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Piercing the Nonprofit Corporate Veil

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PIERCING THE NONPROFIT CORPORATE VEIL

I. INTRODUCTION

Statistics indicate that as many as one-half of the organizations and enterprises in the United States today are nonprofit in nature.[1] Many of those nonprofit organizations and enterprises are corporations.[2] In fact, as many as one-fifth of all of the corporations in the United States are nonprofit and that proportion is steadily growing.[3] Despite this growth, the law applicable to nonprofit corporations remains at a remarkably immature state of development.[4] Many legislatures have merely superimposed general corporate law on nonprofit corporations.[5] Often these enactments merely de-

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1. Oleck, *Nature of Nonprofit Organizations in 1979*, 10 U. TOL. L. REV. 962, 962 (1979).

2. Some jurisdictions refer to these corporations as nonprofit while others call them not-for-profit. Both terms can be used interchangeably since there is no essential distinction between them. Hansmann, *Reforming Nonprofit Corporation Law*, 129 U. PA. L. REV. 497, 501 n.3 (1981). In this comment the term nonprofit corporation will be used.

3. Hansmann, *supra* note 2, at 500. The vast array of incorporated charities includes hospitals, youth centers, museums, the Red Cross and fund raising organizations which solicit for worthy causes. Other nonprofit corporations include consumer protection groups, community development leagues, community service organizations, social groups, country clubs and trade and political associations. Brown, *The Not-For-Profit Corporation Director: Legal Liabilities and Protection*, 28 FED'N INS. COUNS. Q. 57, 58 (1977).

4. Brown, *supra* note 3, at 58. Nonprofit corporations are currently regulated by diverse statutory formulations. Some jurisdictions have general corporation statutes which govern both profit and nonprofit corporations with only minimal distinctions provided for nonprofit corporations. Other jurisdictions have enacted separate profit and nonprofit corporation statutes. Still other statutes governing nonprofit corporations are so scattered throughout the state codes, they defy classification. Henn & Boyd, *Statutory Trends in the Laws of Nonprofit Organizations: California, Here We Come*, 66 CORNELL L. REV. 1103, 1107 (1981). *See also* 1 W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 2.4 (rev. perm. ed. 1974).

5. Ellman, *On Developing a Law of Nonprofit Corporations*, ARIZ. ST. L.J. 153, 154 (1979); Henn & Boyd, *supra* note 4, at 1104. The Model Nonprofit Corporation Act was consciously drafted to follow the Model Business Corporation Act as closely as possible. There are deviations only where necessary. This enables a jurisdiction adopting the Act to use the large body of case law that has developed through interpretations of the Model Business Corporation Act. Hansmann, *supra* note 2, at 528. *See generally* MODEL NONPROFIT CORP. ACT (1964). Those jurisdictions adopting the Model Nonprofit Corporation Act include: ALA. CODE §§ 10-3-1 to -72 (1975); ALASKA STAT. §§ 10.20.005-.725 (1962); ARK. STAT. ANN. §§ 64-1901 to -1921 (1980); GA. CODE ANN. §§ 22-2101 to -3120 (1977); MINN. STAT. ANN. §§ 317.01-.69 (West 1969); N.J. STAT. ANN. §§ 15.1-1 to -23 (West 1937); OHIO REV. CODE ANN.

fine the organizational requirements. For answers to any other questions, the researcher is directed to the business corporate law of the particular jurisdiction.[6]

Incorporation affords a nonprofit organization limited liability, perpetual duration and centralized organization, while still allowing many of the special state and federal tax exemptions provided for nonprofit organizations.[7] In addition, the nonprofit structure may be chosen by the incorporator because of the positive image a nonprofit corporation conveys to the consuming public.[8] However, the abrogation of the doctrine of charitable immunity and the emergence of new bases for liability, such as corporate negligence,[9] means that nonprofit corporations no longer enjoy special protections. Moreover, their increased involvement in business enterprises has drawn a considerable amount of attention.[10] Owing to their nonprofit nature, caution must be used in defining the powers and duties of their officers, directors and members and in assuring that the boundaries of permissible conduct are not overstepped. The confusion surrounding nonprofit corporate law does not make that task easy.

In particular, it is unclear whether the corporate disregard doctrine will be applied in many jurisdictions to nonprofit corporations. Because of the basic differences between profit and nonprofit corporations there are several inherent problems which will be addressed in this comment.[11] Al-

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§§ 1702.01-.99 (Page 1978). Wisconsin adopted the Model Nonprofit Corporation Act in 1953. WIS. STAT. §§ 181.01-.78 (1953).

6. Ellman, *supra* note 5, at 154.

7. Taft, *Control of Foundations and Other Non-Profit Corporations*, 18 CLEV. ST. L. REV. 478, 478 (1969); Note, *New York's Not-For-Profit Corporate Law*, 47 N.Y.U. L. REV. 761, 761 (1972).

8. Ellman, *supra* note 5, at 158 n.14. It is suggested that the title "nonprofit" may be the "most important benefit the state can confer upon any entity. The public reacts with a disarmed sense of generosity in the face of such a label." Fessler, *Codification and the Nonprofit Corporation: The Philosophical Choices, Pragmatic Problems, and Drafting Difficulties Encountered in the Formulation of A New Alaska Code*, 33 MERCER L. REV. 543, 547 (1982).

9. Spitz & Zarenski, *Liability of a Hospital as an Institution: Are the Walls of Jerico Tumbling?*, 16 FORUM 225, 225 (1980).

10. *See generally* Fessler, *supra* note 8; Hansmann, *supra* note 2, at 500; Henn & Boyd, *supra* note 4, at 1104.

11. Gray, *Impact of Nonprofit Organizations*, TRENDS IN NONPROFIT ORGANIZATIONS LAW 1, 7-8 (1977).

though only a few courts have addressed this issue to date,[12] it is a matter that will require more attention as nonprofit corporations expand their operations into new areas.

A. Nonprofit Corporations Generally

"The defining characteristic of a nonprofit corporation is that it is barred from distributing profits, or net earnings, to . . . its directors, officers, or members."[13] That does not mean that it is prohibited from earning a profit. Rather, it is only the distribution of those earnings as dividends that is prohibited. Net profits, "if any, must be retained and devoted to the purposes for which the nonprofit corporation was formed."[14] Nonprofit corporations generally are "free to pay reasonable compensation to individuals, including controlling individuals, for labor services or capital provided to the organization."[15]

By statute, most nonprofit corporations cannot issue shares.[16] Instead, in many cases, certificates of membership are issued to individuals upon their acceptance into the corporation as members and their payment of dues.[17] Unlike the shares in a profit corporation, these certificates may not be freely transferred.[18] While members of a nonprofit corporation do not have a direct financial stake in the corporation because they do not receive a return on any contribution to the corporation, most members do have the right to vote on the same matters usually decided by shareholders of a profit corporation.[19]

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12. *See, e.g.*, Jabczenski v. Southern Pac. Memorial Hosps., 119 Ariz. 15, 579 P.2d 53 (1978); Macaluso v. Jenkins, 95 Ill. App. 3d 461, 420 N.E.2d 251 (1981); Macfadden v. Macfadden, 46 N.J. Super. 242, 134 A.2d 531 (1957); Revere Press, Inc. v. Blumberg, 431 Pa. 370, 246 A.2d 407 (1968); Ruppa v. American States Ins. Co., 91 Wis. 2d 628, 284 N.W.2d 318 (1979).

13. Hansmann, *supra* note 2, at 501. Most legislative enactments define nonprofit corporations in these terms. *See, e.g.*, CAL. CORP. CODE ANN. § 7111 (West Supp. 1981); WIS. STAT. § 181.02(4) (1979).

14. Hansmann, *supra* note 2, at 501. *See, e.g.*, N.Y. NOT-FOR-PROFIT CORP. LAW § 508 (McKinney 1970).

15. Hansmann, *supra* note 2, at 501.

16. *Id.* at 502.

17. *See, e.g.*, CAL. CORP. CODE ANN. § 5058 (West Supp. 1981); N.Y. NOT-FOR-PROFIT CORP. LAW § 501 (McKinney 1970); WIS. STAT. § 181.11 (1979).

18. *See, e.g.*, N.Y. NOT-FOR-PROFIT CORP. LAW § 501 (McKinney 1970).

19. Ellman, *supra* note 5, at 161.

A few states, by statute, do permit nonprofit corporations to organize on a stock basis.[20] However, these shares do not grant a right of return on the members' investment either during the life of the corporation or upon its termination.[21] The effect of these statutes is to place the members vis-a-vis the officers, directors and corporation in the same status as in the business corporation.[22]

Although nonprofit corporations traditionally have been distinguished from profit corporations by the absence of shareholders, the ban on dividends and a charitable or public benefit purpose, these characteristics are gradually being eroded. There is a trend to liberalize the purposes for which a nonprofit corporation can be organized.[23] In particular, there is a growing trend for nonprofit corporations to have a mixture of business and nonprofit purposes.[24] Pennsylvania and New York have "radically altered the permissible scope of nonprofit corporate activities by allowing them to form for any lawful business purpose to be conducted on a not-for-profit basis."[25] Most states that have adopted the Model Nonprofit Corporation Act allow nonprofit corporations to be organized "for any lawful purpose."[26] This language has

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20. *See* PA. STAT. ANN. tit. 15, § 7752(a) (Purdon 1967); W. VA. CODE § 31-1-144 (1981). States that allow nonprofit corporations to issue shares also require that they note conspicuously on the face of the share certificates that the corporation is nonprofit.

Prior to July 1, 1953, Wisconsin allowed nonprofit corporations to organize on a nonstock or stock basis. WIS. STAT. §§ 180.02(1), 181.02(1) (1951). However, in 1953 when Wisconsin adopted the Model Nonprofit Corporation Act it also enacted § 181.76(3) of the Wisconsin Statutes to allow nonprofit corporations previously organized under Chapter 180, the Business Corporation Law, to elect to be organized under Chapter 181, the Nonstock Corporation Law. Section 180.97(1) of the Wisconsin Statutes was enacted to define the application of Chapter 180 to those nonprofit corporations previously organized on a stock basis. A 1958 attorney general opinion construed this new section as prohibiting nonprofit corporations from organizing on a stock basis subsequent to July 1, 1953. 47 Op. Att'y. Gen. 78 (1958).

21. Brown, *supra* note 3, at 59.

22. MacFarlan, *Nonprofit Corporation Statute Trends*, TRENDS IN NONPROFIT ORGANIZATIONS LAW 21, 27 (1977).

23. Hansmann, *supra* note 2, at 509.

24. Sherrill, *Mixture of Profit and Nonprofit Purposes*, TRENDS IN NONPROFIT ORGANIZATIONS LAW 115, 115-20 (1977); Weeks, *The Not-For-Profit Business Corporation*, 19 CLEV. ST. L. REV. 303, 308 (1970).

25. MacFarlan, *supra* note 22, at 25. *See* PA. STAT. ANN. tit. 15, § 7311 (Purdon 1981); N.Y. NOT-FOR-PROFIT CORP. LAW § 201 (McKinney 1970).

26. *See, e.g.*, OHIO REV. CODE ANN. § 1702.03 (Page 1978); OKLA. STAT. ANN.

been interpreted to permit the pursuit of any purpose that is not inconsistent with the nondistribution constraint.[27] Consequently, it has been suggested that the absence of an express prohibition of business purposes may indirectly permit this blend.[28]

There is mixed reaction to this new trend in nonprofit corporations.[29] Some commentators suggest that this trend will "open a broad and productive area for nonprofits."[30] This "hybrid," it is suggested, could be a "versatile tool" to "aid in the economic or social rehabilitation of the needy."[31] Others, however, question "[t]he wisdom of tempting an individual with revenues he has produced but may not share."[32] The hybrid corporation, it is suggested, "creates a new area that is susceptible to abuse."[33]

Gradually, the distinctions between shareholders and members are being blurred as members' rights and duties are beginning to resemble those of shareholders.[34] For example, a number of states have enacted statutes giving members the right to notice of meetings and the right to demand and inspect corporate records.[35] The New York Not-for-Profit Corporation Law allows members to enter into voting agreements.[36] California and those states adopting the Model Nonprofit Corporation Act permit voting rights to be modified, enlarged or minimized in the articles or bylaws.[37] Some states specifically allow corporations to become mem-

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tit. 18, § 852 (West 1981); TENN. CODE ANN. § 48-401 (1979); WIS. STAT. § 181.03 (1979).

27. Hansmann, *supra* note 2, at 511.

28. Sherrill, *supra* note 24, at 115-16.

29. For favorable reaction, see generally Lesher, *The Non-Profit Corporation—A Neglected Stepchild Comes of Age*, 22 BUS. LAW. 951 (1967); Weeks, *The Not-For-Profit Business Corporation*, 19 CLEV. ST. L. REV. 303 (1970). *Contra* Oleck, *Proprietary Mentality and the New Non-Profit Corporation Laws*, 20 CLEV. ST. L. REV. 145 (1971).

30. Sherrill, *supra* note 24, at 116.

31. *Id.*

32. *Id.* at 117.

33. *Id.*

34. MacFarlan, *supra* note 22, at 28.

35. *Id. See, e.g.*, PA. STAT. ANN. tit. 15, §§ 7508, 7783 (Purdon 1981).

36. N.Y. NOT-FOR-PROFIT CORP. LAW § 619 (McKinney 1970).

37. MacFarlan, *supra* note 22, at 27. *See, e.g.*, CAL. CORP. CODE ANN. §§ 5330, 7330, 9330 (West Supp. 1981); MODEL NONPROFIT CORPORATION ACT § 15 (1964); WIS. STAT. § 181.16 (1979).

bers of nonprofit corporations and thus permit control of these nonprofit organizations through holding companies.[38]

These new trends in nonprofit corporate law are viewed by some critics as inconsistent with traditional nonprofit principles.[39] In particular, section 15 of the Model Act, allowing voting rights to be varied, is viewed as encouraging nonprofit corporations to take on a "proprietary mentality."[40] The right to vote is the basic means of control in many nonprofit corporations.[41] Unequal voting rights plus the use of voting agreements will permit a few members "to fasten their personal control onto a non-profit corporation."[42] Attempts to gain control amount to conduct which inherently contradicts the proper purpose of the nonprofit corporation.[43] Such concentration of control is offensive to those who believe that nonprofit corporations should be democratically controlled by their membership.

Part of the concern in this area is that nonprofit enterprises sweep "far beyond the realm of actual or pretended charity."[44] Many nonprofit corporations "deliberately and habitually generate income substantially in excess of their fixed and recurrent costs."[45] Nonprofit statutes "host far more than a handful of do-gooder organizations," which are "organized for a bewildering variety of goals."[46] "There are estimates that nonprofit entities employ more persons than federal, state and local government combined."[47] They are "the second largest source of employment" in the country.[48]

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38. *See, e.g.*, N.Y. NOT-FOR-PROFIT CORP. LAW § 601 (McKinney 1981); PA. STAT. ANN. tit. 15, § 7760 (Purdon 1981); WIS. STAT. § 181.02(7) (1979).

39. MacFarlan, *supra* note 22, at 27.

40. *Id.*; Oleck, *supra* note 29, at 146.

41. Oleck, *supra* note 29, at 155.

42. *Id.* at 162.

43. *Id.*

44. Fessler, *supra* note 8, at 544.

45. *Id.*

46. *Id.* at 545. Some surprising examples include: "The Aerospace Corporation, a nonprofit [corporation] which receives over $100,000,000 worth of government contracts every year; The National Federation of Independent Businesses, which represents almost 60,000 small businesses across the country; The Automobile Club of Southern California, which has receipts of $120,000,000 a year; and The California Trucking Association, which is the trade association for more than 500 trucking organizations and has yearly sales in excess of $100,000,000." *Id.* at 545-46 n.6.

47. *Id.* at 546.

48. *Id.*

The degree and nature of supervision over nonprofit corporations is minimal.[49] "Under the typical statutory framework those in control of a nonprofit entity are virtually unchecked."[50] Self-perpetuating boards are "free of the term and election requirements imposed upon their counterparts in [business] corporations."[51] While in theory there are no proprietary rights with respect to nonprofit corporations, an officer's or director's unchecked ability to exercise dominion over the corporation's assets and affairs borders perilously close to the definition of ownership.[52]

As myths about nonprofit corporations are dispelled, nonprofit corporate directors, officers and members may find themselves exposed to personal liability. In particular, as the "staggering" wealth[53] of many nonprofit corporations becomes known, creditors and tort victims may assert claims that the nonprofit corporation is really the arm or instrumentality of those controlling members. The court may then be asked to "pierc[e] the corporate veil"[54] and hold those members personally liable.[55]

B. The Disregard Doctrine

Limited liability means that the shareholders of a corporation are not personally liable for the debts, liabilities and obligations of the corporation.[56] When a court decides to disregard the separate entity and pierce the veil behind which the shareholders, directors and officers are hiding, the court will regard the corporation as merely an association of persons[57] and will hold personally liable those persons responsible for the alleged wrongdoing. Application of this

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49. *Id.*

50. *Id.* at 549.

51. *Id.*

52. *Id.*

53. Henn & Boyd, *supra* note 4, at 1104 n.3.

54. Broida, *The History Of The Development Of The Remedy Of "Piercing The Corporate Veil,"* 65 ILL. B.J. 522, 523 (1977).

55. *See* Macaluso v. Jenkins, 95 Ill. App. 3d 461, 420 N.E.2d 251 (1981); Ruppa v. American States Ins. Co., 91 Wis. 2d 628, 284 N.W.2d 318 (1979).

56. Meiners, Mofsky & Tollison, *Piercing The Veil Of Limited Liability*, 4 DEL. J. CORP. L. 351, 353 (1979).

57. *Id.* at 354.

remedy is generally limited to close corporations[58] and parent-subsidiary corporations.[59]

Most courts "have recognized the legitimacy of incorporating to avoid personal liability;"[60] mere desire to avoid personal liability will not cause a court to pierce the corporate veil.[61] That is the clearest guideline a court has given to indicate when the doctrine will not be applied. Precise rules determining when the doctrine will be applied are rarely articulated. Instead, a "totality of the circumstances"[62] rule is employed by courts to enable them to deal with each case on its own facts.[63] Courts defend the doctrine's obscure form by contending that its equitable nature demands that it be flexible and adaptable.[64]

Traditionally, courts would pierce the corporate veil when a fraud or misrepresentation occurred which prejudiced a third party.[65] Then the corporation was treated as a partnership and all of the shareholders were held liable as partners.[66] However, to hold all of the shareholders personally liable for the wrongful conduct of one shareholder or director would create tremendous injustice. Consequently, this practice has been discarded by many courts.[67] In its place a two-tiered test has generally been accepted.[68] Under

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58. Note, *Disregard of the Corporate Entity*, 4 WM. MITCHELL L. REV. 333, 336 (1978). There is no case in which the shareholders of a corporation whose stock was publicly traded or widely held was found personally liable for the obligation of the corporation. Barber, *Piercing The Corporate Veil*, 17 WILLAMETTE L.J. 371, 372 (1981).

59. Note, *supra* note 58, at 336.

60. Barber, *supra* note 58, at 373.

61. *Id.*

62. *Id.* at 374.

63. *Id. See, e.g.*, Horticultural Enters. Corp. v. Allstate Ins. Co., 477 F. Supp. 161 (C.D. Cal. 1979); Brown Bros. Equip. Co. v. State, 51 Mich. App. 448, 452, 215 N.W.2d 591, 593 (1974).

64. Gillespie, *The Thin Corporate Line: Loss of Limited Liability Protection*, 45 N.D.L. REV. 363, 365 (1969).

65. Note, *supra* note 58, at 338.

66. *Id.* at 345.

67. *See* Harris, *Washington's Doctrine of Corporate Disregard*, 56 WASH. L. REV. 253, 253 (1981).

68. *See, e.g.*, Marine Midland Bank, N.A. v. Miller, 664 F.2d 899, 903 (2d Cir. 1981); Horticultural Enters. Corp. v. Allstate Ins. Co., 477 F. Supp. 161, 165 (C.D. Cal. 1979); Tri-State Bldg. Corp. v. Moore-Handley, Inc., 333 So. 2d 840, 841 (Ala. Civ. App. 1976); Home Builders & Suppliers v. Timberman, 75 Ariz. 337, —, 256 P.2d 716, 721 (1953); Futch v. Southern Stores, Inc., 380 So. 2d 444, 445-46 (Fla. App.

that test, a court will pierce a corporate veil when two facts have been established:

(1) such a unity of interest and ownership between the corporation and its shareholders that the individuality of the corporation has ceased, and
(2) the observance of the entity would sanction a fraud or promote injustice.[69]

This test has sometimes been labeled as the "alter ego" rule.[70] While the above standard lends some clarity to the doctrine, the application of those two criteria to particular cases often is clouded, inconsistent and even contradictory.[71] Frequently, courts obscure their analyses by couching their decisions in terms of metaphors that offer no insights into their reasoning.[72] Factors courts balance in determining whether the two-tiered test has been met include the commingling of the funds and assets of the corporations, failure to observe corporate formalities, failure to maintain corporate records or minutes, inadequate capitalization, sole own-

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1980); Chick v. Tomlinson, 96 Idaho 483, —, 531 P.2d 573, 575 (1975); Berlinger's Inc. v. Beef's Finest, Inc., 57 Ill. App. 3d 319, —, 372 N.E.2d 1043, 1048 (1978); Service Iron Foundry v. M.A. Bell Co., 2 Kan. App. 2d 662, —, 588 P.2d 463, 473 (1978); Soloman v. Western Hills Dev. Co., 110 Mich. App. 257, —, 312 N.W.2d 428, 432 (1981); Frank McCleary Cattle Co. v. Sewell, 73 Nev. 279, —, 317 P.2d 957, 959 (1957); Village Press, Inc. v. Stephen Edward Co., 120 N.H. 469, 416 A.2d 1373, 1375 (1980); Norman v. Murray First Thrift & Loan Co., 596 P.2d 1028, 1030 (Utah 1979).

69. Note, *supra* note 58, at 352. *See also* 1 W. FLETCHER, *supra* note 4, § 41 (Supp. 1981); Harris, *supra* note 67, at 258; Comment, *Piercing the Corporate Veil in Louisiana*, 22 LOY. L. REV. 993, 1000-01 (1976).

70. Note, *supra* note 58, at 352.

71. *See, e.g.*, Kirno Hill Corp. v. Holt, 618 F.2d 982 (2d Cir. 1980); Fink v. Montgomery Elevator Co., 161 Colo. 342, 421 P.2d 735 (1966); Chung v. Animal Clinic, Inc., 636 P.2d 721 (Hawaii 1981); Commonwealth *ex rel.* Beshear v. ABAC Pest Control, 621 S.W.2d 705 (Ky. Ct. App. 1981); William B. Roberts, Inc. v. McDrilling Co., 579 S.W.2d 335 (Tex. Civ. App. 1979); Block v. Olympic Health Spa, 24 Wash. App. 938, 604 P.2d 1317 (1979). *See generally* Jonas v. State, 19 Wis. 2d 638, 121 N.W.2d 235 (1963); 1 W. FLETCHER, *supra* note 4, § 41.

72. The courts conclude that the corporation is the "alter ego," "mere adjunct," "instrumentality," "cloak," or "arm" of the controlling shareholder. Hamilton, *The Corporate Entity*, 49 TEX. L. REV. 979, 979 (1971). Although the purpose of the metaphor policy ostensibly is to point to some improper relationship between the shareholder and the corporation, the language merely states legal conclusions and provides no guidelines. Note, *supra* note 58, at 352. Justice Cardozo, commenting on the disregard doctrine in Berkey v. Third Ave. Ry., 244 N.Y. 84, 155 N.E. 58 (1926), suggested that a misunderstanding of the metaphors used presented a danger to the corporate theory. *Id.* at —, 155 N.E. at 61.

ership of all shares, inequitable conduct, lack of arm's length transactions and manipulation of corporate assets.[73]

There are inherent problems in applying this two-tiered test to nonprofit corporations. First, since members do not own the corporation, some substitute for unity of ownership and interest is necessary. Second, since nonprofit corporations are by nature different from profit corporations, some standard for determining inequitable conduct must be established.

II. Disregarding the Nonprofit Corporate Entity

A. Who Will Be Liable?

With the exception of only a few cases,[74] the corporate disregard doctrine has been invoked successfully to impose personal liability only against shareholders of business corporations.[75] The rationale in such a case is that since the shareholder's interests have become inseparable from that of the corporation in the pursuit of profit and financial growth, the shareholder is no longer distinct from the corporation and, therefore, should be personally liable for the corporation's debts and obligations.[76] Applying that same rationale to a nonprofit corporation which has no shareholders, but has members who pay minimal dues[77] and expect no financial return on their contributions,[78] presents some knotty problems.

Most courts consider unity of ownership and interest between the shareholder and the corporation an essential element in their decision to disregard.[79] Although members of

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73. Barber, *supra* note 58, at 374-75.

74. *See* Macaluso v. Jenkins, 95 Ill. App. 3d 461, 420 N.E.2d 251 (1981); Macfadden v. Macfadden, 46 N.J. Super. 242, 134 A.2d 531 (1957). The corporate disregard doctrine has been unsuccessfully invoked to impose personal liability in: Jabczenski v. Southern Pac. Memorial Hosps., 119 Ariz. 15, 579 P.2d 53 (1978); Revere Press, Inc. v. Blumberg, 431 Pa. 370, 246 A.2d 407 (1968); Ruppa v. American States Ins. Co., 91 Wis. 2d 628, 284 N.W.2d 318 (1979).

75. Gillespie, *supra* note 64, at 372-73 n.38.

76. Harris, *supra* note 67, at 258.

77. Gillespie, *supra* note 64, at 372-73 n.38.

78. Brown, *supra* note 3, at 61.

79. *See, e.g.*, Berlinger's Inc. v. Beef's Finest, Inc., 57 Ill. App. 3d 319, —, 372 N.E.2d 1043, 1048 (1978); Milwaukee Toy Co. v. Industrial Comm'n, 203 Wis. 493, 495, 234 N.W. 748, 749 (1931). *See also* Harris, *supra* note 67, at 258; Comment, *supra* note 69, at 1000-01; Note, *supra* note 58, at 352.

nonprofit corporations do not own shares, they generally do have the right to vote on matters designated in the articles of incorporation or bylaws.[80] Moreover, an active member of a nonprofit corporation naturally has a personal interest in the corporation.[81] While the right to vote does give members control over corporate affairs similar to that of shareholders, that coupled with inequitable conduct should not become the basis for applying the doctrine. Otherwise, members may be subjected to personal liability whenever the equities of the case would merit a shifting of responsibility from the claimant. Instead the courts should adopt a test which substitutes active control and dominion for unity of ownership and interest.

1. The Ownership Control Approach

The Illinois Court of Appeals in *Macaluso v. Jenkins*[82] did not find the absence of stock ownership an obstacle to applying the corporate disregard doctrine. In *Macaluso*, John Jenkins founded a nonprofit corporation named the Industrial Police Association (I.P.A.); he was the treasurer and chairman of the board. On behalf of the corporation, Jenkins entered into a contract with Frank Macaluso to have some printing done. When the contract price was not paid, Macaluso sought to have Jenkins and Paulette Zecca, another director of the corporation, held personally liable by means of the corporate disregard doctrine.

The court quickly rejected the defendants' argument that the ownership requirement of the disregard doctrine could not be met because Jenkins did not own any shares. Instead, the court relied on the fact that Jenkins exhibited "ownership control."[83] Ownership control was exhibited by Jenkins' power to authorize loans to the corporation, make decisions about seminars held by the corporation, appoint a vice-president, make most or all of the decisions affecting the corporation and unilaterally start and dissolve an office in

80. *See supra* notes 37 & 41 and accompanying text.

81. Revere Press, Inc. v. Blumberg, 431 Pa. 370, —, 246 A.2d 407, 411 (1968).

82. 95 Ill. App. 3d 461, 420 N.E.2d 251 (1981).

83. *Id.* at —, 420 N.E.2d at 256.

Florida.[84] Moreover, Jenkins himself demonstrated his ownership control when he testified at trial that the other director had no input into making decisions concerning the corporation.[85] This ownership control exhibited by Jenkins was sufficient to show that the separate personalities of the corporation and Jenkins had ceased to exist.[86] The corporation had become the "alter ego" of Jenkins.[87]

Since the doctrine of disregard is essentially equitable in nature,[88] the Illinois court concluded that the corporation's nonprofit status did not bar the court from applying the doctrine. Equitable remedies, the court maintained, look to substance rather than to form.[89] Jenkins' conduct alone was sufficient to demonstrate that he and the corporation had ceased to exist as separate entities.

While the ownership control principle appears to be a logically consistent substitute for the ownership requirement of the disregard doctrine, it does not clearly define the degree of ownership control that may be exerted before a court will find members personally liable. In *Macaluso*, the plaintiff also sought to hold Paulette Zecca, the secretary and director, liable for the contract price. The court declined to do that, maintaining that Zecca did not exercise "sufficient ownership and control to be the alter ego" of the corporation.[90]

In reaching its conclusion as to Zecca, the Illinois court focused on a rather limited set of facts. The court explained that Zecca was only a part-time voluntary clerical worker who occasionally made out checks authorized by Jenkins.[91] In addition, the court emphasized that Zecca, although the secretary, never assumed responsibility for the financial records.[92] Emphasis was also placed on Zecca's testimony at trial that she merely followed Jenkins' orders and had no

84. *Id.* at —, 420 N.E.2d at 255.
85. *Id.*
86. *Id.* at —, 420 N.E.2d at 256.
87. *Id.* at —, 420 N.E.2d at 257.
88. *Id.* at —, 420 N.E.2d at 255.
89. *Id.*
90. *Id.* at —, 420 N.E.2d at 257.
91. *Id.*
92. *Id.*

input into any decision making.[93] Without any further considerations, the court concluded that Zecca was merely a clerical volunteer for the corporation.

Zecca's other ties with Jenkins and his corporations were ignored by the court. Prior to incorporating the I.P.A., Jenkins had founded a corporation which provided armed guards for industrial sites. Zecca was the assistant director of security for that corporation. Out of the same offices in which Jenkins ran the above corporation, a private investigation firm and the I.P.A., Zecca operated a cleaning service. Moreover, evidence indicated that Zecca's cleaning service paid the rent for the offices,[94] although the original plan was to have I.P.A. pay the rent.[95] Zecca's corporation also loaned over $9,000 to the I.P.A.[96] While these additional facts may not be sufficient to establish that Zecca did exercise ownership control over I.P.A., they nonetheless indicate that Zecca was more closely tied to I.P.A. than an ordinary, part-time volunteer clerk would be.

The substance-form argument of the *Macaluso* court may be a debatable premise. In many respects, the position of a member in a nonprofit corporation differs in substance from that of a shareholder.[97] While a member of a nonprofit corporation may benefit from the corporation's existence and prefer that it survive and prosper, no immediate economic loss will result from its demise.[98] Since the ban on distributions prohibits those who control a nonprofit organization from distributing to themselves out of the corporation's income, the most that can be lost is any reasonable compensation they receive for the services they render.[99] Usually that will be a minimal amount since many members offer their services gratuitously.[100] Moreover, members may easily withdraw from a nonprofit corporation if they lose interest or are disappointed. Their only loss is the forfeited

93. *Id.*
94. *Id.* at —, 420 N.E.2d at 254.
95. *Id.* at —, 420 N.E.2d at 255-56.
96. *Id.* at —, 420 N.E.2d at 257.
97. Brown, *supra* note 3, at 61.
98. *Id.*; Henn & Boyd, *supra* note 4, at 1135.
99. Hansmann, *supra* note 2, at 505.
100. Henn & Boyd, *supra* note 4, at 1129 n.210.

dues. On the other hand, shareholders who withdraw forfeit the value of their investments unless they can find eager buyers.

It is recognized, however, that a nonprofit corporation can be operated as if it were a close profit corporation. Directors and officers can seize control and run the corporation as if they were the owners.[101] The founder of a nonprofit corporation can structure it so that he or she is the only member and, therefore, able to choose all members of the board and all of the officers.[102] Moreover, as suggested earlier, many nonprofit corporations have self-perpetuating boards which are immune from the dismay of the members.[103] This "unchecked ability to remain in nonaccountable indefinite dominion over its assets and affairs borders on 'ownership.' "[104] Aside from the ban on distributions, such a nonprofit corporation would differ little from many close profit corporations. Therefore, if courts apply the principles of the disregard doctrine consistently to nonprofit corporations, they will not allow dominant members of a nonprofit corporation to hide behind the corporate shell. Rather, since those members treat that corporation as their own property, they may also be held personally liable for the debts and obligations of that corporation.

2. Nonprofit Corporations Without Members

Generally, nonprofit corporations can be divided into two categories: public benefit (charitable) corporations and mutual benefit corporations.[105] As their names suggest, mutual benefit corporations are formed for the benefit of the members[106] while public benefit corporations are formed for some charitable purpose.[107] While all mutual benefit corporations by definition have members, there are many public

101. Oleck, *Non-Profit Types, Uses and Abuses: 1970*, 19 CLEV. ST. L. REV. 207, 233 (1970). In another commentary, Oleck maintained that as many as one-half of all nonprofit corporations are run by individuals or small groups. Oleck, *supra* note 29, at 165. *See also* Fessler, *supra* note 8, at 549.

102. Ellman, *supra* note 5, at 156 n.10.

103. Fessler, *supra* note 8, at 549; Oleck, *supra* note 29, at 162.

104. Fessler, *supra* note 8, at 549.

105. Ellman, *supra* note 5, at 154.

106. *Id.*

107. *Id.*

benefit corporations that do not.[108] Several states expressly provide that nonprofit corporations may be formed with or without members.[109] If there are no members, then the directors decide the matters usually left to the vote of the members.[110]

Two problems arise when one tries to hold the directors of a nonprofit corporation personally liable under the disregard doctrine. First, unlike the directors of most close profit corporations, the directors of nonprofit corporations do not own any shares and may not even pay any dues.[111] Consequently, stretching the ownership control principle to these directors appears less congruent. Second, there is confusion in many jurisdictions as to whether corporate law or trust law should be used to evaluate the directors' conduct.[112]

A trustee status for directors presents some problems. "Under the trust concept, legal title to the assets vests in the trustees, and the equitable interest vests in passive beneficiaries."[113] Such a division of interest "is inconsistent with the corporate form,"[114] and general confusion results from perpetuating the application of outdated trust law to nonprofit corporations.[115] The trust standard also subjects the directors to the highest standard of care and fiduciary conduct.[116] Since many directors of nonprofit organizations often "perform their directors' duties as an avocation or community service,"[117] applying this test may discourage such service.[118]

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108. Fessler, *supra* note 8, at 558.

109. *See, e.g.*, ALA. CODE § 10-3-100 (1975); CAL. CORP. CODE ANN. §§ 5310, 7310, 9310 (West Supp. 1981); GA. CODE ANN. § 22-2501 (1977); WIS STAT. § 181.11 (1979).

110. *See, e.g.*, CAL. CORP. CODE ANN. §§ 5310(b), 7310(b) (West Supp. 1981); MODEL NONPROFIT CORPORATION ACT § 15. *See also* Henn & Boyd, *supra* note 4, at 1129.

111. *See* Brown, *supra* note 3, at 58-59; Oleck, *Trends in Nonprofit Corporation Law in 1976*, 10 AKRON L. REV. 71, 84 (1976).

112. Brown, *supra* note 3, at 67.

113. Henn & Boyd, *supra* note 4, at 1129.

114. *Id.*

115. *Id.* at 1129 n.210.

116. *Id.* at 1129-30.

117. *Id.* at 1130.

118. *Id.*

The directors of many nonprofit corporations rarely receive compensation for their services.[119] Since they cannot expect a return on any contributions they make, they often will not suffer any financial loss from the dissolution of the corporation.[120] Consequently, to apply the ownership principle to the directors, the courts will have to examine and balance the conduct of each director in each case in order to decide if a particular director handled the corporation's assets to further his or her own personal interest.[121]

There is support for the proposition that the directors of public benefit corporations should be held to a higher standard of care in the performance of their duties.[122] Since the funds are derived from public donations[123] and they are to be used to benefit the public, supporters argue that the corporation more closely resembles a charitable trust than a business corporation.[124] Therefore, they argue that it is improper to apply a corporate standard to the actions of the governing bodies solely because of the organizational structure.[125]

Applying a higher standard of care to the directors of a nonprofit corporation may encourage the directors to exert more dominance and control over the corporate assets to satisfy their fiduciary duties.[126] On the other hand, if this conduct is interpreted as using corporate assets for their own personal use, the directors may be held personally liable for the corporate obligations.

These complications do not arise in a profit corporation setting because the fiduciary duty concept is not involved. While many shareholders in close corporations are also directors and officers, the court, in a case involving the disregard doctrine, does not reach a conclusion based on whether or not the director's fiduciary duty was breached. Emphasis is placed on finding an ownership and interest unity between

119. Brown, *supra* note 3, at 61.
120. *Id.*
121. Ashley v. Ashley, 482 Pa. 228, —, 393 A.2d 637, 641 (1978).
122. Brown, *supra* note 3, at 64.
123. Fessler, *supra* note 8, at 555.
124. Brown, *supra* note 3, at 70.
125. *Id.*
126. *Id.*

the shareholder and the corporation.[127] The court's focus can be narrow in these situations, unlike those involving public benefit corporations, because the role of shareholder and director can at least in theory be separated.

There is also growing support for the proposition that directors of public benefit corporations should be charged with the same standard of fidelity to the donors or patrons as are directors of profit corporations.[128] Supporters of that view stress the part-time and uncompensated status of the majority of the directors of nonprofit corporations.[129] They also emphasize that directors of public benefit corporations have powers and duties similar to those of directors of profit corporations.[130] While this approach does not make it easier to decide if a director's conduct exhibits an ownership mentality, it does eliminate some of the tension between the disregard doctrine and the fiduciary duty concept.

B. The Need for a Clear Standard

The standards applied to profit corporations are confused and convoluted. While some jurisdictions still cling to the traditional fraud approach,[131] others have adopted the two-pronged standard.[132] No matter which test is expressly espoused, the courts still apply these tests inconsistently.[133] Frequently, the type, nature, mode of operation, purpose and resources of each corporation are ignored in framing the standards and assessing the justice of a particular result.[134] Courts have also failed to make distinctions between the standard applied when the claim asserted is a breach of con-

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127. *See, e.g.*, Berlinger's Inc. v. Beef's Finest, Inc., 57 Ill. App. 3d 319, —, 372 N.E.2d 1043, 1048 (1978); Jonas v. State, 19 Wis. 2d 638, 644-45, 121 N.W.2d 235, 239 (1963).

128. Brown, *supra* note 3, at 70. *See, e.g.*, Beard v. Achenbach Memorial Hosp. Ass'n, 170 F.2d 859, 862 (10th Cir. 1948).

129. Brown, *supra* note 3, at 70.

130. *Id.*

131. *See, e.g.*, Delta Airlines v. Wilson, 210 So. 2d 761 (Fla. Dist. Ct. App. 1968); Schriock v. Schriock, 128 N.W.2d 852 (N.D. 1964); Brundred v. Rice, 49 Ohio St. 640, —, 32 N.E. 169, 172 (1892); Note, *supra* note 58, at 338.

132. *See supra* note 68 and accompanying text.

133. *See supra* note 71 and accompanying text.

134. *See* Note, *supra* note 58, at 355.

tract claim as opposed to a tort claim.[135] Applying these muddled standards to the already unsettled area of nonprofit corporate law only creates more confusion.

When a fraud is involved, a court will often disregard the corporate entity and hold the wrongdoer liable for the injury.[136] However, there must be sufficient identity of the corporation with the culprits and the fraudulent conduct.[137] The same rules apply to nonprofit corporations. If a fraudulent purpose or use of a nonpecuniary association is established, a court of equity has the power to pierce the corporate entity even though there are no shareholders and its formation ostensibly is in the public interest.[138]

For example, in *Macfadden v. Macfadden*[139] the court pierced the corporate entity on the grounds that recognition of the corporate form would create an injustice. In *Macfadden* the plaintiff's husband, as part of a settlement agreement, gave his wife a life estate in real estate held by one of the nonprofit corporations he controlled. Upon his death, the corporation tried to sell the land. The court disregarded the corporate form and held that the land was subject to the wife's life estate.[140]

1. Measuring Inequitable Conduct

Traditionally, a finding of fraud was necessary to invoke the disregard doctrine;[141] remnants of that requirement still exist. Those jurisdictions following the two-pronged test still require proof of some inequitable conduct as a condition of applying the doctrine.[142] This heavy burden is placed on the claimant because of the strong policy favoring limited liabil-

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135. *Id.*

136. 1 W. FLETCHER, *supra* note 4, § 44.

137. *Id.*

138. Macfadden v. Macfadden, 46 N.J. Super. 242, —, 134 A.2d 531, 534 (1957); 1 W. FLETCHER, *supra* note 4, § 44.

139. 46 N.J. Super. 242, 134 A.2d 531 (1957).

140. *Id.* at —, 134 A.2d at 535.

141. Barber, *supra* note 58, at 338.

142. Central Inv. Corp. v. Mutual Leasing Assoc., 523 F. Supp. 74, 78 (S.D. Ohio 1981) (need proof of fraud or inequitable conduct); Cooperman v. California Unemployment Ins. App. Bd., 49 Cal. App. 3d 1, —, 122 Cal. Rptr. 127, 131 (1975) ("corporate entity will be disregarded to prevent fraud, to protect third persons or to prevent grave injustice"). *See generally*, 1 W. FLETCHER, *supra* note 4, §§ 25, 41.

ity.[143] Since the remedy is equitable, the court balances the policy of maintaining limited liability against the injustices that may result if the corporate form is kept intact.[144]

While each court may express the requirements of this second prong differently, each court is looking for conduct that will swing the balance in favor of the claimant. Washington courts require shareholder conduct which exhibits fraud, misrepresentation or some form of manipulation of the corporation so as to benefit the shareholder while harming the claimant.[145] Similarly, Wisconsin and Illinois courts consider whether adherence to the fiction of separate existence would sanction a fraud or defeat some strong equitable claim.[146]

Clearer guidelines than those expressed above are needed to define what kind of inequitable conduct will cause the court to impose personal liability on the members of nonprofit corporations. When fraud is involved the answer is easy. However, inequitable conduct as defined by a variety of courts has included the commingling of corporate assets,[147] the failure to maintain adequate corporate records and to comply with corporate formalities,[148] the draining of corporate assets by drawing large salaries,[149] thin capitalization[150] and sole ownership of all stock.[151]

Most courts have maintained that sole ownership of all stock is not sufficient cause to pierce the corporate veil.[152]

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143. Harris, *supra* note 67, at 253. California and Pennsylvania expressly provide by statute that members of a nonprofit corporation are not personally liable for the debts, liabilities or obligations of the corporation. CAL. CORP. CODE ANN. §§ 5350(a), 7350(a), 9350(a) (West Supp. 1981); PA. STAT. ANN. tit. 15, § 7554(a) (Purdon 1981). In the absence of a similar statutory enactment, members of nonprofit corporations would enjoy limited liability by virtue of the doctrine's common law origin.

144. Note, *supra* note 58, at 335-36.

145. *See, e.g.*, Morgan v. Burks, 93 Wash. 2d 580, —, 611 P.2d 751, 756 (1980).

146. Berlinger's Inc. v. Beef's Finest, Inc., 57 Ill. App. 3d 319, —, 372 N.E.2d 1043, 1048 (1978); Jonas v. State, 19 Wis. 2d 638, 644, 121 N.W.2d 235, 238-39 (1963).

147. *See, e.g.*, Barber, *supra* note 58, at 374.

148. *Id.* at 374-75.

149. *See* Sprecher v. Weston's Bar, 78 Wis. 2d 26, 39, 253 N.W. 493, 498 (1976).

150. *See, e.g.*, *id.*; Harris, *supra* note 67, at 266.

151. *See* Berlinger's Inc. v. Beef's Finest, Inc., 57 Ill. App. 3d 319, —, 372 N.E.2d 1043, 1048-49 (1978).

152. Cooperman v. California Unemployment Ins. App. Bd., 49 Cal. App. 3d 1, 122 Cal. Rptr. 127 (1975); Barnes v. Finnegan Enters., 150 Ga. App. 430, 258 S.E.2d

The rationale is that sole ownership does not destroy the corporation's separate existence. Similarly, sole control by a member of a nonprofit corporation should not be sufficient cause to disregard the corporation's separate entity. In *Macaluso*, Jenkins' sole control over the I.P.A. was not the determining factor in the court's decision. Rather, the court carefully scrutinized Jenkins' conduct as a whole to determine whether upholding I.P.A.'s separate existence would promote an injustice.[153]

The commingling of corporate assets was a significant factor in the court's determination in *Macaluso*. The court relied on evidence demonstrating that Jenkins drew funds from I.P.A.'s accounts and transferred them to his other corporations.[154] Also stressed was the original agreement that I.P.A. would pay the phone bills and rentals for the offices which housed all of the businesses.[155] Especially in view of the ban placed on dividends and distributions, this factor provides a sound basis to apply the disregard doctrine to nonprofit corporations. Because no uniform accounting standards have been applied to nonprofit corporations,[156] however, the commingling of corporate assets may not be an easy practice to spot. Moreover, since no national law requires public benefit corporations to account for the ways their contributions are disbursed, misappropriations and illegal distributions to members may be difficult to detect.[157]

The court in *Macaluso* also considered Jenkins' failure to follow corporate formalities and keep corporate records. Evidence demonstrated that during I.P.A.'s operation no books or financial records were ever kept.[158] However, it seems that that factor was not as prominent as Jenkins' handling of the corporate assets.

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55 (1979); Baird & Warner, Inc. v. Addison Indus. Park, 70 Ill. App. 3d 59, 387 N.E.2d 831 (1979); Service Iron Foundry v. M.A. Bell Co., 2 Kan. App. 2d 662, 588 P.2d 463 (1978); Block v. Olympia Health Spa, 24 Wash. App. 938, 604 P.2d 1317 (1979); Milwaukee Toy Co. v. Industrial Comm'n, 203 Wis. 493, 234 N.W. 784 (1931).

153. Macaluso v. Jenkins, 95 Ill. App. 3d 461, —, 420 N.E.2d 251, 255-56 (1981).

154. *Id.* at —, 420 N.E.2d at 256.

155. *Id.*

156. Oleck, *supra* note 1, at 969.

157. *Id.*

158. 95 Ill. App. 3d at —, 420 N.E.2d at 256.

Similarly, the Wisconsin Supreme Court, in *Ruppa v. American States Insurance Co.*,[159] rejected the absence of corporate formalities as a sufficient reason to disregard the separate entity of a nonprofit corporation. The plaintiff in that case wanted the members of the Madison Saddle Club to be held personally liable for the injuries he sustained as a participant in one of the horse shows the club sponsored. The only grounds he offered as a basis to invoke the disregard doctrine were that the business was conducted informally, the club had no regular meeting place, the mail was received at the secretary's place of employment and the club's only asset was a bank account.[160] Since Ruppa failed to prove fraud or inequitable conduct as required by the Wisconsin test, the court held that there were insufficient grounds to disregard the corporate status of the club.[161]

The factor that figured most prominently in the court's conclusions in *Macaluso* was Jenkins' treatment of the corporate assets. Evidence demonstrated that he was depleting the corporation of its minimal assets for his own personal benefit. Jenkins used I.P.A.'s funds to pay for his auto repairs, his restaurant tabs and charitable contributions.[162] Funds were directly drawn in his name or to cash.[163] Jenkins even helped a friend make a payment on the friend's Florida condominium.[164] This conduct led the court to conclude that Jenkins used " 'the corporate entity for his own personal benefit to the exclusion of the plaintiff, and thereby [became] unjustly enriched at the expense of corporate creditors.' "[165] In keeping with the equitable nature of the remedy, the personal use of corporate assets and the commingling of corporate funds should figure most prominently in a court's decision to disregard the corporate status of a nonprofit corporation.

. Inadequate Capitalization as a Standard

The use of inadequate capitalization as a determining factor has stirred debate in cases involving profit corpora-

159. 91 Wis. 2d at 628, 284 N.W.2d 318 (1979).
160. *Id.* at 645, 284 N.W.2d at 325.
161. *Id.* at 645, 284 N.W.2d at 324-25.
162. 95 Ill. App. 3d at —, 420 N.E.2d at 256.
163. *Id.*
164. *Id.*
165. *Id.*

tions.[166] Since some nonprofit corporations are minimally capitalized through membership dues and outside contributions, thin capitalization may be an issue in cases in which the claimant requests that the corporate form be disregarded. Consequently, some basis for determining what constitutes inadequate capitalization must be devised. In evaluating profit corporations, courts look to whether the capital put at risk by the shareholders is grossly disproportionate to the nature of the business and the risks reasonably foreseeable from its operation.[167] The rationale is that individuals should not be able to transfer their risks of doing business to innocent members of the general public by use of the corporate form.[168]

Courts must decide at what time the adequacy of capital will be judged. While some courts look only to initial capital,[169] this approach is criticized as ignoring the fact that corporations suffer losses and incur other liabilities during their operation.[170] The better view, it is argued, is to look at the entire economic position of the corporation and then assess whether the corporation affords adequate protection to its creditors.[171]

It is generally accepted that inadequate capitalization alone should not upset the corporate status of a profit corporation.[172] Other factors indicating some inequitable conduct by the shareholders must also be present. A similar view was taken by the courts in both *Ruppa* and *Macaluso*. In *Ruppa* the court ignored the fact that the club's only asset was a single bank account. It was sufficient that the club "obtained public and liability and property damage insurance to be in force during the horse show."[173] Because the

166. *See generally* Barber, *supra* note 58; Note, *supra* note 58; Note, *Disregarding The Corporate Fiction In Florida: The Need For Specifics*, 27 U. FLA. L. REV. 175 (1974).

167. Note, *supra* note 58, at 359; 1 W. FLETCHER, *supra* note 4, § 413 (Supp. 1981).

168. Note, *supra* note 58, at 360 n.172.

169. Meiners, Mofsky & Tollison, *supra* note 56, at 354.

170. Comment, *supra* note 69, at 1013-14.

171. *Id.* at 1014. *See also* Note, *supra* note 58, at 362.

172. Note, *supra* note 58, at 359; 1 W. FLETCHER, *supra* note 4, § 41.3.

173. 91 Wis. 2d at 640, 284 N.W.2d at 322-23.

club's past history was free of any accidents, the court ignored the fact that the insurance policy did not cover bodily injury or the death of any person participating in the show.[174] In *Macaluso*, the court dismissed the complaint of undercapitalization on the ground that Macaluso assumed the risk through his knowledge of I.P.A.'s minimal assets and his consent to enter into a contract.[175]

It appears from these two cases that inadequate capitalization alone will not cause the court to hold members personally liable. In some cases involving nonprofit corporations, this may be a sound policy. Creditors who deal with nonprofit corporations are aware of the corporations' limited assets and the principle of limited liability. Moreover, creditors of nonprofit corporations should be held to a duty to investigate because they are in the business sector.[176] Absent some fraudulent or inequitable conduct by controlling members, inadequate capitalization is not a compelling reason to apply the doctrine.

In contrast, there is support for the idea that a different standard should be applied to tort claims which by nature are nonconsensual. It is argued that the failure to follow formalities, sole ownership of all the shares and absence of corporate books are irrelevant to a tort claim.[177] Instead, the concern should be whether the controlling shareholder is responsible for the operational policies causing the tort and the undercapitalization.[178]

Applying that principle to nonprofit corporations without some added requirement of inequitable conduct will have a chilling effect on the growth and operation of many nonprofit corporations. Members and directors will be reluctant to take on very active roles for fear of incurring personal liability.[179] A better solution would be legislation that requires nonprofit corporations to carry liability insurance.[180]

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174. *Id.*

175. 95 Ill. App. 3d at —, 420 N.E.2d at 257. *Accord* White v. Winchester Land Dev. Corp., 584 S.W.2d 56 (Ky. Ct. App. 1979).

176. Note, *supra* note 58, at 356.

177. Note, *supra* note 166, at 181.

178. *Id.* at 194.

179. Brown, *supra* note 3, at 60.

180. Barber, *supra* note 58, at 394.

The other alternative is for the nonprofit corporation to provide its active members and/or directors with liability insurance.[181]

C. *Application in Wisconsin*

Although the Wisconsin Supreme Court in *Ruppa* declined to disregard the corporate status of the saddle club, it seems clear that the court will apply the doctrine in an appropriate case. In *Jonas v. State*[182] the court clearly enunciated the test used in applying the disregard doctrine to profit corporations. It stated that the doctrine would be applied whenever recognizing the corporate fiction would "accomplish some fraudulent purpose, operate as a constructive fraud, or defeat some strong equitable claim."[183] Central to that determination is a finding of unity of interest and ownership. As expressed in *Milwaukee Toy Co. v. Industrial Commission*,[184] the court will look to see if the person " 'is simply dealing with his own property through a corporate agency as absolutely as he might deal with it as an individual.' "[185]

In *Ruppa*, the court applied the *Jonas* standard to a nonprofit corporation. In addition, the court cited the test stated by the United States Supreme Court in *Anderson v. Abbott*.[186] The *Anderson* Court established public policy, fraud and obvious inadequacy of capital as the exceptions to the rule of limited liability.[187] When the Wisconsin court stated that none of the circumstances justifying disregard was present, it appeared to be including both the *Jonas* and *Anderson* criteria.

It seems clear from *Ruppa* that Wisconsin will apply the doctrine to a nonprofit corporation only if some fraud or inequitable conduct is present. In *Ruppa*, the court dismissed

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181. Oleck, *supra* note 111, at 90. "Directors' and officers' liability insurance is now a significant new speciality area in the insurance business." *Id.*

182. 19 Wis. 2d 638, 121 N.W.2d 235 (1963).

183. *Id.* at 644, 121 N.W.2d at 238-39 (quoting Milwaukee Toy Co. v. Industrial Comm'n, 203 Wis. 493, 496, 234 N.W. 748, 749 (1931)).

184. 203 Wis. 493, 234 N.W. 748 (1931).

185. *Id.* at 495, 234 N.W. at 749.

186. 321 U.S. 349 (1944).

187. *Id.* at 362.

the plaintiff's contention that the lack of formalities and inadequate capital constituted sufficient grounds.[188] As "measured by the nature and magnitude of the corporate undertaking,"[189] a single bank account was not too little capital. Emphasis was placed on the fact that the club had no prior history of accidents.[190]

The decision in *Ruppa* is consistent with the court's requirement of fraud or inequitable conduct. In *Sprecher v. Weston's Bar*,[191] while the court considered the facts that Julia Weston dominated the corporation, ignored corporate formalities and invested little capital, the central consideration of the court was her withdrawal of large salaries so as to virtually eliminate corporate profits.[192] It was that inequitable conduct which unjustly enriched Weston at the expense of outside creditors.[193] In *Ruppa*, on the other hand, the members of the saddle club drew no salary for their services, received none of the profits and contributed excess profits to charities. There was no evidence of such inequitable conduct.

III. CONCLUSION

As nonprofit corporations expand the kinds of enterprises in which they engage, they will be facing new forms of liability. In particular, as nonprofit corporations begin to resemble profit corporations more closely, they will face the same vulnerability to liability. This includes the disregard doctrine. To handle these claims, clear standards must be enunciated which will deal with the absence of ownership interest and the presence of public interest in many nonprofit corporations. Special consideration also will have to be given to the unique nature of nonprofit corporations. Failure to do this will only lead to greater confusion in an al-

188. 91 Wis. 2d at 645, 285 N.W.2d at 324.
189. 321 U.S. at 362.
190. 91 Wis. 2d at 645, 285 N.W.2d at 325.
191. 78 Wis. 2d 26, 253 N.W.2d 493 (1977).
192. *Id.* at 39, 253 N.W.2d at 498.
193. *Id.* at 39, 253 N.W.2d at 499.

ready unsettled area of corporate law and will cause harm to nonprofit corporations.

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