Delaware Joins Virginia in Allowing Reverse Veil-Piercing Under Certain Circumstances

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09.21.2021

Recently, the Delaware Court of Chancery (the ?Court?), expanded the potential liability of a parent company?s subsidiaries by allowing reverse veil-piercing in *Manichaean Cap., LLC. v. Exela Techs., Inc.,* C.A. No. 2020-0601-JRS, (Del. Ch. May 25, 2021) (the ?Case?).

The Case arose out of a merger between SourceHOV Holdings, Inc. (Holdings) and Exela Technologies, Inc. (Exela). The plaintiffs, former stockholders of Holdings, dissented from the merger and were awarded an appraisal judgment. The plaintiffs sought to hold Holdings and its affiliated entities accountable for the appraisal judgment because the judgment could not be paid by the appraisal judgment debtor. In deciding the Case, Delaware joins Virginia and North Carolina in recognizing reverse veil-piercing. *See C.F. Trust, Inc., et al. v. First Flight Limited Partnership*, 580 S.E.2d 806 (Va. 2003); *Strategic Outsourcing, Inc. v. Stacks*, 626 S.E.2d 800 (N.C. Ct. App. 2006).

The plaintiffs successfully sought liability against Exela and its subsidiaries under two theories: (1) piercing the corporate veil upwards to reach Exela based on the abuse of corporate form by Exela through fraudulent actions, which is traditional veil-piercing, and (2) piercing the corporate veil downwards to reach Holdings? subsidiaries to enforce the charging order against those entities, which is reverse veil-piercing.

The Case was one of first impression as historically the Court has only recognized traditional veil-piercing whereby a plaintiff pierces the corporate veil by going upwards to reach a parent company?s assets when the corporate form is used to hide assets or engage in some other fraud or injustice. In contrast, reverse veil-piercing ?involves the imposition of liability on a business organization for the liabilities of its owners.? *Id.* at 25. In the context of a parent and subsidiary relationship, the Court treats the assets of the subsidiary as those of the parent when the subsidiary is merely an *alter ego* of the parent. *Id.* at 25-26.

The Court had to determine what factors should be used when reviewing a claim for reverse veil-piercing. *Id.* at 4, 35. The Court explained that the analysis should begin with the factors that Delaware courts employ when reviewing a traditional veil-piercing claim, which are often called the ?alter ego? factors. *Id.* at 35. These include ?insolvency, undercapitalization, commingling of corporate and personal funds, the absence of corporate formalities and whether the subsidiary is simply a façade for the owner.? *Id.* Then, the Court should inquire whether the owner is using the corporate form to perpetuate fraud or injustice, focusing on an additional eight factors. *Id.* at 35-36. In this instance, the Court determined the factors were appropriately satisfied to allow reverse veil-piercing. The analysis is extremely fact specific and focuses on whether reverse veil-piercing is the only means by which the plaintiffs can collect the appraisal judgment.

The Court emphasized the limited circumstances under which reverse veil-piercing should be allowed and appears focused on ensuring that no innocent parties are harmed by allowing reverse veil-piercing. Whether plaintiffs are successful in pleading this theory will be fact specific and limited to special circumstances but may subject subsidiaries to liability for the parent?s debts. This Case indicates that reverse veil-piercing continues to be recognized by the courts and that, moving forward, companies doing business in Delaware should expect to see this theory arise more often in pleadings. In addition, many other states look to Delaware as a standard of corporate law and, after this Case, are more likely to use it as precedent and recognize reverse veil-piercing in the future.

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