



Recent Developments in LLC Veil Piercing

Highlights

Limited Liability Companies (LLCs) were first established in 1977 by the state of Wyoming. Other states have since followed suit, and the LLC has become a popular business form. Owners of private businesses are choosing LLC structures in record numbers because they provide strong liability protection and increased flexibility compared to corporations.

Some statistics from Independent researcher Bill Hobbs of HobbsOnline:

- LLC formation set records in fiscal year or calendar year 2003 in 24 of 27 states surveyed
- The rate of acceleration of LLC formation was between 200-400% during 1999-2003

One reason people choose LLCs is because of the perception that LLCs are not subject to veil piercing. However, since the LLC structure is relatively new, there is not a lot of case law (court cases) or statutory guidance (laws) that clearly indicate whether an LLC can have its veil pierced and the owners held personally responsible for liabilities and debts of the business.

In the absence of clear direction from the courts, some people have concluded that LLC owners cannot be held personally liable for actions taken by an LLC.

The Wyoming State Supreme Court recently issued an important ruling on LLC veil piercing. In this case, the question was asked, "can the entity veil of a limited liability company (LLC) in Wyoming be pierced in the same manner as a corporation, or not?" The court ruled that the same veil piercing rules apply to both corporations and LLCs.

Other state courts have taken similar positions since this ruling. These cases indicate that owners/investors in LLCs must run their entities with the same diligence as owners/investors of corporations or limited partnerships.

The Case of Livestock v. Flahive

Flahive Oil & Gas LLC was a Wyoming based company owned and managed by Roger Flahive. Mr. Flahive entered into a contract with landowner Kaycee Land and Livestock. The contract allowed Flahive Oil & Gas to use the surface of real property located in Johnson County, Wyoming.

A dispute arose where Kaycee Land and Livestock alleged that Flahive Oil & Gas caused environmental contamination to the property. The cleanup costs for the contamination were substantial, and Flahive Oil & Gas LLC had no assets. As a result, Kaycee Land and Livestock went to court seeking to pierce the LLC veil and hold owner Roger Flahive personally liable for the contamination cleanup costs. This case went before the District Court of Johnson County in Wyoming.

The Legal Issue

Kaycee Land and Livestock argued that an LLC should be no different from a corporation when it comes to piercing the corporate veil. The Wyoming rule for corporate veil piercing reads "there must be such unity of interest and ownership [between the corporation and the individual] that . . . adherence to the fiction of the

separate existence of the corporation would, under the particular circumstances, sanction a fraud or promote injustice”.

The District Court submitted a “certified question” on LLC veil piercing to the Wyoming State Supreme Court.

A “certified question” is a question of law submitted to a federal or state court by a lower court or tribunal. In other words, the District court was asking the Supreme Court, “How should Wyoming state law be applied here?”

The certified question in the *Livestock v. Flahive* case was:

“In the absence of fraud, can the entity veil of a limited liability company (LLC) in Wyoming be pierced in the same manner as a corporation, or not?”

This question is significant for two primary reasons:

1. In answering the certified question, the Wyoming Supreme Court would be setting expectations and providing a clear legal doctrine for future use;
2. Since Wyoming is the “mother state” that invented LLCs, Wyoming’s legal treatment of LLCs is often seen as a model for other states to follow.

The Legal Decision

The Wyoming Supreme Court agreed with *Kaycee* that the same rules apply to corporations and LLCs when it comes to piercing the entity’s veil. In addition, the language the court used in its opinion gives other courts a lot of leeway to decide to pierce the veil.

The Supreme Court listed a variety of corporate veil piercing factors that would also apply to LLC veil piercing. This list includes:

Alter Ego Issues

- Commingling of funds and other assets
- Individuals treating business assets as personal assets
- Personal guarantees for debts of the business
- Inappropriate “domination and control” by owners
- Use of the business as a “mere instrumentality” or shell for the actions of an individual
- Formation of the business solely to transfer liabilities from another business or individual

Entity Creation Issues

- Failure to obtain authority to issue or subscribe to stock
- Inadequate capitalization or the absence of business assets

Entity Governance

- Failure to properly maintain corporate records and/or confusing records between multiple entities;
- Concealment or misrepresentation of entity ownership

The Wyoming court made a strong argument for LLC veil piercing: “We have long recognized that piercing the corporate veil is an equitable doctrine. The concept of piercing the corporate veil is a judicially created remedy for situations where corporations have not been operated as separate entities . . . and, therefore, are not entitled to be treated as such . . . Every state that has enacted LLC piercing legislation has chosen to follow corporate law standards and not develop a separate LLC standard . . . We can discern no reason, in either law or policy, to treat LLCs differently than we treat corporations” (*Livestock v. Flahive*, 2002 WY 73, 46 P. 3d 323)

Other courts are taking positions similar to the Wyoming Supreme Court in Livestock. For example, a Louisiana court allowed employees of Orleans Regional Hospital, an LLC, to pierce the LLC veil for wages and other damages (Hollowell v. Orleans Regional Hospital 217 F.3d 379).

Summary & Conclusion

The Limited Liability Company (LLC) is a new legal form of business entity. The impact of new laws takes a while to become clear and it was unclear how LLCs would be treated by the courts in a veil piercing situation.

The decision of the Wyoming Supreme Court in Livestock v. Flahive and similar decisions in other states send a clear message: if you own an LLC, you will be held to the same corporate governance and compliance standards as owners of corporations. In other words, you must work as hard to keep your LLC compliant as a corporation owner.

As with a corporation, if you keep the rules, you can plan on liability protection if a challenge arises.

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