

Piercing/Protecting the Corporate Veil & Alter Ego Liability

A Rossdale CLE Telephonic Seminar

CORPORATE VEIL PIERCING *Fundamental Concepts*

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CORPORATE VEIL PIERCING:

Fundamental Concepts

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I. IMPORTANT CONSIDERATIONS IN VEIL-PIERCING

A. General Rule: Non-Liability.

A fair statement of the General Rule is that a shareholder [member, manager], beneficial owner, subscriber, or affiliate is not liable for the entity's debts or obligations (or those of co-owners or employees) simply because of his/her/its status as such.

See, e.g.: Dornfried v. Granquist, No. CV000502628, 2003 WL 1996024 (**Conn.** Super. March 27, 2003); *In re Broadstripe, LLC*, 444 B.R. 51, 102 (Bankr.D.**Del.**2010) (quoting *Geyer v. Ingersoll Publ'ns Co.*, 621 A.2d 784, 793 (**Del.** Ch.1992); *Thomas & Thomas Court Reporters, L.L.C. v. Switzer*, 810 N.W.2d 677, 685 (**Ind.** 2012); *Smith v. Isaacs*, 777 S.W.2d 912, 913 (**Ky.** 1989); *Ogea v. Merritt* 130 So.3d 888 (**La.** 2013)(SMLLC case); *Hobensee v. Turner*, 133 So. 3d 141 (**La.** COA, 4th Cir. 2014) (Citing: *La. Re v. Stat.* 12: 1320 (D)); *Restaurant of Hattiesburg, LLC v. HRS*, 84 So. 3d 32, 38-39 (**Miss.** COA 2012) (citing, *inter alia*, *Miss. Code Ann.* §37-29-305(1) (Rev.2009)); *Grand Legacy, LLP v. Gant*, 66 So.3d 137, 146-47 (¶¶29-35) (**Miss.** 2011); *Willis v. Donnelly*, 199 S.W.3d 262, (**Tex.**2006); *Neel v. Tenet Health Sys. Hosps. Dallas, Inc.*, 378 S.W.3d 597 (**Tex.** App.–Dallas 2012); *Spring Street Partners-IV, L.P. v. Lam*, 730 F.3d 427, 443 (**5th Cir. (Tex.)** 2013); *Tex. Bus. Orgs. Code* § 101.114)¹; *Unif. Limited Liability Company Act*, 6A U.L.A. 426 (1995))².

A typical formulation of the concept:

[C]ase law generally **favors maintaining corporate entities** and avoiding attempts to pierce the corporate veil.” (*Citation omitted*). “[T]he cardinal rule of corporate law is that a corporation possesses a legal existence separate and apart from that of its officers and shareholders’.... [t]his rule applies ‘whether such shareholders are individuals or corporations.’” (*Citations omitted*).

Francois v. Colonial Freight Systems, Inc., CA No. 3:06-cv-434 (USDC SD **Miss.** 12/14/07).

¹ Liability of members and managers. (a) The debts, obligations or other liabilities of a limited liability company, whether arising in contract, tort or otherwise: (i) Are solely the debts, obligations or other liabilities of the company; and (ii) Do not become the debts, obligations or other liabilities of a member or manager solely by reason of the member acting as a member or manager acting as a manager.

² SECTION 304. LIABILITY OF MEMBERS AND MANAGERS.

(a) A debt, obligation, or other liability of a limited liability company is solely the debt, obligation, or other liability of the company. A member or manager is not personally liable, directly or indirectly, by way of contribution or otherwise, for a debt, obligation, or other liability of the company solely by reason of being or acting as a member or manager. This subsection applies regardless of the dissolution of the company.

(b) The failure of a limited liability company to observe formalities relating to the exercise of its powers or management of its activities and affairs is not a ground for imposing liability on a member or manager for a debt, obligation, or other liability of the company.

Most states have a strong public policy "favor[ing] maintaining corporate entities and avoiding attempts to pierce the corporate or LLC veil. "Piercing the veil of an LLC should be reserved "for **factual circumstances which are clearly extraordinary** — where to do otherwise would `subvert the ends of justice." *Francois, supra*. Similarly, see: *Thomas & Thomas Court Reporters, L.L.C. v. Switzer*, 810 N.W.2d 677, 685 (**Ind.** 2012).

CAVEAT: Personal Liability for Own Actions. There is one extremely significant exception to the limited liability provided by corporations/LLCs and exists in all states. If you form an LLC/Corporation, you will remain personally liable for any wrongdoing you commit during the course of your LLC business. For example, LLC owners can be held personally liable if they:

- 1) personally and directly injure someone during the course of business due to their negligence;
- 2) fail to deposit taxes withheld from employees' wages;
- 3) intentionally do something fraudulent, illegal, or reckless during the course of business that causes harm to the company or to someone else, or
- 4) treat the LLC as an extension of their personal affairs, rather than as a separate legal entity.

Polo Fashions, Inc. v. Craftex, Inc., 816 F.2d 145, 149 (**4th Cir.** 1987) ([a] corporate official may be held personally liable for tortious conduct committed by him, though committed primarily for the benefit of the corporation); see also *Farm Fresh Direct By a Cut Above LLC v. Downey*, Civ. No. ELH-17-1760, 2017 WL 4865481, at *5 (**D. Md.** Oct. 26, 2017); *Rothy's, Inc. v. JKM Technologies, LLC*, 360 F. Supp. 3d 373 (USDC WD **Virginia** 2018).³

³ The Comment to Section 304 of the *Unif. Limited Liability Company Act*, 6A U.L.A. 426 (1995)) provides numerous examples and states:

Because the member or manager liability at issue is solely vicarious, the shield is irrelevant to claims seeking to hold a member or manager directly liable on account of the member's or manager's own conduct. Put another way, "[t]here is no question" that "the member-manager of a limited liability company who causes his business to breach common law and statutory duties may be held independently liable for his personal torts." *Dep't of Agric. v. Appletree Mktg., L.L.C.*, 485 **Mich.** 1, 4, 18, 779 N.W.2d 237, 239, 247 (2010).

B. Who Does Veil-Piercing Reach?

1. Cases Limiting Reach to a Corporation's Shareholders.

In *In re Opus East, L.L.C. (Burtch v. Opus, L.L.C.)*, 480 B.R. 561 (D. Del. 2012) the trustee sought to pierce the veil of the debtor, a Delaware LLC, to impose liability on the debtor's sole member and an affiliated corporation. The court found that the trustee failed to state a cause of action to pierce the corporate veil between the debtor and the affiliated corporation because the *alter ego* theory only applies when one seeks to hold liable the controlling owner of the company, and the only member of the debtor was the Minnesota LLC. The court noted that a member of an LLC is the equivalent of a shareholder of a corporation.

Alter-ego liability can be extended only to a corporation's shareholders. *Powertrain, Inc. v. Ma*, 88 F. Supp. 3d 679, 695 (USDC ND Miss. 2015) (citing *Gray v. Edgewater Landing, Inc.*, 541 So.2d 1044, 1047 (Miss.1989)); *DW Investments, LLC v. Barnett*, 149 So. 3d 489, 492 (Miss. 2014) (emphasis added); and *Rest. of Hattiesburg, LLC v. Hotel & Rest. Supply, Inc.*, 84 So. 3d 32, 39 (Miss. Ct. App. 2012) (**applying same veil-piercing rules to LLCs**); *Swift Financial Corporation v. Bath Planet of Mississippi, LLC*, Civil Action No. 3:15cv846-DPJ-FKB (USDC SD Miss. 2016). **The mere fact that the member commonly controlled two entities did not support alter-ego liability.** *Institutform Technologies, LLC v. Cosmic TopHat, LLC*, 959 F. Supp. 2d 1335 (N.D. Ga. 2013).

A **third-party sister or sibling entity** controlled by a subject entity will generally not be held responsible for the subject entity's actions, especially when the third-party sister or sibling entity involves minority owners who have no interest in the subject entity. *Tyson Fresh Meats, Inc. v. Lauer Limited, L.L.C.*, 918 F. Supp. 2d 835 (N.D. Iowa 2013).

In *Swift Financial Corporation v. Bath Planet of Mississippi, LLC*, Civil Action No. 3:15cv846-DPJ-FKB.(USDC SD Miss. June 6, 2016), the court refused to extend liability to a **shareholder's wife** and reaffirmed that alter-ego liability can be extended only to a corporation's shareholders.

BUT SEE: *Northern Tankers (Cyprus) Ltd. v. Backstrom*, 967 F. Supp. 1391 (D. Conn. 1997) (applying **Federal common law** and **reached through to the individuals controlling**

the corporation and some of the other LLC's they owned and operated); and *Restaurant of Hattiesburg, LLC v. HRS*, 84 So. 3d 32, 42 (Miss. COA 2012) (considered the liability of an **affiliated corporation** under a veil piercing theory without discussion of the law limiting the reach of veil piercing).

Additional cases discussing the issue are: *Minno v. Pro-Fab, Inc.*, 121 Ohio St.3d 464, 905 N.E.2d 613, 617 (2009) ("[a] corporation's veil may not be pierced in order to hold a second corporation liable for the corporate misdeeds of the first when the two corporations have common individual shareholders but **neither corporation has any ownership interest in the other[.]**");⁴ *Molinos Valle Del Cibao, C. por A. v. Lama*, 633 F.3d 1330, 1351 (11th Cir. 2011) (under Florida law a plaintiff was not permitted to pierce the corporate veil against a **non-shareholder director**); *Thibodeau v. Cole*, 740 A.2d 40, 42 (Me. 1999) (**only shareholders** may be held liable when piercing the corporate veil); and *Allred v. Exceptional Landscapes, Inc.*, 227 N.C.App. 229, 743 S.E.2d 48, 53-54 (N.C. 2013)(refusing to pierce the veil to reach a **non-shareholder**).

2. Reaching Officers, Managers, and Others.

Two recent **Colorado** decisions have addressed whether and under what circumstances a creditor of an LLC can pierce the veil and reach an affiliate that did not even have an ownership interest in the LLC. These cases decided that, on the facts, one non-member manager could be reached and the other could not.

In *Sheffield Services Company v. Trowbridge*, 211 P.3d 714 (Col. App. 2009) (overruled in part, *Weinstein v. Colborne Foodbotics, Inc.*, 2013 CO 33 (Colo. 2013)), veil piercing was used to **reach a non-member manager**. The court held that the Colorado LLC statute does not expressly preclude common law veil piercing to hold a manager personally liable for an LLC's actions, analogizing the circumstance to a board of directors of a corporation. The court discussed the Colorado common law of corporate veil piercing and pointed out that the court of appeals in

⁴ In contrast to a shareholder's ownership of a corporation or a parent corporation's ownership of another corporation, the common shareholder ownership of sister corporations does not provide one sister corporation with the inherent ability to exercise control over the other. **Any wrongful act committed by one sister corporation might have been instigated by the corporation's owners, but it could not have been instigated by the corporation's sister.** 905 N.E.2d at 617.

LaFond v. Basham, 683 P. 2d 367 (**Colo.** COA 1st Div. 1984) extended corporate veil piercing doctrine beyond corporate shareholders by concluding that a corporate entity may be disregarded, and **corporate directors** held personally liable if equity requires. The court characterized LLC managers as similar to corporate officers and directors, and the court saw no reason to decline to extend the reasoning in *LaFond* to LLC managers.

The reasoning in *Sheffield* might or might not hold up in other jurisdictions, though the code words “if equity requires” can be seen as a substitute for the concept of “fraudulent purpose in conception or operation of the business”, discussed, *supra*, as one of the three alternative tests for piercing the veil. *Sheffield* may be seen as just an extension of that concept to another entity, not having ownership in the LLC to be pierced, which nevertheless was used to work some kind of fraud or similar inequitable practice that deprived the plaintiff of its recovery. It would seem that this concept is more likely to be employed in cases of torts rather than contracts, though perhaps a “tortious breach of contract” or some similar concept overlapping tort and contract law might be employed.

In 2019, in a case of first impression, *i.e.*, veil-piercing in the context of a **single-member, single-purpose LLC that is managed under contract with a management company**, the Colorado Court of Appeals went the other way. In *Sedgwick Properties Development Corporation v. Hinds*, 2019 WL 2865935 (**Colo.App.** 2019) the Court **declined to foist liability on the management company which had no ownership interest in the LLC and which had only managed the LLC**. There was no proof that the LLC was a “mere shell”, was thinly capitalized, or commingled assets or used corporate funds for non-corporate purposes. Though the LLC to be pierced did not follow corporate formalities, and the same individual who controlled the LLC was also the principal of the management company, the Court refused to find that the LLC was the management company's *alter ego*.

In reaching its decision, the COA recognized that the *Colorado LLC Act* was silent regarding the personal liability of managers under a veil-piercing theory, and that a **manager of an insolvent LLC does not owe the LLC's creditors the same fiduciary duties that the directors of an insolvent corporation owe the corporation's creditors**. The COA reminded

that LLCs are different from corporations, and a Court should “tread carefully” when applying traditional veil piercing analysis to LLCs, especially single-member ones or ones managed by a management company.

Especially in light of *Sheffield*, it should be noted that in *Sedgwick* no fraud or wrongful motive/intent was found. One can conclude that *Sedgwick* was really no different than *Sheffield* but for there being no fraud or similar reason for equity to step in.

Note that the previously discussed *Lunneborg v. My Fun Life*, 421 P. 3d 187, 203 (Idaho 2018) recognized that "piercing the corporate veil imposes personal liability on otherwise protected **corporate officers, directors**, and shareholders for a company's wrongful acts allowing the finder of fact to ignore the corporate form." *Citing: Wandering Trails, LLC v. Big Bite Excavation, Inc.*, 156 Idaho 586, 594, 329 P.3d 368, 376 (2014). The non-shareholder held liable in *Lunneborg* was an officer of company whose veil was pierced and worked actively in the company and participated in the conduct the Court found inequitable.

WY Stat §17-29-304(c) (2018):

For purposes of imposing liability on any member or **manager** of a limited liability company for the debts, obligations or other liabilities of the company, a court shall consider only the following factors no one (1) of which, except fraud, is sufficient to impose liability: (i) Fraud; (ii) Inadequate capitalization; (iii) Failure to observe company formalities as required by law; and (iv) Intermingling of assets, business operations and finances of the company and the members to such an extent that there is no distinction between them. Subsection (d) provides that in making a piercing the veil analysis, a court shall not consider, inter alia, "Flexible operation or organization including the failure to observe any particular formality relating to the exercise of the company's powers or management of its activities."

3. Reaching Parties with No Ownership - Control

A majority of jurisdictions addressing this question **allow veil-piercing against non-shareholders**. *Buckley v. Abuqir*, 380 Ill.Dec. 624, 8 N.E.3d 1166, 1171-77 (Ill. App. 2014) (citing *Fontana*, 362 Ill.App.3d 491, 298 Ill. Dec. 654, 840 N.E.2d 767, 778 (2005) (Illinois law does not preclude piercing the corporate veil and imposing personal liability for the corporation's debts because of status as a non-shareholder)).

Lunneborg v. My Fun Life, 421 P. 3d 187, 203 (Idaho, 2018), permits piercing the corporate veil when an individual **exercises sufficient control over the corporation, despite their status as a non-shareholder**.

We adopt the majority rule in Idaho. Stock **ownership**, while important, is **not a necessary prerequisite** to pierce the corporate veil—it is merely **one factor** to consider. As we noted above, there are several factors a court of equity may consider when determining whether to pierce the corporate veil. Similarly, in these circumstances, when a claimant seeks to hold a non-shareholder liable for corporate debts, the court may look to a range of evidence to consider whether fairness dictates allowing recovery against a non-shareholder-officer, with the **primary consideration** being the element of **control or influence exercised** by that person in the affairs of the corporation.

- *Freeman v. Complex Computing Co., Inc.*, 119 F.3d 1044, 1051 (2d Cir. 1997) (if an individual **exercises sufficient control** over the corporation they may be held liable despite the fact they are a non-shareholder);
- *Angelo Tomasso, Inc. v. Armor Const. & Paving, Inc.*, 187 Conn. 544, 447 A.2d 406, 412 (1982) ("stock ownership, while important, is not a prerequisite to piercing the corporate veil but is merely one factor to be considered.... It is clear that the **key factor** in any decision to disregard the separate corporate entity is the **element of control or influence** exercised by the individual sought to be held liable over corporate affairs.");
- *Mantle v. North Star Energy & Construction LLC*, 437 P.3d 758, 799 (Wyo. 2019) (No evidence that the non-member "exercised any control. No precedent for extending veil piercing to non-members, the Court **declined to make any extension** in this case.);
- *A.G. Dillard, Inc. v. Stonehaus Construction, LLC*, No. 151182, 2016 WL 3213630 (Va. June 2, 2016) (plaintiff **sought to** satisfy a judgment against an LLC by **reaching the assets** of the LLC's member, **the member's spouse, and other entities owned or controlled**

by the member. The plaintiff relied on veil piercing (both traditional and reverse) and fraudulent conveyance claims. The Virginia Supreme Court made clear that the **same standards that apply for veil piercing in the corporate context apply in the LLC context.** Plaintiff did not allege that wife had any relationship with the LLC other than indirectly through her husband. Spouse's assets could not be reached by piercing the veil).

4. Reaching Affiliates and Related Parties

a. Lateral Piercing

Unlike veil piercing through the alter ego theory, allowing creditors to reach shareholders of the debtor, the single employer/single business enterprise theory is a method of laterally piercing the veil. It **allows a creditor to reach the assets of one company to satisfy the debts of another company.** Some, but not all, jurisdictions utilize the Single Employer/Single Business Enterprise Doctrine to establish alter ego for veil piercing purposes. Delaware is a user of this theory. To pierce the corporate veil under the alter ego theory requires a showing that the corporation and its shareholders operated as a single economic entity and that an overall element of injustice or unfairness is present. *In re Opus East, L.L.C. (Burtch v. Opus, L.L.C.)*, 480 B.R. 561 (D. Del. 2012).

McBeth v. Porges, 171 F.Supp.3d 216 (S.D.N.Y. 2016) presents perhaps one of the most recent discussions of the "single entity theory" utilized in Delaware, New York and some other jurisdictions. According to *McBeth*, in an alter-ego inquiry under Delaware law, the court must determine **whether the relevant parties operated as a "single entity"** by considering various factors (adequate capitalization, solvency, corporate formalities, siphoning of company funds, and whether the company functioned as a facade for the controlling owner). Additionally, a Delaware alter-ego claim requires an element of fraudulent intent, though proof of actual fraud is not necessary, at least in this formulation. Showing a mingling of the operations of the entity and its owner and an overall element of injustice and unfairness will suffice. The *McBeth* court also noted that, "Courts and commentators have noted that this **standard is less than clear, and it has been criticized for its ambiguity and randomness.**"

In an alter-ego inquiry under Delaware law, the court must determine **whether the relevant parties operated as a "single entity"** by considering various factors (adequate

capitalization, solvency, corporate formalities, siphoning of company funds, and whether the company functioned as a facade for the controlling owner). Additionally, a Delaware alter-ego claim requires an element of fraudulent intent, though proof of actual fraud is not necessary, at least in this formulation. Showing a mingling of the operations of the entity and its owner and an overall element of injustice and unfairness will suffice. The *McBeth* court also noted that, "Courts and commentators have noted that this **standard is less than clear** and it has been criticized for its ambiguity and randomness."

There are other worthwhile points in *McBeth*. First, is a pleading issue: where an alter ego claim does not sound in fraud, it is not subject to the particularity requirement of Rule 9(b) of the *Federal Rules of Civil Procedure*. Second, is another pleading/discovery issue: where all a plaintiff has are theories and speculation, he is unlikely to be able to survive a motion to dismiss. "What *McBeth* does not know is precisely how the Defendants squandered or misappropriated his money." The Court then noted that the *Federal Rules of Civil Procedure* do "not unlock the doors of discovery for a plaintiff armed with nothing more than conclusions" or speculation. (Citing: *Ashcroft v. Iqbal*, 556 U.S. 662, 678-79, 129 S. Ct. 1937 (2009)).

The decision in *In re JNS Aviation, LLC*, 376 B.R. 500, 528 (Bankr.N.D.Tex.2007), *aff'd*, 395 Fed.Appx. 127, 128 (5th Cir. 2010) provides a succinct explanation of the **single enterprise theory**.

The single business enterprise theory of corporate disregard is similar in purpose to *alter ego*, but is not considered synonymous with the alter ego strand. *North American Van Lines, Inc. v. Emmons*, 50 S.W.3d 103 (Tex.App.-Beaumont 2001). The **single business enterprise doctrine is an equitable doctrine applied to reflect partnership type liability principles when corporations integrate their resources and operations to achieve a common business purpose.** 15 TEX. JUR.3D, *Corporations* §173 (2007). Under the single business enterprise theory, when corporations are not operated as separate entities but rather integrate their resources to achieve a common business purpose, each constituent corporation may be held liable for debts incurred in the pursuit of that business purpose. *Id.* As opposed to "piercing" through the corporate shield to hold a shareholder or perhaps another affiliated company liable, the single business

enterprise doctrine recognizes the corporate shields of the two companies but treats the two as partners given their common business purpose and thereby subjects each "partner" to the liabilities of the "partnership" formed by their relationship.

For another case accepting the "single employer theory", see: *Rowland v. Franklin Career Services, LLC*, 272 F. Supp. 2d 1188 (D. **Kan.** 2003) (evidence of interrelated operations, centralized control of labor relations, common management, and common ownership gave rise to fact issue as to whether LLC was part of an integrated enterprise with LLC that employed plaintiff so as to constitute a "single employer" for purposes of plaintiff's *Title VII* discrimination claim).

However, some states, Mississippi for one, have **never adopted the "single business enterprise theory"** to hold affiliated LLCs jointly liable for each other's debts. *Restaurant of Hattiesburg, LLC v. HRS*, 84 So. 3d 32, 42 (**Miss.** COA 2012) (case involved the possible liability not of an owner or manager, but of an affiliated corporation, the Court holding that the plaintiff would have to prove "actual frustration of identity due to the shared bank account in order to prevail".)

In 2009, after the Bankruptcy Court's opinion in *JNS Aviation, supra*, in 2008, the Supreme Court of **Texas expressly abrogated the single business enterprise theory** as "fundamentally inconsistent" with the *Texas Business Corporation Act* in *SSP Partners v. Gladstrong Investments (USA) Corp.*, 275 S.W.3d 444, 454-56 (**Tex.**2008) because fraud, abuse or injustice were not factors in the "single business enterprise theory" and was, therefore, inconsistent with veil piercing. The court recognized that, **"Creation of affiliated corporations to limit liability while pursuing common goals lies firmly within the law and is commonplace,"** and that the *Texas Business Corporations Act* employs a strict approach to veil piercing which requires fraud in certain cases. *SSP Partners* held, "[t]here is nothing abusive or unjust... in the abstract" with corporations sharing "offices, accounting, employees, services, and finances." *Id.* at 454.

Though the court rejected the use of the single business enterprise theory to pierce the veil, subsequent cases have utilized the theory as proof of the alter ego prong of the veil piercing test, e.g., *Tryco Enterprises, Inc. v. Robinson*, 390 S.W.3d 497 (**Tex.** COA 2012). This seems to be

consistent with cases like *Opus East (Delaware)*, *supra*, where the court requires some substantial proof of fraud or injustice along with the common business enterprise/alter ego.

NOTE: *Restaurant of Hattiesburg, LLC v. HRS*, 84 So. 3d 32, 35 (**Miss.** COA 2012) (discusses the possibility of holding an affiliated corporation of the debtor liable under a veil-piercing theory); *Andrews v. Kerr McGee Corp.*, No. 1:00CV158-D-A, 2001 WL 1704144 (N.D. **Miss.** Dec. 5, 2001) (concerning Delaware law)

Other decisions include: *Paramount Petroleum Corp. v. Taylor Rental Ctr.*, 712 S.W.2d 534, 536-37 (**Tex. App.-Houston** [14th Dist.] 1986, *writ ref'd n.r.e.*); *Nat'l Plan Adm'rs, Inc. v. Nat'l Health Ins. Co.*, 150 S.W.3d 718, 744 (**Tex. App.-Austin** 2004) *rev'd sub nom.* *Nat'l Plan Adm'rs, Inc. v. Nat'l Health Ins. Co.*, 235 S.W.3d 695 (**Tex.** 2007); *Pan Pacific Sash & Door Co. v. Greendale Park, Inc.*, 333 P.2d 802 (**Cal. Ct. App.** 1958); *Las Palmas Assoc. v. Las Palmas Ctr. Assoc.*, 1 Cal. Rptr. 2d 301 (**Cal. Ct. App.** 1991); *SSP Partners v. Gladstrong Investments*, 275 S.W.3d 444 (**Tex.** 2008); and *F.T.C. v. Network Servs. Depot, Inc.*, 617 F.3d 1127, 1136 (**9th Cir.** 2010).

B. Reverse Veil Piercing

The **general rule** in all states is that the **money or property of an LLC cannot be taken by creditors to pay off the personal debts or liabilities of the LLC's owners**. Similar to corporations, the money or property held in an LLC belongs to the LLC, not the member/owners individually, and may not be applied by creditors to pay a member's individual debts. This protection from personal creditors is one of the key reasons people form LLCs. In addition to providing LLC members with personal liability protection from the LLC's business debts, the LLC also protects the business and its owners from exposure to any debts or personal liability the other LLC members/owners may incur that are unrelated to the LLC's business.

Section 108(a) of the *Uniform Act* provides that, "A limited liability company is an entity distinct from its member or members." The Comment to Section 108 explains this important characteristic.

Subsection (a)—The "separate entity" characteristic is fundamental to a limited liability company and is inextricably connected to both the liability shield, Section 304, and the inability of creditors of a member or transferee to reach the assets of the limited liability

company absent a "reverse pierce" or a claim of fraudulent transfer.

See, e.g., *Litchfield Asset Mgmt Corp. v. Howell*, 799 A2d 298 (**Conn.** Ct. App. 2002) (applying an "outside reverse pierce" to allow judgment creditor of member to reach assets of LLC) (overruled on other grounds by *Robinson v. Coughlin*, 830 A2d 1114 (**Conn.** 2003)); *Egle v. Egle*, 817 So. 2d 136, 140 (**La.** Ct. App. 2002) (allowing plaintiff to proceed with claims that transfers made by her ex-spouse *inter alia* to an LLC were sham transactions).

One prominent commentator, Professor Larry Ribstein⁵, has made this observation about LLC's and reverse limited liability:

Reverse limited liability refers to the use of partnership-type entities as, effectively, asset-protection trusts. This has occurred because of the combination of limitations on creditors' access to debtors' interests in partnership-type firms and provisions permitting use of such firms by non-profit, one-owner entities. The courts have attempted to curtail this unexpected development with fraudulent conveyance, veil-piercing, and bankruptcy rules that do not reach the basic problem.

"In a reverse piercing action, however, the claimant seeks to reach the assets of a corporation or some other business entity... to satisfy claims or a judgment obtained against a corporate insider." *Com'r of Env. Prot. v. State Five Indus.*, 37 A. 3d 724 (**Conn.** 2012) (Citing: *C.F. Trust, Inc. v. First Flight, L.P.*, 266 Va. 3, 10, 580 S.E.2d 806 (2003); see also *In re Blatstein*, 192 F.3d 88, 100 (**3d Cir.**1999); *Postal Instant Press, Inc. v. Kasma Corp.*, 162 Cal.App.4th 1510, 1513, 77 Cal.Rptr.3d 96 (2008), *cert. denied*, 2008 **Cal.** LEXIS 10671 (August 27,2008); annot., 2 *A.L.R.6th* 195, § 2 (2005)). The Connecticut Supreme Court then provided a good **summary of the issues with reverse veil piercing**:

Although some courts have adopted reverse veil piercing with little distinction as a logical corollary of traditional veil piercing, because the two share

⁵ Ribstein, Larry E., 30 *DELAWARE JOURNAL OF CORPORATE LAW* 200 [Public Law and Legal Theory Working Paper Series No. 04-08], REVERSE LIMITED LIABILITY AND THE DESIGN OF BUSINESS ASSOCIATION (This paper can be downloaded without charge from the Social Science Research Network Electronic Paper Collection: http://papers.ssrn.com/pape.tar?abstract_id=534602)

the same equitable goals, others wisely have recognized 733*733 important differences between them and have either limited, or disallowed entirely, reverse veil piercing. See G.S. Crespi, "The Reverse Pierce Doctrine: Applying Appropriate Standards," 16 *J. Corp. L.* 33, 37 (1990) ("reverse pierce claims implicate different policies and require a different analytical framework from the more routine corporate creditor veil-piercing attempts"). Three specific concerns have been identified. "First, reverse piercing bypasses normal judgment-collection procedures, whereby judgment creditors [of an individual judgment debtor] attach the judgment debtor's shares in the corporation and not the corporation's assets." (Internal quotation marks omitted.) *Postal Instant Press, Inc. v. Kaswa Corp.*, *supra*, 162 Cal.App.4th at 1520, 77 **Cal.** Rptr.3d 96. When corporate assets are attached directly for the benefit of the creditors of an individual, it prejudices rightful creditors of the corporation, who relied on the entity's separate corporate existence when extending it credit and "underst[ood] their loans to be secured — expressly or otherwise — by corporate assets." *Floyd v. Internal Revenue Service*, 151 F.3d 1295, 1299 (10th Cir.1998).

Second, if a "corporation has other non-culpable shareholders, they [too] obviously will be prejudiced if the corporation's assets can be attached directly. In contrast, in ordinary piercing cases, only the assets of the particular shareholder [or other insider] who is determined to be the corporation's alter ego are subject to the attachment." (Internal quotation marks omitted.) *Postal Instant Press, Inc. v. Kaswa Corp.*, *supra*, 162 **Cal.** App.4th at 1520, 77 Cal.Rptr.3d 96. Thus, "[a] key factor in any outsider reverse piercing controversy is the presence of corporate shareholders other than the insider against whom the outsider is asserting the primary claim. If other shareholders do exist, allowance of a reverse pierce would prejudice those shareholders by allowing the outsider to attach assets in which they have an interest." G.S. Crespi, *supra*, 16 *J. Corp. L.* at 65.[14]

Finally, because corporate veil piercing is an equitable remedy, it should be granted only in the absence of adequate remedies at law. See *Naples v. Keystone Building & Development Corp.*, *supra*, 295 **Conn.** at 233, 990 A.2d 326; see also *Floyd v. Internal Revenue Service*, *supra*, 151 F.3d at 1300; 1 W. Fletcher, *Cyclopedia of the Law of Private Corporations* (1999) § 41.25, p. 604; annot., 2 *A.L.R.6th*, *supra*, § 3, at p. 195. In the case of a traditional veil pierce, "[w]hen a judgment debtor is a corporation, the judgment creditor cannot reach the assets of the individual shareholders due to limitations on liability imposed by corporate law"; *Postal Instant Press, Inc. v. Kasma Corp.*, *supra*, 162 Cal.App.4th at 1522, 77 **Cal.Rptr.3d** 96; thereby justifying the invocation of equity. Conversely, when the judgment debtor is a shareholder or other insider, many legal remedies potentially are available to reach corporate assets that rightfully should be available for collection, including the attachment of the debtor's shares in the corporation, if he or she is a shareholder, garnishment of his or her pay from the corporation, if he or she 734*734 is an employee, challenging of his or her transfers of assets to the corporation as fraudulent conveyances or illegal conversion, or attribution of individual conduct to the corporation under theories of agency or *respondeat superior*. See *id.*, at 1520, 77 **Cal.Rptr.3d** 96; *Floyd v. Internal Revenue Service*, *supra*, at 1300. If pursued, these remedies may "[obviate] the need for the more drastic remedy of corporate disregard." *Floyd v. Internal Revenue Service*, *supra*, at 1300; see, e.g., *Owens & Sons, Inc. v. Guastella East, Inc.*, 354 So.2d 571, 572 (**La.App.**1977) (finding reverse pierce "an unnecessary and therefore unavailable remedy" where judgment creditor could execute on debtors' shares).

When the preceding concerns are implicated, courts have declined to impose reverse veil piercing. To summarize, "a court considering reverse veil piercing must weigh the impact of such action upon innocent investors. A court considering reverse veil piercing must also consider the impact of such an act upon innocent secured and unsecured creditors. The court must also consider the availability of other remedies the creditor may pursue." *C.F. Trust, Inc. v. First Flight, L.P.*, *supra*, 266 **Va.** at 12-13, 580 S.E.2d 806.

In *Litchfield Asset Management Corp. v. Howell*, *supra*, [*Litchfield Asset Management Corp. v. Howell*, 70 **Conn.** App. 133 - Conn: Appellate Court 2002] a ninety-seven percent owner of an LLC who owed

plaintiff \$657,207.38, contributed \$144,679 to the LLC after plaintiff sued. Other owners, including the debtor's daughters, contributed \$10 each. Relying on traditional corporate veil-piercing rules, the court pierced the veil, emphasizing the control exercised by the majority owner, the owner's unauthorized use of company funds to pay personal expenses (instead of drawing a regular salary or distributions that a creditor might have reached through a charging order), and the owner's commingling of business and personal affairs and funds.

In a case somewhat similar to *Litchfield, C.F. Trust, Inc. v. First Flight Ltd. Partnership*, 306 F.3d 126 (4th Cir. 2002), opinion on certified question, 580 S.E.2d 806 (Va. 2003):

The state court held that Virginia law would permit reverse veil piercing under the general Virginia corporate veil-piercing standard. That test required showing that the limited partnership "has been controlled or used by the debtor to evade a personal obligation, to perpetrate a fraud or a crime, to commit an injustice, or to gain an unfair advantage." *C.F. Trust, Inc.*, 580 S.E.2d at 811. The court must consider the impact of piercing on innocent partners and creditors, and "the availability of other remedies the creditor may pursue." *Id.* The court did not make an explicit exception to veil-piercing for limited partnerships, although it indicated that the creditor's "other remedies," such as the charging order remedy, may be relevant.

C.F. Trust indicates that, while the limited partnership control rule and charging order remedy do not preclude veil-piercing, the creditor will be remitted to these remedies unless it can show some abuse. This abuse might include the debtor's use of control to prevent the creditor's access to distributions, as in both *Litchfield* and *C.F. Trust*. Moreover, *C.F. Trust* shows that a court will reverse-pierce even if the debtor is not the sole owner, at least where the other owner (in this case the son) is complicit in the scheme.

Ribstein, supra, at 218.

Ribstein then makes this observation concerning reverse piercing:

These partnership reverse piercing cases leave significant questions concerning the circumstances in which the court will pierce. To begin with, it is not clear whether the courts will follow corporate reverse piercing cases. Some of these cases have refused to apply this remedy because of the need to protect innocent non-debtor owners of the corporation and the availability of other creditor remedies, presumably including attachment. See *In re Blatstein*, 192 F.3d 88, 100 (3d Cir. 1999); *Cascade Energy & Metals Corp. v. Banks*, 896 F.2d 1557, 1576 (10th Cir. 1990); *Acree v. McMahan*, 585 S.E.2d 873, 875 (Ga. 2003). Neither justification for reluctance to pierce may exist in a partnership case, where the asset-holding entity is a sole proprietorship or family-owned non-profit firm, and the charging order blocks the creditor from access to the firm's assets.

In the recent decision of *Sky Cable, LLC v. DirecTV, Inc.*, 886 F.3d 375 (4th Cir. (W.Va.) 2018), the 4th Circuit observed that “reverse veil piercing attaches liability to the entity for a judgment against the individuals who hold an ownership interest in that entity. See *C.F. Tr., Inc. v. First Flight, L.P.*, 306 F.3d 126, 134 (4th Cir. 2002) (explaining that reverse piercing renders the entity liable for debts of a member); see also *Zabra Spiritual Tr. v. United States*, 910 F.2d 240, 244 (5th Cir. 1990) (noting that courts can reverse pierce a corporation's veil based on a finding of alter ego).” *Id.* at 385.

The *Sky Cable* Court then discussed the two kinds of reverse piercing:

Reverse piercing is classified into two types, namely, insider reverse piercing and outsider reverse piercing. See 1 Fletcher, *supra*, § 41.70. **"Insider" reverse piercing** applies when "the controlling [member or shareholder] urges the court to disregard the corporate entity that otherwise separates the [member or shareholder] from the corporation." 1 James D. Cox & Thomas Lee Hazen, *Treatise on the Law of Corporations* § 7:18 [Cox & Hazen] (3d ed. 2017). However, many courts strongly oppose allowing a company's veil to be pierced for the benefit of the individuals who themselves have created the company.[6] **386*386** *Id.*; 2 F. Hodge O'Neal & Robert B. Thompson, *Close Corporations and LLCs: Law and Practice* § 8:18 [O'Neal & Thompson] (Rev. 3d ed.) ("[C]ourts rarely permit a corporation to be disregarded for the benefit of its own shareholders.").

"Outsider" reverse piercing, the type relevant here, applies when an outside third party, frequently a creditor, urges a court to render a company liable in a judgment against its member. *First Flight*, 306 F.3d at 134 ("Outsider reverse veil-piercing extends [the] traditional veil-piercing doctrine to permit a third-party creditor to 'pierce the veil' to satisfy the debts of an individual out of the corporation's assets." (citation omitted and second alteration in original)). Many courts have allowed outsider reverse piercing in actions by creditors, *Cox & Hazen, supra*, § 7:18, because outsider reverse piercing "follows logically the premises of traditional veil piercing," *O'Neal & Thompson, supra*, §8:18. The states that have barred outsider reverse piercing have done so "in large part because of the potential harm to innocent shareholders [or members]." *Cox & Hazen, supra*, § 7:18.

Id. at 385-86.

The same considerations that permit of a piercing of the corporate veil will also apply to reverse piercing.

Although there are obvious differences between piercing an entity's veil to render an individual liable, and piercing the veil to render a company liable, we have explained that in many jurisdictions **"the same considerations that justify [traditional] piercing [of] the corporate veil may justify piercing the veil in 'reverse.'"** *First Flight*, 306 F.3d at 135 (citing 1 Fletcher, *supra*, § 41.70). But see *Cancan Dev., LLC v. Manno*, No. CV 6429-VCL, 2015 WL 3400789, at *22 (Del. Ch. May 27, 2015) (observing that reverse piercing may require different analysis). Notably, in Delaware, disregarding the corporate fiction "can always be done if necessary to prevent fraud or chicanery," a principle that would support both traditional and reverse veil piercing. See *Adams v. Clearance Corp.*, 35 Del.Ch. 459, 121 A.2d 302, 308 (1956) (emphasis added) (noting that disregarding corporate form can be appropriate but not addressing veil piercing directly). Just as traditional veil piercing permits a court to hold a member liable for a company's actions, reverse veil piercing permits a court to hold a company liable for a member's actions if recognizing the corporate form would cause fraud or similar injustice. See *Pauley*, 239 A.2d at 633; *Harco Nat'l Ins. Co. v. Green Farms, Inc.*, No. CIV. A. 1131, 1989 WL 110537, at *4 (Del. Ch. Sept. 19, 1989) (observing that *Pauley* applied directly to corporate veil piercing).

Reverse veil piercing is **particularly appropriate when an LLC has a single member**, because this circumstance alleviates any concern regarding the effect of veil piercing on other members who may have an interest in the assets of an LLC. See 1 *Fletcher, supra*, § 41.70 (noting that "potential harm" to other members "must be considered"). Therefore, when an entity and its sole member are *alter egos*, the rationale supporting reverse veil piercing is especially strong. And because Delaware courts apply the alter ego theory only in exceptional circumstances, recognition of reverse veil piercing for the limited purpose of preventing fraudulent conduct would not threaten the general viability of the corporate form in **Delaware**. See *Wallace*, 752 A.2d at 1183.

Id. at 387.

The Court went on to conclude, in an LLC context, that the **Delaware** charging statute would not preclude the remedy of reverse veil-piercing, at least in this context.

Accordingly, we conclude that Delaware's LLC charging statute does not prevent a court from reverse piercing the veil of an LLC that serves only as an alter ego of its sole member, because such an LLC is a "sham entity." See *Crosse v. BCBSD, Inc.*, 836 A.2d 492, 497 (**Del.** 2003). The district court therefore correctly held that under Delaware law, outsider reverse piercing of an LLC is warranted to render an LLC a co-judgment debtor when the LLC is the alter ego of its sole member.

Sky Cable, LLC v. DirecTV, Inc., 886 F. 3d 375, 389 (**4th Cir.** 2018).

For an interesting, very recent decision recognizing the doctrine of outsider reverse veil piercing try *McKay v. Longman*, 211 A.3d 20 (**Conn.** 2019). The discussion is interesting, though perhaps academic, at least in Connecticut. On the day that oral arguments were heard, the Connecticut legislature passed a statute prohibiting the application of outsider reverse veil piercing.

C. Determination is Fact Specific and State Specific.

Whether to pierce “corporate veil” is normally a **fact issue**. *E.g., Gardner v. Marcum*, 665 S.E.2d 336 (Ga. App. 2008). “Veil piercing determinations are **fact specific and differ with the circumstances of each case.**” *Thomson-CSF, S.A. v. Am. Arbitration Assn.*, 64 F.3d, 773, 777-78 (2d Cir. 1995); *American Protein Corp. v. AB Volvo*, 844 F.2d 56, 60 (2d Cir. 1988)(**no one factor or combination of factors is dispositive**); *Network Enterprises, Inc. v. APBA Offshore Productions, Inc.*, 427 F. Supp. 2d 463, 488-89 (S.D.N.Y. 2006); *Williamson v. Recovery Ltd. P’ship*, 542 F.3d 43, 53 (2d Cir.2008) (“general principle guiding courts is **achieve an equitable result.**”) (Cited in *Clipper Wonsild, supra*); *In re Opus East, L.L.C. (Burtch v. Opus, L.L.C.)*, 480 B.R. 561 (D. Del. 2012); and *United States v. Funds Held in the Name or for the Benefit of Wetterer*, 210 F.3d 96, 106 (2d Cir.2000). “[T]he decision whether to disregard the corporate form to impose liability is **fact intensive.**” *Wachovia Secs., LLC v. Banco Panamericano, Inc.*, 674 F.3d 743, 756 (7th Cir. 2012) (citing: *Laborers' Pension Fund v. Lay-Com, Inc.*, 580 F.3d 602, 610 (7th Cir. 2009)); *Case Fin., Inc. v. Alden*, No. 1184-VCP, 2009 WL 2581873, at *4 (Del. Ch. Aug. 21, 2009).⁶

From there, the analysis must also become **state specific** in that different states have placed different emphasis upon which test will be utilized and, within those tests, which factors will be emphasized or reduced in stature. An excellent and expansive statement of the premise is set forth in *Mantle v. North Star Energy & Construction LLC*, 437 P.3d 758, 800 (Wyo. 2019), citing *Green Hunter Energy, Inc. v. Western Ecosystems Tech.*, 2014 WY 144, 337 P.3d 454 (Wyo. 2014).

However, given veil-piercing's "**fact-driven,**" "**flexible**" inquiry **that depends so heavily "on the particular circumstances" and "special facts" of the case**, we cannot conclude a court's hands are tied when it finds technical violation of a statute, but no fraudulent intent. Implicit in the district court's conclusion that the fraudulent transfers did not warrant veil-piercing is the conclusion that no injustice would result from refusing to pierce the veils of

⁶ In **Delaware**, determining whether to pierce the veil requires a fact intensive inquiry, which may consider the following factors, none of which are dominant: (1) whether the company was adequately capitalized for the undertaking; (2) whether the company was solvent; (3) whether corporate formalities were observed; (4) whether the controlling shareholder siphoned company funds; and (5) whether, in general, the company simply functioned as a facade for the controlling shareholder. There also must be an element of fraud to justify piercing the corporate veil.

the member entities, and we have said "**an injustice or unfairness must always be proven.**" *Id.* at ¶ 34, 337 P.3d at 464.

D. Veil-Piercing is a Remedy, Not a Cause of Action.

Theories seeking to pierce the corporate veil are **not causes of action but a remedy**. See, e.g., *Mapco, Inc. v. Carter*, 817 S.W.2d 686, 688 (**Tex.**1991); *Gallagher v. McClure Bintliff*, 740 S.W.2d 118, 119 (**Tex.App.-Austin** 1987, *writ denied*); *Rokni v. Mostadim*, No. B173905, 2005 WL 250314 (**Cal.** App. 2 Dist. Feb. 3, 2005); *Powertrain, Inc. v. Ma*, 88 F. Supp. 3d 679, 695 (USDC ND **Miss.** 2015) (citing: *EDW Invs., LLC v. Barnett*, 149 So.3d 489, 492 (**Miss.**2014) and *Gray v. Edgewater Landing, Inc.*, 541 So.2d 1044, 1047 (**Miss.**1989)). Piercing the veil is a means of imposing on a member, manager or affiliate of an LLC liability for obligation of the LLC. *Dick's Last Resort of the West End, Inc. v. Market/Ross, Ltd.*, 273 S.W.3d 905, 909 (**Tex.App.-Dallas** 2008, *pet. denied*) (citing *Cox v. S. Garrett, L.L.C.*, 245 S.W.3d 574, 582 (**Tex.App.-Houston** [1st Dist.] 2007, *no pet.*)). See also: *Daniels v. CDB Bell, LLC*, 300 S.W.3d 204, 211 (**Ky.** App. 2009) (citing William Meade Fletcher, *Fletcher Cyclopedia of The Law Of Corporations*, §41.29 (2006)); *Green v. Freeman*, 749 S.E.2d 262, 271 (**N.C.** 2013); *U.S. v. Best Foods*, 524 **U.S.** 51, 118 S. Ct. 1876, 141 L. Ed. 2d 43, 157 A.L.R. Fed. 735 (1998) (claim of piercing the corporate veil will not independently support federal jurisdiction). The remedy is pursued when and if the LLC cannot satisfy the judgment.

The recent Virginia decision in *Bennett v. Garner*, 913 F.3d 436 (**4th Cir. (Va.)** 2019) is representative of the **difference between taking a judgment and pursuing a remedy**. In *Bennett*, the Circuit found that an action to set aside an allegedly fraudulent conveyance was a remedy (in actions to collect on a judgment and not impart new liability on the defendants) which was bolstered by a Virginia statute allowing such claims to be brought after judgment. The Court also allowed the plaintiffs claim to pierce the defendants LLC shell since such an action in Virginia required the plaintiff to obtain judgment before seeking to pierce the limited liability veil. The Court also held that Virginia's *res judicata* **doctrine did not bar either the piercing or the fraudulent conveyance action**.

E. Piercing the Veil is an Equitable Remedy.

The doctrine of piercing the corporate veil is an **equitable remedy** that permits a court to impose liability on an individual or entity that uses a corporation merely as an instrumentality to conduct that individual's or entity's business. *Seater Construction Company, Inc. v. Deka Investments, LLC*, No. 2–12–1140, 2013 WL 3272487, at *7 (**Ill.** Ct. App. June 24, 2013); *Wandering Trails, LLC v. Big Bite Excavation, Inc.*, 156 **Idaho** 586, 591, 329 P.3d 368, 373 (2014). The **significance** is that if veil piercing is an equitable claim, then the **trial judge must decide** whether to pierce the veil. *Lunneborg v. My Fun Life*, 421 P. 3d 187, 198 (**Idaho** 2018), 1 William Meade Fletcher, *Fletcher Cyclopedia of the Law of Corporations*, § 41.25, at 162 (rev. vol. 2006); *Mantle v. North Star Energy & Construction LLC*, 437 P.3d 758, 799 (**Wyo.** 2019) (Piercing the veil is an equitable remedy, thus, the ultimate conclusion as to whether to pierce the veil is a **question of law for the court**. Citing *Fletcher Cyc. Corp.* § 41.25).

"[P]iercing the veil of a subsidiary in order to deal with its parent corporation **should not be lightly undertaken**," *Francois v. Colonial Freight Systems, Inc.*, *supra*, (citing: *Gray v. Edgewater Landing, Inc.*, 541 So. 2d 1044, 1047 (**Miss.** 1989); *Highway Dev. Co. Inc. v. Mississippi State Highway Comm'n*, 343 So. 2d. 477, 480 (**Miss.** 1977)), and it should only be undertaken in "those **extraordinary factual circumstances** where to do otherwise would subvert the ends of justice." *Penn Nat'l Gaming, Inc. v. Ratliff*, 954 So. 2d 427, 431 (**Miss.** 2007) (citing *Gray v. Edgewater Landing, Inc.*, at 1046).

Because veil piercing is an equitable remedy, Courts have also drawn other equitable maxims into its application, including the *uncle and s doctrine*. In *Mantle*, *supra*, the Wyoming court agreed that "the doctrine that a party who seeks the equitable remedy of piercing the LLC veil must come with clean hands."

"When one party is seeking recovery in equity, the **trial court is vested with discretion in determining the "equities" between the parties.**" *Schmidt v. Huston*, 2016 WL 7387384, at *4 (**Idaho** Dec. 21, 2016) (quoting *Griggs v. Safeco Ins. Co. of Am.*, 103 **Idaho** 790, 792, 654 P.2d 378, 380 (1982)), and as a general principle, is granted broad discretion in fashioning equitable relief. *Rowe v. Burrup*, 95 **Idaho** 747, 750, 518 P.2d 1386, 1389 (1974).

Thus, a trial court's exercise in applying equitable principles requires "recourse to principles of justice to correct or supplement the law as applied to particular circumstances, [including] the judicial prevention of hardship that would otherwise ensue from the literal interpretation of a fair-minded application of a trial court's discretion." (Citation omitted)

Lunneborg v. My Fun Life, 421 P. 3d 187, 198 (**Idaho** 2018)

The trial court is responsible for determining factual issues that exist with respect to this equitable remedy and for fashioning the equitable remedy. A court **may empanel an advisory jury on factual questions** relevant to piercing the veil, but is not required to do so. *Wandering Trails, LLC v. Big Bite Excavation, Inc.*, 329 P.3d 368 (**Idaho** 2014).

F. Causation and the Requirement of Personal Benefit.

A plaintiff must show that the person to be held liable **personally benefitted from the alleged abuse** of the corporate form. See *On Command Video Corp. v. Roti*, 705 F.3d 267, 273-74 (**7th Cir.** 2013); *Lopez v. Ram Shirdi Inc.*, No. 10 CV 6590 (USDC N.D. **Ill.**, ED. August 26, 2014).

In order for a member/manager to be charged personally he/she/it **must have committed the acts** giving rise to the veil piercing liability. *Ridge Clearing & Outsourcing Solutions, Inc. v. Khashoggi*, 2011 WL 3586455 (S.D.**N.Y.**, Slip Copy, Aug. 12, 2011) ("In deciding whether to pierce the veil—an extraordinary remedy reserved for circumstances where equity demand it—the Court is obligated to determine whether a person's domination and control of a corporation was the **proximate cause of a wrong to plaintiff.**")

In re Polo Builders, Inc. (Brown v. Real Estate Resource Management, LLC), 388 B.R. 338 (Bankr. N.D. **Ill.** 2008) (any **harm resulted from plaintiff's lack of due diligence** in dealing with LLC and acceptance of risk associated with shell entity rather than the lack of formalities).

This requirement that the wrongful action be the proximate cause of the loss or damage to the plaintiff dovetails into the section concerning the special problems of those with contract obligations seeking to pierce the veil versus those with tort obligations. Numerous cases point out the lack of sufficient factual development of the details of how the contract creditor was

misled or defrauded and how he/she/it could not have protected itself at the outset of, or at least earlier in the relationship. It is also important to note that reliance, *i.e.*, **reasonable reliance, on the information provided or appearances observed is a key element to piercing a veil**. In addition, as in every case (and often overlooked) is the **causation bridge** – tying what the defendant did or did not due to the damage to the plaintiff.

“There is **no fraud or injustice**, hence no basis for piercing a corporate veil, **without reliance** by a would-be piercer... A creditor will not be heard to complain about having extended credit to an assetless corporation if he knew or should have known it was assetless.” *Brady v. UBS Financial Services, Inc.*, Case No. 10-CV-284-SPF-FHM. (USDC N.D. **OK**. March 26, 2013).

G. Piercing May Be Sought Before or After Judgment.

Judgment against an LLC and collection efforts **may precede an action to pierce the veil**, though it is often included in the original complaint. *Inter-Tel Techs., Inc. v. Linn Station Props., LLC*, 360 S.W.3d 152, 155 (**Ky.** 2012).⁷ See also: *Restaurant of Hattiesburg, LLC v. HRS*, 84 So. 3d 32, 44 (**Miss.** COA 2012).

SIGNIFICANT CAVEAT: *Basic Capital Management, Inc. v. Dynex Capital, Inc. et al*, 976 F.3d 585 (5th Cir. 2020). In a rather complicated set of facts, the 5th Circuit determined that a piercing claim could have been brought during an earlier stage in the litigation (*i.e.*, prior to the decision on appeal returning the case to the District Court) and was, therefore, time barred.

Although Plaintiffs include allegations about events that occurred after the state-court litigation began, *i.e.*, the transfer of DCI's assets to Dynex Capital, those allegations do not mean that Plaintiffs were unable to bring their alter-ego claim in the state-court litigation. See *Barr*, 837 S.W.2d at 631 ("Discovery should put a claimant on notice of any need for alternative pleading. Moreover, if success on one theory becomes doubtful because of developments during trial, a party is free to seek a trial amendment."). In this case, while the state-court litigation was pending, Plaintiffs were aware of the fact that DCI had no assets and had engaged in a series of transfers of its assets to Dynex

⁷ See also: *Westmeyer v. Flynn*, 889 N.E.2d 671 (**Ill.** App. 2008); *Wachovia Securities, LLC v. Neubauer*, No. 04 C 3082, 2004 WL 2526390 (N.D. **Ill.** Nov. 5, 2004); *In Re JNS Aviation, LLC*, 376 BR 500, 521-22 (Bankr. ND **Texas** 2007) (Nick Corp. need not relitigate its breach of contract claim as a condition to seeking recovery against the Non-Debtor Defendants under its asserted theories of veil piercing.)

Capital. These facts would have put a reasonable plaintiff on notice of the need for alternative pleading, including the possibility of an alter-ego claim. Indeed, in the state-court litigation, Plaintiffs alleged that Dynex Capital was liable because it "made representations to [Plaintiffs] that [DCI] was willing, ready, and able, and had the financial stability and resources, to provide \$160,000,000 in loans to [Plaintiffs]." Further, at trial, Plaintiffs (unsuccessfully) attempted to "amend [the complaint] to formally seek damages directly from Dynex Capital" for breach of contract on the theory that Dynex Capital ratified the loan commitment. See *Nilsen v. City of Moss Point*, 701 F.2d 556, 563 (5th Cir. 1983) ("[B]oth courts and commentators agree that theories which were the subject of an untimely motion to amend, filed in the earlier action, 'could have been brought' there."). Plaintiffs' failure to raise an alter-ego claim against Dynex Capital during the state-court litigation does not mean that they can raise such a claim now.

The Court found that the alter-ego claim was barred by res judicata. **THIS IS A POTENTIALLY DANGEROUS PRECEDENT FOR THE UNWARY.**

H. What State's Law Applies?

Generally, the **law of the state of the LLC's organization controls**.⁸ However, under certain circumstances courts will apply the **most significant relationship test**. *E.g., Construction, LLC v. Gravelroad Entertainment, LLC*, Civil Action No. 6: 07-155-DCR, 2008 WL 2038878 (E.D. Ky. May 12, 2008); *Tyson Fresh Meats, Inc. v. Lauer Limited, L.L.C.*, 918 F. Supp. 2d 835 (N.D. Iowa 2013) (**Internal affairs doctrine** applied to piercing the corporate veil and/or alter ego theories and Nebraska law thus governed whether the LLC's veil may be pierced or whether the LLC is the alter ego of the other defendants).

⁸ *E.g., Andrews v. Kerr McGee Corp.*, No. 1:00CV158-D-A, 2001 WL 1704144 (N.D. Miss. Dec. 5, 2001); *ColfTech, LLC v. JLL Partners, Inc.*, 538 F. Supp. 2d 1355 (D. Kan. 2008); *On Command Video Corp. v. Roti*, 705 F.3d 267, 272 (7th Cir. 2013); *Canal Insurance Co. v. Montello, Inc.*, 822 F. Supp. 2d 1177, 1183 (N.D. Okla. 2011); *Howell Contractors, Inc. v. Berling*, 383 S.W.3d 465 (Ky. App. 2012); *Bronstein v. Crowell, Weedon & Co.*, No. B191738, 2007 WL 969559 (Cal. App. 2 Dist. April 3, 2007); *Sky Cable, LLC v. DirecTV, Inc.*, 886 F. 3d 375, 386 (4th Cir. 2018); *First Nat'l City Bank v. Banco Para El Comercio Exterior de Cuba*, 462 U.S. 611, 621, 103 S.Ct. 2591, 77 L.Ed.2d 46 (1983); *Taurus IP, LLC v. DaimlerChrysler Corp.*, 726 F.3d 1306, 1336 (Fed. Cir. 2013); *Midwest Renewable Energy, LLC v. Am. Eng'g Testing, Inc.*, 894 N.W.2d 221 (Neb. 2017); *A.V.E.L.A., Inc. v. Estate of Marilyn Monroe, LLC*, 241 F.Supp.3d 461 (S.D.N.Y. 2017), (New York's choice of law rules provide that the law of the state of incorporation determines when the corporate form will be disregarded and liability will be imposed on shareholders).

Morgan Howard (United States), LLC v. Lewis, No. FSTCV054006343S, 2006 WL 2348892 (Conn. Super. July 14, 2006) (stating **Delaware law governs rights** of member of Delaware LLC, but **Connecticut law governs standing**, and concluding member lacked standing to bring claims as direct claims under either Connecticut or Delaware law).

In *Curci Investments, LLC v. Baldwin*, 14 Cal. App. 5th 214 (Cal. Court of Appeal, 4th Appellate Dist., 3rd Div. 2017), the California Court of Appeals applied **California law to determine the issue of reverse veil piercing**, and not Delaware law although the debtor's LLC was formed in Delaware.

In *JPMorgan Chase Bank, N.A. v. McClure*, 393 P.3d 955 (Col. 2017) the Colorado Supreme Court addressed the relative priority of **competing charging orders** against an Arizona judgment debtor's membership interests in several Colorado LLCs. One judgment creditor argued that the charging orders obtained by the other judgment creditor from an Arizona court under the Arizona LLC statute were invalid because the Arizona charging order statute applies only to LLCs organized under Arizona law. The court found it unnecessary to address this question because, even assuming Arizona law authorizes charging orders against interests in foreign LLCs, the court ultimately concluded that the charging orders issued in Arizona were not entitled to priority over charging orders issued in Colorado before the Arizona charging orders were domesticated in Colorado.

PORTABILITY OF PRECEDENT:

Be careful of the portability, or not, of another jurisdiction's precedents.

II. VEIL PIERCING: WHAT IS REQUIRED.

A. General Recognition of Veil Piercing.

“Piercing” may generally be defined as a remedy by which a third-party seeks to have set aside the limited liability otherwise afforded by an entity in order to impose upon the shareholders, owners [or managers] of a corporation or LLC personal liability for an entity debt. An often-cited summary of the concept is found in *Schlecht v. Equitable Builders, Inc.*, 535 P. 2d 86, 88 (Or.1975):

While, for all ordinary purposes, a corporation is regarded as a legal entity separate and distinct from its stockholders, yet, as Judge Sanborn said in *United States v. Milwaukee Refrigerator Transit Co.*, C.C., 142 F. 247, 255, “when the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime, the law will regard the corporation as an association of persons.

Most courts that have addressed the question of piercing an LLC have found that piercing is possible under the same or similar circumstances to when it is available in an action against a corporation.⁹

⁹ See, e.g.: **Alabama:** *Filo Am., Inc. v. Olboss Trading Co., L.L.C.*, 321 F. Supp. 2d 1266, 1269 (M.D. Ala. 2004); **Connecticut:** *Bowen v. 707 On Main*, No. CV020282643S, 2004 WL 424501, at *3 (Conn. Super. Ct. Feb. 24, 2004); *All Metals Industries, Inc. v. TD Banknorth*, No. CV075002464S, 2008 WL 731954 (Conn. Super. Feb. 27, 2008); **Delaware:** *Nefjets Aviation, Inc. v. LHC Communications, LLC*, 537 F.3d 168, 178 (2nd Cir. 2008); **Florida:** *In re Multimedia Communications Group Wireless Assocs. of Liberty County (Mills v. Webster)*, 212 B.R. 1006 (Bankr. M.D. Fla. 1997); **Georgia:** *Bonner v. Bruson*, 585 S.E.2d 917, 918 (Ga. Ct. App. 2003); **Illinois:** *On Command Video Corp. v. Roti*, 705 F.3d 267, 269 (7th Cir. (Ill.) 2013); *Westmeyer v. Flynn*, 889 N.E.2d 671 (Ill. App. 1st Dist. 2008); *Seater Construction Company, Inc. v. Deka Investments, LLC* No. 2–12–1140, 2013 WL 3272487, at *8 (Ill. Ct. App. June 24, 2013) (quoting *Westmeyer v. Flynn*, 382 Ill. App. 3d 952, 960 (2008)); **Indiana:** *Four Seasons Manufacturing, Inc. v. 1001 Coliseum, LLC*, 870 N.E.2d 494 (Ind. App. 2007); *Troutvine Estates Development Company, LLC v. Comsub Design and Engineering, Inc.*, 854 N.E.2d 890 (Ind. App. 2006) (Subsequent: *Troutvine Estates Development Company, LLC v. ComSub Design and Engineering, Inc.*, No. 45A04-0802- CV-111, 2008 WL 2439916 (Ind. App. June 18, 2008)); **Kentucky:** *Pannell v. Shannon*, 425 SW 3d 58 (Ky. 2014), but see: *Turner v. Andrew*, 413 S.W.3d 272, 277 n. 4 (Ky. 2013); *Mountain Paving and Construction, LLC v. Workman*, No. 2012-CA-001822-MR (Ky. COA, January 24, 2014); *Rednour Properties, LLC v. Spangler Roof Services, LLC*, No. 2009-CA-001159-MR (Ky. COA June 10, 2011, Mod.: July 8, 2011); *Sudamax Industria E Comercio De Cigarros, Ltd. v. Buttes & Ashes, Inc.*, 516 F. Supp. 2d 841 (W.D. Ky. 2007); *In re Howland*, Civil Action No. 5:14-426-KKC (USDC ED Ken.CD Lexington, June 7, 2016); **Louisiana:** *Hollowell v. Orleans Regional Hospital*, No. Civ. A. 95-4029, 1998 WL 283298 (E.D. La. May 29, 1998); *Hamilton v. AAI Ventures, L.L.C.*, 768 So.2d 298 (La. App. 2000); *Hollowell v. Orleans Reg'l Hosp. LLC*, 217 F.3d 379, 385 n. 7 (5th Cir.2000) (citing Eric Fox, Piercing the Veil of Limited Liability Companies, 62 *Geo. Wash. L.Rev.* 1143, 1167-68 (1994)); **Minnesota:** *Tom Thumb Food Markets, Inc. v. TLH Properties, LLC*, No. C9-98-1277, 1999 WL 31168 (Minn. Ct. App. Jan. 26, 1999); **Mississippi:** *Restaurant of Hattiesburg, LLC v. HRS*, 84 So. 3d 32, 38-39 (Miss. COA 2012); **Utah:** *Ditty v. Checkrite, Ltd., Inc.*, 973 F. Supp. 1320 (D. Utah 1997); **West Virginia:** *Kubican v. The Tavern, LLC*, 752 S.E.2d 299 (W.Va. 2013); **Wyoming:** *Kaycee Land & Livestock v. Flahive*, 46 P.3d 323, 325-26 (Wyo. 2002); *Gasstop Two, LLC v. Seatwo, LLC*, 225 P.3d 1072 (Wyo. 2010)). **Federal common law.** *United States v. Best Foods*, 524 U.S. 51 (1998), (“the choice between state and federal [veil-piercing] law may in many cases present questions of academic interest, but little practical

In the recent decision in *Sky Cable, LLC v. DirecTV, Inc.*, 886 F. 3d 375 385 (4th Cir. (W.Va.) 2018), the 4th Circuit stated:

Nevertheless, courts have disregarded the legal distinction between a business entity and the individuals who hold ownership interests in that entity, if maintaining the distinction would "produce injustices or inequitable consequences." *DeWitt*, 540 F.2d at 683 (citation omitted). In such circumstances, a court may "pierce the veil" separating the entity and its constituent members and treat the entity and its members as identical. See *id.* **Importantly, similar circumstances warrant piercing the veil of both corporations and LLCs.** *NetJets*, 537 F.3d at 176.

See also: *DeWitt Truck Brokers, Inc. v. W. Ray Flemming Fruit Co.*, 540 F.2d 681, 683 (4th Cir. 1976); *NetJets Aviation, Inc. v. LHC Commc'ns, LLC*, 537 F.3d 168, 176 (2d Cir. 2008).

B. Veil Piercing Requirements.

1. Two Step Test – Alter Ego and Inequitable Result

A typical formulation to pierce the veil and impose personal liability on an LLC's members or managers requires that the claimant must show that:

1. LLC is the *alter ego* of the members, *i.e.*, that there is a unity of interest and ownership to a degree that separate personalities of the LLC and members do not exist, and
2. If the acts complained of were to be treated as only the acts of the LLC, an **inequitable result** would follow or the ends of justice would be subverted.

significance." *Id.* at 63, n. 9 (quoting *In re Ascushnet River & New Bedford Harbor Proceedings*, 675 F. Supp. 22, 23 (D. Mass. 1987)). Piercing is a remedy, and where the underlying jurisdiction is Federal, Federal common law will apply, *e.g.*, in cases where the maritime jurisdiction of the Federal courts is invoked. *Clipper Wonsild Tankers v. Biodiesel Ventures, LLC*, 851 F. Supp. 2d 504 (USDC SD New York 2012) (Alter ego theories of liability are *prima facie* admiralty claims so long as the underlying claim arose in admiralty."); *In the Matter of the Arbitration Between Holborn Oil Trading, Ltd. and Interpetrol Bermuda, Ltd.*, 774 F.Supp. 840, 844 n. 4 (S.D.N.Y.1991); see also: *Constellation Energy Commodities Group vs. Transfield ER Cape Ltd.*, 801 F.Supp.2d 211, 223 (S.D.N.Y.2011); *Wagilam Exp. (Singapore) Pte. Ltd. v. ATL Shipping, Ltd.*, 475 F.Supp.2d 275, 282 (S.D.N.Y. 2006); *Status Intl. S.A. v. M&D Maritime, Ltd.*, 994 F.Supp. 182, 186 (S.D.N.Y. 1998). *Northern Tankers (Cyprus) Ltd. v. Backstrom*, 967 F. Supp. 1391 (D. Conn. 1997); See also: *NY State Elec. & Gas Corp. v. FirstEnergy Corp.*, 808 F. Supp. 2d 417 (USDC ND New York 2011); *Dolco Inv. Ltd. v. Moonriver Dev. Ltd.*, 486 F.Supp.2d 261, 271-72 (S.D.N.Y. 2007); *Preston vs. Frantz*, 11 F.3d 357, 358-59 (2d Cir.1993); *Arctic Ocean Int'l. Ltd. v. High Seas Shipping, Ltd.*, 622 F.Supp.2d 46, 53 (S.D.N.Y.2009); *Kirino Hill Corp. v. Holt*, 618 F.2d 982, 985 (2d Cir. 1980).

This formulation **requires BOTH prongs** of the test; being an *alter ego* alone, without some fraudulent or seriously inequitable conduct will not suffice to pierce the veil.¹⁰ **Accord:** *Calipjo v. Purdy*, 439 P.3d 218 (**Haw.** 2019); *Wright v. Scales 925 Atlanta, LLC*, 761 Fed.Appx. 884 (**11th Cir. (Ga.)** 2019); *Sun Nurseries, Inc. v. Lake Erma, LLC*, 730 S.E.2d 556 (**Ga.** Ct. App. 2012); *Wandering Trails, LLC v. Big Bite Excavation, Inc.*, 329 P.3d 368, 376 (**Idaho** 2014); *Restaurant of Hattiesburg, LLC v. HRS*, 84 So. 3d 32, 35 (**Miss.** COA 2012)(discusses the possibility of holding an affiliated corporation of the debtor liable); *Andrews v. Kerr McGee Corp.*, No. 1:00CV158-D-A, 2001 WL 1704144 (N.D. **Miss.** Dec. 5, 2001) (concerning **Delaware** law)¹¹; *McWilliams Ballard, Inc. v. Level 2 Development*, 697 F. Supp. 2d 101 (D. **D.C.** 2010); *Mantle v. North Star Energy & Construction LLC*, 437 P.3d 758 (**Wyo.** 2019); *Green Hunter Energy, Inc. v. Western Ecosystems Tech.*, 2014 WY 144, 337 P.3d 454 (**Wyo.** 2014); *WY Stat* §17-29-304(c) (2018).

2. Other Expressions of the Veil-Piercing Test.

Though essentially the same as others, **Mississippi** has phrased the formulation slightly differently.¹²

1. some **frustration of expectations** regarding the party to whom he looked for performance;¹³
2. the **flagrant disregard of corporate formalities** by the defendant corporation and its principals; **and**
3. a demonstration of **fraud or other equivalent misfeasance** on the part of the corporate shareholder."

¹⁰ Note in discussion of *The Texas Approach*, at common law, applicable to tort claims in **Texas**, that *alter ego*, using the corporate form for an illegal purpose, or using the corporation as a sham to perpetuate a fraud are "either/or" not "both/and". Proof of alter ego alone in Texas will suffice, at least for tort claimants, whereas it will not in other states.

¹¹ **Delaware's** two elements: (1) complete domination and control by the member such that the LLC and its parent operated as a single economic entity, and (2) deliberate and purposeful misuse of the corporate form that results in unfairness, injustice, and injury to the plaintiff.

¹² *Francois v. Colonial Freight Systems, Inc.*, Civil Action No. 3:06-cv-434 (U.S.D.C. SD **Mississippi**, December 14, 2007) *Id.* (citing *Gray v. Edgewater Landing, Inc.*, 541 So.2d 1044, 1047 (**Miss.**1989)). The *Francois'* decision also notes that Mississippi expressly rejects the federal ten-factor approach applied in *Gammill v. Lincoln Life & Annuity Distribs.*, 200 F.Supp.2d 632, 634- 35 (S.D.**Miss.**2001)(citing: *Buchanan v. Ameristar Casino Vicksburg, Inc.*, 957 So.2d 969, 976-77 (¶¶25-26) (**Miss.**2007)); *Brown v. Waldron*, 186 So. 3d 955 (**Miss.** COA 2016).

¹³ *Restaurant of Hattiesburg, LLC v. HRS*, 84 So. 3d 32 (**Miss.** COA 2012).

Colorado¹⁴ has a similar formulation: 1) corporate entity is an alter ego or mere instrumentality; 2) corporate form was used to perpetrate a fraud or defeat a rightful claim; **and** 3) an equitable result would be achieved by disregarding the corporate form.

Ohio¹⁵ requires three prongs too: 1) alter ego test; 2) fraud or illegal act; **and** 3) injury or unjustified loss.

Alabama¹⁶ has three tests, but **neither requires proof of the other**: 1) Inadequacy of capital; 2) Fraudulent purpose in conception or operation of the business; **or** 3) Operation of the corporation as an instrumentality or alter ego."

Similarly, see: *Thomas & Thomas Court Reporters, L.L.C. v. Switzer*, 810 N.W.2d 677, 685 (Neb. 2012).¹⁷

This **same standard applies** when piercing the corporate veil **for the purpose of tort claims**, *Penn Nat'l Gaming, Inc. v. Ratliff*, 954 So. 2d 427, 431-32 (Miss. 2007) though it can be argued that the "frustration of expectations" prong is primarily, if not exclusively, applicable to contract claims.

C. The Alter Ego Issue.

1. What is "Alter Ego"?

"Alter Ego" is such a unity of interest and ownership that the separate personalities of the corporation and the individual no longer exist. *Wachovia Secs., LLC v. Banco Panamericano, Inc.*, 674 F.3d 743, 756 (7th Cir. 2012) (citing: *Sea-Land Servs., Inc. v. Pepper Source*, 993 F.2d 1309, 1311

¹⁴ *Martin v. Freeman*, 272 P.3d 1182 (Colo. App. 2012).

¹⁵ *Denny v. Breawick, LLC*, 2019 WL 2266690 (Ohio App. 2019).

¹⁶ *Mama's Enterprises, LLC v. U.S.*, 883 F. Supp. 2d 1128, 1135 (USDC ND Ala. 2012) (citing: Alabama law. *First Health, Inc. v. Blanton*, 585 So.2d 1331, 1334 (Ala.1991)).

¹⁷ "[T]he individual members and managers of a limited liability company are generally not liable for a debt, obligation, or liability of the company. And a court will disregard such a company's identity only where the company has been used to commit fraud, violate a legal duty, or perpetrate a dishonest or unjust act in contravention of the rights of another. The company's identity as a separate legal entity will be preserved, as a general rule, until sufficient reason to the contrary appears. And a plaintiff seeking to impose liability on an individual member or manager has the burden of proving that the company's identity should be disregarded to prevent fraud or injustice to the plaintiff." *Id.* at 685

(7th Cir. 1993)). The standard formulation of the *alter ego* or *instrumentality theory* requires both alter ego and that the corporate fiction was used for an illegitimate or illegal purpose.

The alter ego determination must be made in view of "**the totality of the facts.**" *United States v. Funds Held in the Name or for the Benefit of Wetterer*, 210 F.3d 96, 106 (2d Cir.2000). **No one factor is dispositive**, and courts have considered **additional factors** as well. *See: Williamson v. Recovery Ltd. P'ship*, 542 F.3d 43, 53 (2d Cir.2008).

"Domination is established not by such a bright-line test, but by **examination of the way a corporation functions** — whether the owners use the corporation as a mere device to further their personal rather than the corporate business." *Federal Nat'l Mortgage Ass'n v. Olympia Mortgage Corp.*, 724 F. Supp. 2d 308, 319 (E.D.N.Y. July 7, 2010) (quoting *Morris v. New York State Dept. of Taxation and Finance*, 82 N.Y.2d 135, 141 (1993)); *FMC Finance Corp. v. Murphree*, 632 F.2d 413 (5th Cir. Miss. 1980) (disregard will vary with the circumstances of each case).

2. Factors in Determining Alter Ego.

There are tons of cases setting out myriad factors to consider in the alter ego determination. The following is a listing of the most commonly used factors, though other issues may be considered.

- **Common business name, offices, employees, or centralized accounting/ common office space, address and telephone numbers of corporate entities**¹⁸;
- Whether the parent and subsidiary (LLC and its members/managers) have **common ownership, directors, officers or personnel**;
- **Improper Formation**¹⁹;

¹⁸ **Typically** in the alter ego/inequitable result test **something more than commonality of various business factors is required**. "Two or more corporations are separate and distinct entities although the same individuals are the incorporators of, or own stock, in the several corporations, and although such corporations may have the same persons as officers." *Murdock Acceptance Corp. v. Adcox*, 138 So. 2d 890, 895 (Miss. 1962). "[T]he mere fact that one owns all the stock of the other, or substantially all, is not enough to warrant disregard, in the absence of some fraudulent purpose; nor is the fact that there was an opportunity to exercise control. Furthermore, the fact that the shareholders of the two corporations are the same is not of itself sufficient to treat the two corporations as one." *Johnson & Higgins of Miss., Inc. v. Commr. of Ins. of Miss.*, 321 So. 2d 281, 285 (Miss. 1975) (quoting 1 W. Fletcher, *Cyclopedia of the Law of Private Corporations* § 43, at 210 (Perm. Ed.1974)).

¹⁹ **Improper formation** was considered as **an element** in determining to pierce an LLC veil in *Allison v. Danilovic*, No. B163363, 2004 WL 2797988 (Cal. App. 2 Dist. Dec. 7, 2004) (CEO, director, and 66% owner of LLC liable for unpaid wage claim under alter ego theory). An LLC's **failure to issue membership interests**, rather than stock, would be a factor to consider in the alter ego analysis. *Flores v. DDJ, Inc.*, No. 1:99 CV 5878 AWI DLB, 2007 WL 4269259 (E.D. Cal. Nov. 30,

- Inadequate or grossly **inadequate capitalization**;
- Intermingling/**commingling** of funds;²⁰
- Whether **corporate formalities** of the subsidiary have been observed;²¹
- **Independence** of the corporation/LLC **from its owner(s)**: a) Do the directors or executives fail to act independently in the interest of the subsidiary, or do they instead take orders from the parent, and act in the parent's interest? b) Degree of business discretion shown by the allegedly dominated corporation? c) Whether the dealings between the entities are at arm's length? d) Failure to maintain arm's length relationships among related entities? e) Is the corporation a mere facade for the operation of the dominant shareholders/owners? f) One entity's employees rendered services on behalf of the other entity?
- **Use of the property** of the subsidiary by the parent/owner as its own or the intermingling of property between the entities;
- **Financial status** of the company: a) Does the parent corporation finance the subsidiary, b) Payment or guarantee of the corporation's debts by the dominating

2007). In *Peinado v. Barnett*, No. A093923, 2001 WL 1380441 (Cal. App. Nov. 6, 2001) the court found that the **LLC was not legally established** because it only had one member where the statute required two, and the LLC had failed to make requisite filings with the Secretary of State and considered this along with other factors to find a unity of interest between the LLC and its owner.

²⁰ Commingling of assets is certainly a factor to be considered in determining whether the alter ego threshold has been reached. E.g., *Martin v. Freeman*, 272 P.3d 1182 (Colo. App. 2012). In *Utzler v. Braca*, 972 A.2d 743 (Conn. App. 2009) defendant personally liable under the instrumentality rule, finding that the LLC's owner treated the plaintiff's investment as if it were his personal fund available for his personal needs and regularly deposited funds that he received from the plaintiff and from the financing for the project into a commingled bank account from which he made withdrawals for purposes unrelated to the project. **CONTRA**: However, as the **Wyoming Supreme Court** has stated, "Intermingling of assets, business operations, and finances is also **insufficient** to justify piercing the veil **standing alone**." *Mantle v. North Star Energy & Construction LLC*, 437 P.3d 758, 799 (Wyo. 2019), citing *GreenHunter Energy, Inc. v. Western Ecosystems Tech.*, 2014 WY 144, 337 P.3d 444, 464 (Wyo. 2014). Typically, a **single instance** of commingling is insufficient to demonstrate such dominion and control as would be necessary to pierce the LLC veil under the instrumentality or identity theory. *Pomilli v. Pro-Line Painting*, No. CV044001774, 2005 WL 1433185 (Conn. Super. May 13, 2005). For another case discussing commingling but denying *per se* liability for it, see *Restaurant of Hattiesburg, LLC v. HRS*, 84 So. 3d 32, 42 (Miss. COA 2012).

²¹ In virtually all states the emphasis on this requirement has been reduced but determining in what regard it has been discarded or continues to be utilized will require a state-by-state examination, particularly in reference to LLC's. Because of the difference between LLC's and traditional corporations, especially as to the "intentional" lack of formality of LLC management and operation, most courts no longer recognize the failure to observe corporate formalities as a separate ground for veil piercing, unless required by statute or the LLC agreement. The *Official Comments* to the most recent version of Section 304 of the *Uniform Limited Liability Company Act* takes the same position. REV. UNIF. LIMITED LLAB. CO. §304(b), comment, 6B U.L.A. 476 (2008) (disregard of corporate formalities is inappropriate, because informality of organization and operation is both common and desired.) See further discussion *infra*.

entity,²² c) Insolvency of the debtor corporation d) Does one entity pay the wages of the other entity's employees, e) Does the parent pay the salaries and other expenses or losses of the subsidiary.

- **Record keeping:** Absence of corporate records? One entity made undocumented transfers of funds to the other entity? Allocation of profits and losses between the entities is unclear?
- Is the company **treated independently from its owner(s) in its records**: Is the subsidiary described by the parent (in papers of statements) as a department or division of the parent or is the business or financial responsibility of the subsidiary referred to as the parent corporation's own? Whether the companies are treated as independent profit centers?
- Owner(s) sought to be charged were **involvement in the formation** of the company: Does the parent own all or most of stock of the subsidiary? Did the owner(s) sought to be charged subscribe to all of the capital stock of the subsidiary or otherwise cause its formation? Does the subsidiary have any assets except those conveyed to it by the parent/owner?
- Does the subsidiary **do any business except with the parent/owner**?
- Besides the dominant party, **do the other officers**, directors, members or managers **actually function** as such, *i.e.*, how much are they just window dressing?²³
- Diversion of assets from the corporation by or to a stockholder or other person or entity **to the detriment of creditors**.

²² Whether the members or managers of an LLC have given one or more personal guarantees is a factor to be considered in piercing the veil and especially as to whether or not a creditor was misled about the solvency of the entity. *E.g., Hellenic Lines Limited v. Winkler*, 249 F. Supp. 771 (USDC SD N.Y. 1966).

²³ In *Akzona Inc. v. El Du Pont De Nemours & Co.*, 607 F. Supp. 227 (USDC D. Del. 1984) the court considered the guarantee of one of the company's owners in its consideration of whether or not the entity was the agent of its owners.

Excellent discussions of factors are contained in *Tryco Enterprises*,²⁴ *Clipper Wonsild Tankers*²⁵ and *Wachovia Sec., LLC*.²⁶

In *Breen v. Judge*, 4 A.3d 326, 331-32, 124 Conn.App. 147 (**Conn.** COA 2010), the Connecticut court listed ten (10) factors relevant to whether an entity is dominated or controlled, finding that at all times Judge was no more than a 50% owner of the LLC.²⁷ The *Breen* Court found that the LLC was a properly formed company doing business in Connecticut; the LLC followed the various entity-related formalities, such as keeping separate books, filing company tax returns, and filing dissolution documents when it dissolved. The LLC operated a truck-outfitting business with increasing sales for each of its first three years, although it ultimately failed. Based on those factors the court found that neither the instrumentality test nor the control test was satisfied, and therefore affirmed the trial court's decision not to pierce the LLC's veil.

²⁴ *Tryco Enterprises, Inc. v. Robinson*, 390 S.W.3d 497, 508 (**Tex.** App.—Houston [1st Dist.] 2012, no pet.) lists the following factors: a) whether the entities shared a common business name, common offices, common employees, or centralized accounting; b) whether one entity paid the wages of the other entity's employees; c) whether one entity's employees rendered services on behalf of the other entity; d) whether one entity made undocumented transfers of funds to the other entity; and e) whether the allocation of profits and losses between the entities is unclear.

²⁵ Another formulation is found in *Clipper Wonsild Tankers v. Biodiesel Ventures, LLC*, 851 F. Supp. 2d 504, 510 Dist. Court, SD **New York** 2012 and in *MAG Portfolio Consultant. GMBH v. Merlin Biomed Group LLC*, 268 F.3d 58, 63 (**2d Cir.**2001): (1) disregard of corporate formalities; (2) inadequate capitalization; (3) intermingling of funds; (4) overlap in ownership, officers, directors, and personnel; (5) common office space, address and telephone numbers of corporate entities; (6) the degree of business discretion shown by the allegedly dominated corporation; (7) whether the dealings between the entities are at arm's length; (8) whether the corporations are treated as independent profit centers; (9) payment or guarantee of the corporation's debts by the dominating entity, and (10) intermingling of property between the entities.

²⁶ According to *Wachovia Secs., LLC v. Banco Panamericano, Inc.*, 674 F.3d 743, 756 (**7th Cir.** 2012), "To determine whether there is a unity of interest such that the corporate form should be disregarded, courts consider the following factors, among others: (1) inadequate capitalization; (2) insolvency of the debtor corporation; (3) failure to observe corporate formalities; (4) non-functioning of the other officers or directors; (5) absence of corporate records; (6) commingling of funds; (7) diversion of assets from the corporation by or to a stockholder or other person or entity to the detriment of creditors; (8) failure to maintain arm's length relationships among related entities; and (9) whether the corporation is a mere façade for the operation of the dominant shareholders." (Citing: *Gass v. Anna Hosp. Corp.*, 911 N.E.2d 1084, 1091, 392 **Ill.** App. 3d 179, 331 **Ill.** Dec. 854 (2009)).

²⁷ In this **multi-member LLC case** the factors used were: (1) the absence of corporate formalities; (2) inadequate capitalization; (3) whether funds are put in and taken out of the corporation for personal rather than corporate purposes; (4) over-lapping ownership, officers, directors, personnel; (5) common office space, address, phones; (6) the amount of business discretion by the allegedly dominated corporation; (7) whether the corporations dealt with each other at arm's length; (8) whether the corporations are treated as independent profit centers; (9) payment or guarantee of debts of the dominated corporation; and (10) whether the corporation in question had property that was used by other of the corporations as if it were its own.

The Idaho Supreme Court put all these **factors into perspective** in *Lunneborg v. My Fun Life*, 421 P. 3d 187, 199-200 (**Idaho** 2018):

We cite these authorities as persuasive considerations to guide courts' analyses in these circumstances, but we decline to adopt 200*200 a more-detailed list of factors. These **cases are driven by their factual intricacies**, and we conclude that adopting a formal list of non-exclusive factors is unnecessary. We adopt the reasoning of the **Utah Supreme Court** which recently noted that such factors are

merely helpful tools and not required elements.

Indeed, "factors adopted as significant in a particular decision to disregard the corporate entity should be treated as guidelines and not as a conclusive test." 1 William Meade Fletcher et Al., *Fletcher Cyclopedia of Corporations* § 41.30 (2006). Rather, "a **careful review of the entire relationship** between various corporate entities and their directors and officers" **is necessary**. *Id.* § 41.10. Thus, **each alter ego case should be determined based on its individual facts by evaluating the entire relationship between the corporation and its shareholders.** (Citing: *Jones & Trevor Marketing, Inc. v. Lowry*, 284 P. 3d 630 (**Utah** 2012)).

Some piercing factors **may not apply to LLCs in the same way** they apply to corporations. *FILO America, Inc. v. Olhoss Trading Company, LLC*, 321 F. Supp. 2d 1266 (M.D. **Ala.** 2004). Establishing that the corporation/LLC is the alter ego of its members or managers requires a showing that there is a **unity of interest and ownership to a degree that separate personalities of the LLC and members do not exist**. In a single member LLC case *Regency Centers, L.P. v. Civic Partners Vista Village I, LLC*, No. G038095, 2008 WL 2358860 (**Cal.** App. 4 Dist. June 11, 2008) found the single member to be the LLC's alter ego, while recognizing that the *alter ego* doctrine is applied strictly and sparingly under California and Delaware law.²⁸

²⁸ See also: *In the Matter of the Arbitration Between Holborn Oil Trading, Ltd. and Interpetrol Bermuda, Ltd.*, 774 F.Supp. 840, 844 n. 4 (S.D.N.Y.1991); *Holborn*, 774 F.Supp. at 844-45; *MAG Portfolio Consultant. GMBH v. Merlin Biomed Group LLC*, 268 F.3d 58, 63 (**2d Cir.**2001); *Jones & Trevor Mktg., Inc. v. Lowry*, 284 P.3d 630, 636 (**Utah** 2012) (adopting eight factors "as useful

D. The Inequitable Result Issue.

1. Overview of Inequitable Result.

The second issue of the two-step test for veil piercing is that if the acts complained of were to be treated as only the acts of the corporation/LLC, an inequitable result would follow or the ends of justice would be subverted. Piercing the veil is an equitable doctrine. The second prong of the veil-piercing analysis "is best understood as asking **if there has been an abuse of limited liability.**" *On Command Video Corp. v. Roti*, 705 F.3d 267, 273 (7th Cir. 2013). This requires something **less than** an affirmative showing of **fraud**, but something **more than the mere prospect of an unsatisfied judgment.** *In re Teknek, LLC (Fisher v. Hamilton)*, 343 B.R. 850 (Bankr. N.D. Ill. 2006) (citing: *Wachovia Securities, LLC v. Banco Panamericano, Inc.*, 674 F.3d 743, 756 (7th Cir. 2012)). We will see this premise played out in other cases. A plaintiff must show that the person to be held liable personally benefited from the alleged abuse of the corporate form. See *On Command*, 705 F.3d at 273-74. *Flores v. DDJ, Inc.*, No. 1:99 CV 5878 AWI DLB, 2007 WL 4269259 (E.D. Cal. Nov. 30, 2007) reiterated that the existence of an unsatisfied creditor does not itself create an inequitable result.

Courts caution against being **too formulaic with analysis** of the factors and facts of a piercing case and in favor of keeping an eye on the **goal of the exercise: avoiding an inequitable result or injustice.** *Castleberry v. Branscum*, 721 S.W.2d 270, 273 (Tex.1986); *Francois v. Colonial Freight Systems, Inc.*, Civil Action No. 3:06-cv-434 (USDC SD Mississippi, 12/14/07) (citing: *Highway Dev. Co. v. Miss. State Highway Comm'n*, 343 So.2d 477, 480 (Miss. 1977)). **No one factor is dispositive**, and courts have considered additional factors as well. *Williamson v. Recovery Ltd. P'ship*, 542 F.3d 43, 53 (2d Cir. (Ohio) 2008).

Something of an **outlier** with a strong dissent: *Martin v. Freeman*, 272 P.3d 1182 (Colo. App. 2012) (Proof that corporate form was used to defeat a creditor's rightful claim is sufficient, the wrongful intent or bad faith not required to pierce the veil).

considerations"); *Automotive Finance Corp v. Joliet Motors, Inc.*, 761 F.Supp.2d 789, 793 (N.D. Ill. 2011) (listing eleven non-dispositive factors)); *In re Phillips*, 139 P.3d 639, 644 (Colo. 2006) (*en banc*) (while courts may consider a variety of factors in determining whether a unity of interest exists, the court specified eight such factors for consideration); *Calipjo v. Purdy*, 439 P.3d 218 (Haw. 2019)(identified 19 factors, no single one of which is dispositive).

2. Factors in Determining Inequitable Result.

a. **Failure to Maintain Corporate Formalities.** Some piercing factors may not apply to LLCs in the same way they apply to corporations. *FILO America, Inc. v. Olboss Trading Company, LLC*, 321 F. Supp. 2d 1266 (M.D. Ala. 2004).

In LLC's. Because of the difference between LLC's and traditional corporations, especially as to the "intentional" lack of formality of **LLC** management and operation, **most courts no longer recognize** the failure to observe corporate formalities as a separate ground for veil piercing, unless required by statute or the LLC agreement. The Official Comments to the most recent version of Section 304 of the *Uniform Limited Liability Company Act* takes the same position. REV. UNIF. LIMITED LIAB. CO. §304(b), comment, 6B U.L.A. 476 (2008) (disregard of corporate formalities is inappropriate, because informality of organization and operation is both common and desired.) Presumptively, all of the states which have adopted the ULLCA adhere to this position

E.g.: **Texas**; **Illinois** (805 ILCS 180/10-10(c) (1998));²⁹ **Wyoming** (*Wyo. Stat. Ann.* §17-29-304(b)); **South Dakota** (*S.D. Codified Laws Ann.* 47-34A-303(b)); and **Georgia**.³⁰

NOTE: These statutes do not prohibit alter ego consideration; they only prohibit corporate informality alone from being a separate ground for veil-piercing.³¹

²⁹ *Seater Construction Company, Inc. v. Deke Investments, LLC*, No. 2-12-1140, 2013 WL 3272487, at *8 (Ill. Ct. App. June 24, 2013). (quoting *Westmeyer v. Flynn*, 382 Ill. App. 3d 952, 960 (2008)); *In re Securities Investor Protection Corporation v. R.D. Kushnir & Co.* (*R.D. Kushnir & Co. v. Adler Drobný Fischer LLC*), 274 B.R. 768 (Bankr. N.D. Ill. 2002).

³⁰ *Institutform Technologies, LLC v. Cosmic TopHat, LLC*, 959 F. Supp. 2d 1335, 2013 WL 4038722 (N.D. Ga. 2013).

³¹ E.g., subsequent cases to the **Illinois** statute found veil piercing remains available with respect to members and managers of Illinois LLCs under traditional veil piercing theories such as alter ego, fraud, and undercapitalization. *In re Subadolnik (Denmar Builders, Inc. v. Subadolnik)*, Bankruptcy No. 08-71951, Adversary No. 08-7116, 2009 WL 2591338 (Bankr. C.D. Ill. Aug. 20, 2009); *Cement-Lock v. Gas Technology Institute*, 618 F. Supp. 2d 856 (N.D. Ill. 2009); *In re Teknek, LLC (Fisher v. Hamilton)*, 343 B.R. 850 (Bankr. N.D. Ill. 2006). To the same affect: *American Action Network v. Cater America, LLC*, 983 F. Supp. 2d 112 (USDC D.C. 2013).

Other jurisdictions, such as **Delaware**³², **Illinois**³³, **Mississippi**³⁴ and **Minnesota**³⁵, have taken the position that **less weight** should be placed on **following corporate formalities** in LLC cases. Texas declined to adopt a rule that LLCs sharing a bank account is *per se* an abusive practice. *SSP Partners v. Gladstrong Investment (USA) Corp.*, 275 S.W.3d 444, 455 (**Tex.** 2008) ("We have never held corporations liable for each other's obligations merely because of centralized control, mutual purposes, and shared finances.")

CAVEAT: *Sky Cable, LLC v. DirecTV, Inc.*, 886 F.3d 375 (**4th Cir.** 2018)³⁶: "LLCs must observe fewer internal formalities than corporations, **but the principle that they should follow ordinary formalities and norms when doing business with other entities is the same.** *NetJets Aviation, Inc. v. LHC Commc'ns, LLC*, 537 F.3d 168, 178 (**2d Cir.** 2008)."

CONTRA: In *Denny v. Breanwick, LLC*, 2019 WL 2266690 (**Ohio** App. 2019), the Court considered the lack of corporate formalities as a factor in determining that the *alter ego* prong was met **despite the Ohio LLC Act** expressly providing that failure to observe formalities is not a factor to consider in piercing an LLC's veil.

b. Intentional Undercapitalization. Undercapitalization is one of the primary ways to satisfy the inequitable result element. *E.g., Ridge Clearing & Outsourcing Solutions, Inc. v. Khashoggi*, 2011 WL 3586455 (S.D.N.Y., Slip Copy, Aug. 12, 2011). See also: *Andrews v. Kerr McGee Corp.*,

³² *NetJets Aviation, Inc. v. LHC Communications, LLC*, 537 F.3d 168, 178 (**2nd Cir. (Del.)** 2008); *Cement-Lock v. Gas Technology Institute*, 523 F. Supp. 2d 827 (N.D. **Ill.** 2007) (in Delaware corporate formalities may not be as significant for LLC piercing).

³³ *Longview Aluminum, L.L.C. v. Industrial General, L.L.C.*, No. 02 C 0168, 2003 WL 21518585 (N.D. **Ill.** July 2, 2003) (failure to use LLC designator).

³⁴ *Restaurant of Hattiesburg, LLC v. HRS*, 84 So. 3d 32, 42 (**Miss.** COA 2012) (evidence that the corporate owner comingled the LLC's funds with that of another entity owned by the parent was insufficient to establish *per se* abuse where there was evidence that the parent separately accounted for the funds and expenditures to each of the entities).

³⁵ *Cognex Corporation v. VCode Holdings, Inc.*, Civ. No. 06-1040 (JNE/JJG), 2006 WL 3043129 (D. **Minn.** Oct. 24, 2006) (corporate formalities are less relevant in LLC context).

³⁶ "If legally separate entities fail to follow **corporate formalities when doing business with one another**, this failure may raise an inference that the entities are one and the same. See *NetJets*, 537 F.3d at 178. Additionally, piercing an entity's veil under the alter ego theory is **particularly appropriate when a single individual or entity completely dominates and controls another entity.** [*Wallace ex rel. Cencom Cable Income Partners II, Inc. v. Wood*, 752 A.2d 1175, 1183-84 (**Del. Ch.** 1999)]." *Id.* at 390.

No. 1:00CV158-D-A, 2001 WL 1704144 (N.D. **Miss.** Dec. 5, 2001). **However**, in many jurisdictions, the undercapitalization must have existed at the **time the entity was formed or during the time frame in issue**.³⁷ The existence of an unsatisfied creditor does not itself create an inequitable result, and an inequitable result does not follow in cases where the corporation was once adequately capitalized and then encountered bad financial times. *Flores v. DDJ, Inc.*, No. 1:99 CV 5878 AWI DLB, 2007 WL 4269259 (E.D. **Cal.** Nov. 30, 2007). To the same point is *Mantle v. North Star Energy & Construction LLC*, 437 P.3d 758, 799 (**Wyo.** 2019) (LLC was **not initially undercapitalized** and only became insolvent under the plaintiff's management at a time when the LLC had failed to maintain LLC formalities.

Undercapitalization is a factor to consider in LLC veil-piercing analysis, but the **weight** we give it **depends on the degree of undercapitalization and the reason for it**. (Citation omitted) It is a "relative concept" the weight of which "[depends]. on the particular circumstances of the case." (Citation omitted) In *GreenHunter*, we found the LLC was undercapitalized because "when [the plaintiff's] invoices were submitted to the LLC, it often had no money in its operating account, and ... it received periodic money transfers from [its member], which decided how much money would be transferred to the LLC to pay specific bills it decided to pay, and when." (Citation omitted) "Put another way, the LLC was continually undercapitalized by choice, not by external forces[.]" (Citation omitted) In contrast, any undercapitalization in *Gasstop* was a result of "the lack of the success of the business," which "operated for approximately two years at a loss" due to "the poor location, lack of customers and poor traffic count." (Citation omitted) There, we found "no evidence to pierce the LLC veil" and affirmed the district court's judgment. (Citation omitted)

Id.

³⁷ *Milk v. Total Pay and HR Solutions, Inc.*, 634 S.E.2d 208 (**Ga.** App. 2006)(undercapitalization must be coupled with evidence of an intent, at the time of capitalization, to avoid payment of future debts) and *Instituform Technologies, LLC v. Cosmic TopHat, LLC*, 959 F. Supp. 2d 1335 (N.D. **Ga.** 2013). In Mississippi, undercapitalization alone is not a basis for disregarding the corporate entity." *Powertrain, Inc. v. Ma*, 88 F. Supp. 3d 679, 698 (USDC ND **Miss.** 2015). To the same principle: *Longhi v. Mazzoni*, 914 N.E.2d 834 (**Ind.** App. 2009) and *Sakata v. Cook*, No. F046552, 2006 WL 164915 (**Cal.** App. Jan. 24, 2006).

c. Improper Distributions. Both **Delaware** and **New York** LLC laws contain nearly identical provisions preserving claims against members who receive wrongful distributions: 6 *Del. C.* §18-607 and *New York Limited Liability Company Law* ("LLCL") §508.³⁸ They prohibit the stripping of corporate assets so as to render an LLC insolvent and create a corporate cause of action against LLC members who knowingly and improperly receive a distribution of those assets. *In re Die Fliedermans, LLC*, 323 BR 101, 111 (Bankr. SD **N.Y.** 2005) (citing: *Pepsi-Cola Bottling Co. of Salisbury Md. v. Handy*, 2000 **Del. Ch.** LEXIS 52 at *16 (2000)) and *Board of Mgrs. Of Chocolate Factory Condominium v. Chocolate Partners, LLC*, 2014 NY Slip Op 50754 (**N.Y.** Supreme Court 2014).

However, *Weinstein v. Colborne Foodbotics, LLC* 302 P.3d 263 (**Colo.** 2013), has held that LLC member's liability for unlawful distributions is to the LLC, not the LLC's creditors, and an LLC's creditors may not assert a claim against LLC members for unlawful distribution.

E. The Fraudulent Purpose Test.

Some jurisdictions would add an additional or alternative test to the alter ego/inequitable result test: the **fraudulent purpose test**. *E.g., FILO America, Inc. v. Olhoss Trading Company, LLC*, 321 F. Supp. 2d 1266 (M.D. **Ala.** 2004) (fraudulent purpose in the conception of the business stated a basis for veil piercing). *Accord: Stewart v. Bureaus Inv. Group No. 1, LLC*, 24 F. Supp. 3d 1142 USDC MD **Ala.** 2014).

F. The Frustration of Expectations Test.

This test requires **some frustration of expectations** regarding the party **to whom** the creditor/claimant looked for performance. *Carpenter Properties, Incorporated v. JP Morgan Chase Bank National Association*, No. 15-60309 (**5th Cir. (Miss.)** May 4, 2016) (citing: *Canadian Nat'l Ry. Co. v. Waltman*, 94 So. 3d 1111, 1115 (**Miss.** 2012)). The inquiry focused on whether plaintiff knew it was contracting with the debtor rather than the owner and which entity plaintiff expected to pay its commission under the contract. See, *e.g., Gen. Motors Acceptance Corp. v. Bates*, 954 F.2d 1081, 1085 (**5th Cir.** 1992) (finding that frustration of purpose may be found where a

³⁸ **Kentucky** (*Ky. Rev. Stat. Ann.* § 275.230) and **South Dakota** (*S.D. Codified Laws Ann.* § 47-34A-406) have statutes dealing with improper distributions by LLCs.

corporation purposefully conceals its true persona and identity); *Rosson v. McFarland*, 962 So. 2d 1279, 1285-86 (**Miss.** 2007); and *Richardson v. Jenkins Builders, Inc.*, 737 So. 2d 1030, 1032 (**Miss.** Ct. App. 1999); *Restaurant of Hattiesburg, LLC v. HRS*, 84 So. 3d 32, 40 (**Miss.** COA 2012)(**frustration with the performance of the LLC** or contemplating **difficulty enforcing a judgment is not an injustice warranting** piercing the corporate veil); *Trevino v. Merscorp, Inc.*, 583 F.Supp.2d 521, 530 (**D.Del.**2008) (applying Delaware law). Typically, there must be proof that the plaintiff either actually believed or was justified in believing that the member/manager would perform or was personally guaranteeing performance or payment of the obligation. *E.g.*, *Richardson v. Jenkins Builders, Inc.*, 737 So.2d 1030, 1032 (¶ 9) (**Miss.** COA 1999).

G. Statutory Responses to Veil Piercing: Examples.

The theory of piercing the veil of limited liability in a corporate context is also addressed in statutory law in some jurisdictions.

- *Texas Business Organizations Code*, Title 3, Section 101.002 specifies, *inter alia*, that the code provisions regulating and restricting veil piercing of corporations, *Tex. Bus. Orgs. Code* §§ 21.223 and 21.224, also apply to LLCs, their members, and their managers;
- **Minnesota** has direct statutory recognition of veil piercing: *Minn. Stat. Ann.* §322B.303(2);
- **Wyoming**: *WY Stat* §17-29-304 (b) and (c) (2018);
- **Illinois** (805 *ILCS* 180/10-10(c) (1998)); and
- **South Dakota** (*S.D. Codified Laws Ann.* 47-34A-303(b)).

III. DISTINCTIONS BETWEEN CONTRACT CLAIMS AND TORT CLAIMS

A. The Difference in Kinds of Claims.

The General Rule is that **contract claimants**, unlike most third parties suing in tort, have voluntarily chosen to deal with the corporation and, absent some deception or fraud, would have had the **opportunity to apportion**, through negotiated contract terms, the **risk** that the entity would be unable to meet its obligations. *Shook v. Walden*, 368 S.W.3d at 619-20.

Texas by Statute. In 2011 Texas adopted *Texas Business Organizations Code* §21.223,³⁹ creating substantial differences for contract claimants as opposed to tort claimants. In the case of “any **contractual obligation** of the corporation or any matter relating to or arising from the obligation,” piercing the veil is prohibited in the case of *alter ego*, actual or constructive fraud, a sham to perpetrate a fraud, or other similar theory, **UNLESS** the obligee of the contractual obligation demonstrates that the “holder, beneficial owner, subscriber, or affiliate” sought to be charged with the corporate debt:

1. Caused the corporation to be used for the purpose of perpetrating an actual fraud; and
2. Caused the corporation to perpetrate an actual fraud on the obligee; and
3. The actual fraud was primarily for the direct personal benefit of the holder, beneficial owner, subscriber, or affiliate.⁴⁰

OTHER JURISDICTIONS. Similar formulations.⁴¹

³⁹ *Texas Business Organizations Code* §101.002 imports these rules into the LLC context for members and managers, and, presumably affiliates.

⁴⁰ *Texas Business Organizations Code* §21.223(a)(2) and (b).

⁴¹ *Wachovia Securities, LLC v. Neuhauser*, 528 F. Supp. 2d 834 (N.D. Ill. 2007) (heavy burden on voluntary contract creditor in Illinois); *On Command Video Corp. v. Roti*, 705 F. 3d 267 (7th Cir. 2013) (“[a] creditor will not be heard to complain about having extended credit to an assetless corporation if he knows or should have known it was assetless.”); *LaSalle Bank N.A. v. Mobile Hotel Properties, LLC*, 274 F. Supp. 2d 1293 (S.D. Ala. 2003); *MFP Eagle Highlands, LLC v. American Health Network of Indiana, LLC*, No. 1:07-cv-0424DFH-WGH, 2009 WL 77679 (S.D. Ind. Jan. 9, 2009); *Serio v. Baystate Props., LLC*, 60 A.3d 475 (Md. Ct. Spec. App. Jan. 25, 2013); *Restaurant of Hattiesburg, LLC v. Hotel & Restaurant Supply, Inc.*, 84 So.3d 32 (Miss. COA 2012); *Richardson v Jenkins Builders, Inc., et al*, 737 So.2d 1030, 1031 (Miss. COA 1999).

TORT CLAIMS. The one limitation placed on **tort claims** by the **Texas statute** was that piercing could not be based upon the failure of the corporation to observe any corporate formality (defined broadly and including statutory obligations). §21.223(a)(3). This does not otherwise limit veil piercing concepts developed by the common law in regard to tort claims.⁴² So, presumably, the methods of piercing developed by *Castleberry* and its progeny remain in full operation for tort claims, except as to the usage of violating corporate formalities.

B. Actual Fraud as to Contractual Obligation.

An exception in Texas to the stringent standards regarding contract creditors is where **actual fraud on the plaintiff primarily for the direct personal benefit of the holder**, beneficial owner, subscriber or affiliate is proven. *Tex. Bus. Org's. Code* §21.223(a)(2). *Spring Street Partners-IV, L.P. v. Lam*, 730 F.3d 427, 442-443 (5th Cir. 2013); *Copeland v. D & Construction LLC*, No. 3:13-CV-4432-N-BH (USDC ND TX, Dallas Div. January 14, 2015); *SSP Partners v. Gladstrong Investments (USA) Corp.*, 275 S.W.3d 444, 455 (Tex. 2009); *Ocrum, Inc. v. Bartosh*, No. 01-11-793-CV, 2012 WL 4740859, at *3 (Tex. App. Oct. 4, 2012).⁴³

"Actual fraud" may be defined as "involv[ing] dishonesty of purpose or intent to deceive."⁴⁴ *Tryco Enters., Inc. v. Robinson*, 390 S.W.3d 497 (Tex.App.-Houston [1 Dist.] 2012, writ *dismiss'd*). Fraudulent intent may be determined from an examination of all of the facts and circumstances. *E.g., Matter of Chastant*, 873 F.2d 89, 91 (5th Cir.1989) The court in *In Re HRM Holdings, LLC*, 421 BR 244 (Bankr. ND Texas 2009) stated that:

⁴² In **Texas prior to 2011**, the test for veil piercing did not have two prongs, it had three options, the satisfaction of any one of which will lead to veil piercing. *In re JNS Aviation, LLC*, 376 B.R. 500, 521 (Bankr. N.D. Tex. 2007), *aff'd*, 395 Fed.Appx. 127, 128 (5th Cir.2010) (citing: *Gibraltar Sav. v. L.D. Brinkman Corp.*, 860 F.2d 1275 (5th Cir.1988)). The three options, boiled down by the 5th Circuit from the original *Castleberry* opinion were proof of (1) alter ego, or (2) use of the corporate form as an illegal purpose or, stated otherwise, to avoid legal limitations upon natural persons or corporations; and (3) sham to perpetrate a fraud. *In re JNS Aviation, supra*, at 527 (citing *Pan Eastern Exploration Co. v. Hufco Oils*, 855 F.2d 1106 (5th Cir.1988), and *Gibraltar Savings, supra*).

⁴³ **Texas' actual fraud rule:** "To determine if the [members of an LLC] are liable under the asserted veil-piercing theories, the Court must analyze both the question of whether the facts satisfy any of the asserted veil-piercing strands and the question of whether any of the [members] caused [the LLC] to be used for the purpose of perpetrating and did perpetrate an actual fraud on [the plaintiff] primarily for the direct personal benefit of the considered defendant." *In re JNC Aviation, LLC*, 376 B.R. 500, 527 (Bankr. N.D. Tex. 2007), *aff'd*, 418 B.R. 898 (Bankr. N.D. Tex.2009).

⁴⁴ *Husky Intern. Elecs., Inc. v. Ritz (In re Ritz)*, 513 B.R. 510, 522 (S.D. Tex. 2014), *aff'd*, 787 F.3d 312 (5th Cir.), *cert. granted*, 136 S. Ct. 445 (2015) (*quoting Trustees of Nw. Laundry & Dry Cleaners Health & Welfare Trust Fund v. Burzynski*, 27 F.3d 153, 157 (5th Cir. 1994)); *DeSantis v. Wackenhut Corp.*, 793 S.W.2d 670, 688 (Tex. 1990).

[Actual fraud occurs] when (i) a party conceals or fails to disclose a material fact within the knowledge of that party;(ii) the party knows that the other party is ignorant of the fact and does not have an equal opportunity to discover the truth;(iii) the party intends the other party to take some action by concealing or failing to disclose the fact; and (iv) the other party suffers injury

C. Constructive Fraud as to Contractual Obligations.

Texas, by statute, has now required actual fraud on a creditor plaintiff to pierce a corporate/LLC veil. Constructive fraud will not do the trick.⁴⁵ Nevertheless, in earlier Texas cases, *i.e.*, before statutory intervention, and a formulation which is still classic, Texas common law was that, "constructive fraud is the breach of some legal or equitable duty which, irrespective of moral guilt, the law declares fraudulent because of its tendency to deceive others, to violate confidence, or to injure public interests." *Castleberry v. Branscum*, 721 S.W.2d 270, 271-72, 273 (Tex. 1986) (quoting *Archer v. Griffith*, 390 S.W.2d 735, 740 (Tex.1965) (citations omitted)). *Spring Street Partners-IV, L.P. v. Lam*, 730 F.3d 427, 443 (5th Cir. 2013).

Under the doctrine of constructive fraud, "[n]either fraud nor an intent to defraud need be shown as a prerequisite to disregarding the corporate entity; it is sufficient if recognizing the separate corporate existence would bring about an inequitable result." *Id.* at 272-73. "Examples [of an inequitable result] are when the corporate structure has been abused to perpetrate a fraud, evade an existing obligation, achieve or perpetrate a monopoly, circumvent a statute, protect a crime, or justify wrong." *SSP Partners v. Gladstrong Invs. (USA) Corp.*, 275 S.W.3d 444, 451 (Tex.2008) (citing *Castleberry*, 721 S.W.2d at 272). The *Castleberry* court also stated that, "[t]o prove there has been a sham to perpetrate a fraud, tort claimants and contract creditors must show only constructive fraud." 721 S.W.2d at 273. *Id.* at 443. In jurisdictions, which permit constructive fraud to suffice in a veil piercing claim, these are still good, representative statements of the common law.

⁴⁵ In *SSP Partners v. Gladstrong Invs. (USA) Corp.*, 275 S.W.3d 444, 455 (Tex.2008), the Texas Supreme Court stated that: "[i]n *Castleberry*, we held that the corporate structure could be disregarded on a showing of constructive fraud, even without actual fraud. The Legislature has since rejected that view in certain cases." 275 S.W.3d at 455 (emphasis added) (citation omitted).

POSTSCRIPT

These materials are an OVERVIEW and apply, in general terms, to both corporations and limited liability companies. Many of the peculiarities with regard to LLC's are discussed in the materials. LLC's have become ubiquitous, but they are still relatively new entities to the law, and the cases are now just beginning to flesh out the interpretations of an entity which is primarily a creature of contract rather than statute. Be sensitive to the differences and distinctions in the different kinds of entities, and particularly, the intentional, relative informality of the LLC form. Also note that a number of commentators have published discussion and criticism of the judicial application of veil-piercing concepts.

I particularly call your attention to David K. Millon (J.B. Stombock Professor of Law, Washington and Lee University), *Response, The Still-Elusive Quest to Make Sense of Veil-Piercing*, 89 *Tex. L. Rev.* 15 (2010). This article is a response to three previous empirical studies of veil-piercing: Robert B. Thompson, *Piercing the Corporate Veil: An Empirical Study*, 76 *Cornell L. Rev.* 1036 (1991); Robert B. Thompson, *Piercing the Corporate Veil Within Corporate Groups: Corporate Shareholders as Mere Investors*, 13 *Conn. J. Int'l L.* 379, 385 (1999) and Peter B. Oh, *Veil-Piercing*, 89 *Texas L. Rev.* 81 (2010). Another commentator has suggested that, "Abolishing veil piercing would refocus judicial analysis on the appropriate question – did the defendant-LLC member do anything for which he or she should be held directly liable?" Bainbridge, *Abolishing LLC Veil Piercing*, 2005 *U. Ill. L. Rev.* 77 (2005).

If you are looking for a policy issue or a different way to approach a problem (or a court), articles like these are fertile ground for new ideas and give that “different” argument some “authority.”