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Reverse Veil-Piercing Endorsed by Delaware Chancery Court

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A recent decision in the Delaware Chancery Court broadens the risk of inter-corporate liability by endorsing the theory of "reverse" veil-piercing, where a plaintiff can reach down to the assets of a parent company's subsidiaries.[1] Although many plaintiffs in the past have pursued theories predicated on reverse veil-piercing, the decision from Vice Chancellor Slights is the first time the theory has been formally endorsed by a Delaware court.

The *Manichean* case arose in the context of an appraisal proceeding, where stockholders of a company that intends to merge with another company can either elect to participate in the merger or dissent and seek statutory appraisal of their shares. When the board of SourceHOV Holdings, Inc., a business outsourcing company, presented stockholders with a proposed merger with Exela Technologies, Inc., some stockholders dissented and sought statutory appraisal. After a lengthy appraisal process, and an appeal by SourceHOV, the stockholders prevailed and their shares were appraised at a higher price than they would have received via the merger. After the judgment was entered against SourceHOV, plaintiffs allege that Exela—the new parent company—executed a scheme to prevent post-merger SourceHOV from satisfying the judgment. Plaintiffs asked the court to pierce the corporate veil downwards to enforce the judgment against SourceHOV's solvent subsidiaries.

Typically, veil-piercing operates upwards—to reach a parent company's assets when the corporate form is used to commit misconduct or hide assets of a subsidiary. Ruling for the plaintiffs, VC Slights set out a rule for reverse veil-piercing, specifically one that applies only to "outsider" reverse veil-piercing, in which an outside third party, such as a creditor, requests the court render a subsidiary liable on a judgment against its parent. Recognizing that reverse veil-piercing might serve as a blunt instrument due to the risks of harm to innocent shareholders and third-party creditors of the subsidiary, VC Slights emphasized the doctrine should be used only in exceptional circumstances: "Only in cases alleging egregious facts, coupled with the lack of real and substantial prejudice to third parties, should the court even consider utilizing the reverse veil-piercing doctrine."[2]

Critically, VC Slights' ruling was made in a decision denying a motion to dismiss because he was satisfied, at the early pleading stage, that such exceptional circumstances were present in the *Manichean* case, which included allegations that funds were intentionally diverted.

As a result, and notwithstanding VC Slights' admonition that reverse veil-piercing should be employed only in the rarest of circumstances, plaintiffs will almost certainly view the decision as an opening to plead such a theory more frequently. Delaware business entities, and any company doing business with a Delaware entity or that is a party to a contract subject to Delaware law, should be aware of the possibility that courts could hold corporate subsidiaries liable for the debts of their parent companies.

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1. *Manichean Cap., LLC. v. Exela Techs., Inc.*, C.A. No. 2020-0601-JRS, opinion (Del. Ch. May 25, 2021).

2. *Manichean Cap., LLC v. Exela Tech., Inc.*, C.A. No. 2020-0601-JRS, opinion at 34.