPs. See sources cited *supra* note 108.

[FN321]. *Del. Code Ann. tit. 6, § 1515(c)*.

[FN322]. *Id.* § 1515(b).

[FN323]. See Allan R. Bromberg & Larry E. Ribstein, *Limited Liability Partnerships and the Revised Uniform Partnership Act* 123 (1997).

[FN324]. See *id.* at 126. This language is not intended to increase liability of supervisors, rather it is intended "only to make clear that the liability protection of the LLP does not extend to one's own acts (whether those acts may be those of the partner personally with respect to himself or herself, or relate to some supervisory role)." Wood, *supra* note 320, at 15. Another form of protection is a Limited Liability Limited Partnership, i.e., when a limited partnership becomes a limited liability partnership. In LLLPs, the general partners of the LP have the same limited liability protection as partners in an LLP, Bromberg & Ribstein, *supra* note 323, at 195, while the limited partners of the LP may control the LLLP to a much greater extent than they can in a normal LP. *Id.* Some states have argued for eliminating the "control" rule in its entirety for LLLPs, see, e.g., [Ga. Code Ann. § 14-9-303 \(1998\)](#) (providing that limited partners are not liable as such for the debts of the business), but with the availability of LLCs most states have decided not to bother, Bromberg & Ribstein, *supra* note 323, at 196.

[FN325]. See Bromberg & Ribstein, *supra* note 323, at 130.

[FN326]. See *id.*

[FN327]. See [Del. Code Ann. tit. 12, § 3801 \(1997\)](#).

[FN328]. *Id.* § 3803(a).

[FN329]. *Id.* § 3803(b).

[FN330]. *Id.* § 3803(c).

[FN331]. See [id. § 3809](#).

[FN332]. See Sheldon Jones, et al., *The Massachusetts Business Trust and Registered Investment Companies*, 13 *Del. J. Corp. L.* 421, 423-29 (1988) (arguing that business trusts have a long history and occur where governments create impediments to the formation of limited liability entities). For an extended argument that trusts are creatures of contract law, see John H. Langbein, *The Contractarian Basis of the Law of Trusts*, 105 *Yale L.J.* 625 (1995) [hereinafter Langbein,

Contractarian Basis]; see also Richard A. Epstein, [Contract and Trust in Corporate Law: The Case of Corporate Opportunity](#), 21 *Del. J. Corp. L.* 5 (1996).

[FN333]. See John H. Langbein, The [Secret Life of the Trust: The Trust as an Instrument of Commerce](#), 107 *Yale L. J.* 165, 166, 189 (1997) [hereinafter Langbein, *Secret Life of the Trust*] (arguing that "there is no mystery" why trusts are so attractive; the trust's "contract-like regime" offers a regime "superior to that of corporate law, packaged in a way that facilitates pass-through taxation"). For a comparative analysis of business trust law and how it adapted to the civil law environment of Japan, see Yoshiki Shimada, et al, [Regulatory Frameworks for Pooled Investment Funds: A Comparison of Japan and the United States](#), 38 *Va. J. Int'l L.* 191 (1998).

[FN334]. See, e.g., Van Kampen American Capital Funds, Notice of Annual Meeting of Shareholders 14 (Sept. 11, 1996), quoted in Langbein, *Secret Life of the Trust*, supra note 333, at 188 (Van Kampen proxy statement advocates becoming a DBT); Karen Blumenthal, Fidelity Sets Vote on Scope of Investments, *Wall St. J.*, Dec. 8, 1994, at C1 (Fidelity converted a group of money market funds from Massachusetts Business Trusts to a DBT because DBTs allow fewer shareholder meetings and a smaller quorum of voting shares).

[FN335]. While there has been no case law on the subject, the Delaware statutory law tries to make it clear that the trustee should not be held liable. Langbein, *Secret Life of the Trust*, supra note 333, at 184 n.110.

[FN336]. Langbein, *Contractarian Basis*, supra note 332, at 660.

[FN337]. Langbein hints at this possibility with regard to fiduciary duties. See Langbein, *Contractarian Basis*, supra note 332, at 655.

[FN338]. See Grant Gilmore, *The Death of Contract* (1974); Richard Speidel, *An Essay on the Reported Death and Continued Vitality of Contract*, 27 *Stan. L. Rev.* 1161 (1975). Robert A. Hillman provides an excellent overview of the issues in the controversy. Hillman, *Richness of Contract Law*, supra note 10, at 8-41; see also Amy H. Kastely, [Cogs or Cyborgs?: Blasphemy and Irony in Contract Theories](#), 90 *Nw. U. L. Rev.* 132, 144 (1995) (arguing that Gilmore was secretly advocating an extreme freedom of contract position by painting the alternatives in such a nasty light). For arguments that contract theory no longer matters, see E. Allan Farnsworth, [Developments in Contract Law During the 80s: The Top Ten](#), 41 *Case W. Res. L. Rev.* 203, 225 (1990) (discussing the failure of contract theory to have a meaningful impact on contract practice); Hillman, *Richness of Contract Law*, supra note 10, at 269 (arguing that no one theory can capture the "multiplicity of principles, goals and methods of contract law," and that contract law is too rich for a single theory). But see Jay Feinman, [The Significance of Contract Theory](#), 58 *U. Cin. L. Rev.* 1283, 1285, 1318 (1990) (arguing that theories of contract frame how we approach problems, and our politics, in many ways, determine our choice of theory).

[FN339]. For example, Ian MacNeil and the relational contract school argue that contract law reflects the balance of power between various parties to a contract, and that social norms are highly intertwined within all contracts; even the most discrete ones are embedded in a complex fabric of relations. The relational contract school (in many ways mirroring the legal realists and critical legal studies) argue that the law of contract is a kind of platform for the expression of ideology. Robert W. Gordon, [Macaulay, MacNeil, and the Discovery of Solidarity and Power in Contract Law](#), 1985 *Wis. L. Rev.* 565, 578 (1985). Gordon adds:

[T]he law embodies a set of fantasies about the world that become real when people act upon them as if they are real: when, for example, people accept the terms of a deal imported upon them by powerful others as the product of circumstances and their own volition rather than simply of the power of others, or when they abandon a lifelong trading or business partner because the relation is no longer profitable. Freedom of contract means, among other things, never having to say you are sorry.

Id.; William C. Whitford, [Ian MacNeil's Contribution to Contracts Scholarship](#), 1985 *Wis. L. Rev.* 545 (1985).

Critics of MacNeil's school point out the school's communitarian posture. They claim communitarianism, and by extension, relational contract, works best "precisely where each person in the relevant community is fully capable of protecting itself without direct recourse to legal entitlements." Randy E. Barnett, [Conflicting Visions: A Critique of Ian MacNeil's Relational Theory of Contract](#), 78 *Va. L. Rev.* 1175, 1204 (1992). Neo-classical contract theory, which Barnett describes as liberal, is useful because it provides formal rules and legal entitlements which become very necessary in a heterogeneous culture or society, or when "social consensus and sanctions fail." Id.

[FN340]. See, e.g., Randy E. Barnett, . . . And Contractual Consent, 3 S. Cal. Interdis. L. J. 421, 424-26, 441 (1993) (arguing that law and economics ignores the problem of law's legitimacy and fails to answer the normative question of whether one has a moral obligation to follow the law, and stresses the importance of justice as a critique of formal rules of law); Jean Braucher, The [Afterlife of Contract](#), 90 Nw. U. L. Rev. 49 (1995) (arguing for a "law in action" approach to teaching contract law that looks not just to academic law, but contract law as practiced even before it reaches lawyers); Melvin Aron Eisenberg, The [Limits of Cognition and the Limits of Contract](#), 47 Stan. L. Rev. 211, 226 (1995) (arguing that the high costs of information gathering and the unreliability of human information processing due to humanity's bounded rationality justify specialized treatment of certain contracts that violate the formal rules favoring freedom of contract); Blake D. Morant, [Contracts Limiting Liability](#), 69 Tul. L. Rev. 715, 778 (1995) ("Even those who argue the absolutist position of the supremacy of the freedom of contract doctrine must also recognize that 'freedom' includes the discretion not to enforce agreements."); Eric Posner, [Law Economics, and Inefficient Norms](#), 144 U. Pa. L. Rev. 1697 (1996) (raising the possibility that private norms might be inefficient and state intervention in contract might be necessary); Edward L. Rubin, [Beyond the Shadow of the Law](#), 90 Nw. U. L. Rev. 107 (1995) (arguing that one needs to look to the non-legal aspects of contract law, beyond formal rules and to what people writing and dealing with contracts actually do); G. Richard Shell, [Substituting Ethical Standards for Common Law Rules in Commercial Cases: An Emerging Statutory Trend](#), 82 Nw. U. L. Rev. 1198 (1988) (discussing the emergence of mixed theories of commercial liability based on the goals of promoting trust and honesty in business relations); Richard E. Spiedel, The [Shifting Domain of Contract](#), 90 Nw. U. L. Rev. 254 (1995) (arguing that commentators should focus on contract practice not just contract law). But see Ralph James Mooney, The [New Conceptualism in Contract Law](#), 74 Or. L. Rev. 1131 (1995) (arguing that the general trend is for favoring individualism over community in contract law, reversing the trend started in the Sixties); Douglas K. Newell, [Will Kindness Kill Contract?](#), 24 Hofstra L. Rev. 455 (1995) (arguing that relational and good faith doctrines are creating a form of commercial palimony for parties with weaker contracting positions); Farnsworth, supra note 338, at 223 (discussing the trend in the 80s was against the unconscionability doctrine).

[FN341]. For a survey of the arguments for and against unconscionability, see Hillman, Richness of Contract Law, supra note 10, at 132-67. The classic article on unconscionability which, while describing and denigrating (the UCC's version of) the doctrine as "amorphously unintelligible," ironically provided the framework thorough which most later scholarship viewed unconscionability (i.e., differentiating between procedural and substantive unconscionability), is Arthur Allen Leff, [Unconscionability and the Code. The Emperor's New Clause](#), 115 U. Pa. L. Rev. 485 (1967).

For a more recent analysis attempting to derive a more formal procedure for applying unconscionability, see Richard Craswell, Property Rules and Liability Rules: Unconscionability and Related Doctrines (Jan. 5, 1993) (unpublished conference paper delivered at the University of Chicago Law School Workshop in Law and Economics); see also Robert S. Adler & Richard A. Mann, [Good Faith: A New Look at an Old Doctrine](#), 28 Akron L. Rev. 31 (1994) (discussing and defining the doctrine of good faith).

[FN342]. Steven J. Burton & Eric G. Anderson, Contractual Good Faith: Formation, Performance, Breach, Enforcement 21 (1995). The case law provides another example of how doctrines can be warped to mean things different than originally intended. Here a doctrine designed to increase paternalistic action by the state, on its own terms, was severely limited by giving it a free-market twist.

[FN343]. See Craswell, supra note 341, at 6.

[FN344]. See Booth, Idea of the Firm, supra note 126, at 549; Easterbrook & Fischel, supra note 7, at 50-53.

[FN345]. The cases require what Leff called procedural and substantive unconscionability. See Leff, supra note 341. Courts rarely find unconscionability when just one factor is present.

[FN346]. Hillman, Richness of Contract Law, supra note 10, at 144, 134.

[FN347]. See id. at 161-67. An additional problem is that unconscionability doctrines tend to be applied almost exclusively to sales of consumer goods and it is unclear how it would apply to other contracts.

[FN348]. A Westlaw search on March 27, 1998 of the state cases library using the search "Contract w/20 unconscion!" turns up 59 hits in Delaware, 88 in Indiana, 220 in Illinois, 294 in California, and 506 in New York. A Westlaw search, also on March 27, 1998, of the state headnote library using the search "Contract and Unconscion!" turns up 28 hits in Delaware, 88 in

Indiana, 230 in Illinois, 273 in California, and 501 in New York.

[FN349]. See [Tulowitzki v. Atlantic Richfield Co.](#), 396 A.2d 956, 960 (Del. 1978).

[FN350]. [Del. Code Ann. tit. 6, § 2-302 \(1993\)](#).

[FN351]. See [Tulowitzki](#), 396 A.2d at 960.

[FN352]. This was discussed in the venerable [Williams v. Walker-Thomas Furniture Co.](#), 350 F.2d 445, 450 n.12 (D.C. Cir. 1965) (stating contract is unconscionable if it is "such as no man in his sense and not under delusion would make on the one hand, and no honest or fair man would accept on the other").

[FN353]. See [Tulowitzki](#), 396 A.2d at 959; [Graham v. State Farm Mut. Auto. Ins. Co.](#), 565 A.2d 908, 912 (Del. 1989); [Burge v. Fidelity Bond & Mortgage Co.](#), 648 A.2d 414, 420 (Del. 1994).

[FN354]. The test asks whether the terms are so extreme as to appear unconscionable according to the mores and business practices of that time and place. [Tulowitzki](#), 396 A.2d at 959.

[FN355]. Granting judges too much discretion is the precise problem with unconscionability pointed out by the neo-formalists. This problem was noticed as far back as the 17th century when John Selden noted that "one chancellor has a long foot, another, a short foot, a third an indifferent foot: 'tis the same thing in the Chancellor's conscience." John Selden, *Equity*, in *Table Talk*, quoted in John D. Calamari & Joseph M. Perillo, *Contracts* § 9-40 n.76 (3d ed. 1987). Perhaps the indeterminacy of modern ethics, see, e.g., Leff, *supra* note 58 (arguing that under today's ethics it is impossible to condemn with philosophical certainty the murder of babies, and that is why law and economics is so attractive; it provides a meta-theory for critiquing the law), is why Richard Posner refuses to acknowledge that good faith and unconscionability inject moral or ethical principles into law but instead argues that they are a "stab at approximating the terms the parties would have negotiated had they foreseen the circumstances that have given rise to their dispute." [Market Street Assoc. v. Frey](#), 941 F.2d 588, 595 (7th Cir. 1991). In other words, law and economics tries to masquerade as an objective basis with which to evaluate the consequences of judicial action. But law and economics scholars forget or ignore that they are also promoting subjective, normative values. Leff, *supra* note 58.

[FN356]. This brings us back full circle back to Berlin's thesis of the incommensurability of ultimate values discussed in *supra* note 4.

[FN357]. See Thompson, *Limits of Liability*, *supra* note 147, at 22.

[FN358]. See *id.* at 21.

[FN359]. In this list the author assumes that efficiency arguments (whose normative values include personal autonomy and private property), democracy, as well as a communitarian concern for society's losers and proper "manners" in the market place, all tap into values deeply held by the American people. This is not the place to prioritize those values, even if, contra Berlin, one believes such a thing is possible. The only hope is that the courts consider all the values when contemplating the potential costs and benefits of piercing a particular LLC's veil of limited liability. It is only by considering all the values behind limited liability that courts will be able to placate another value that Americans hold dear: justice. Justice requires that the law be more or less uniform and applied with a degree of consistency. This article has consistently argued that stability in limited liability law is hard to come by, but that broad based view of the purpose of limited liability can help minimize the see-sawing between extremes that is so characteristic of the law in this area. For an analysis of the relationship between stability in the law and justice, see P.S. Atiyah & R.S. Summers, *Form and Substance in Anglo-American Law* (1987).

[FN360]. See the theories of Hansmann, Kraakman, and Booth, discussed in *supra* notes 78, 79, 237-240.

[FN361]. Whether one wants to assign a public choice theory explanation or more noble reasons to the phenomenon is immaterial. For a general discussion of public choice theory, see Edward L. Rubin, [Public Choice and Legal Scholarship](#), 46 *J. Legal Educ.* 490 (1996).

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