



Overlap: A Big Problem for Owners of Multiple Businesses

A legal theory commonly used in veil piercing cases called “overlap” may prove to be the worst enemy of not only your business affairs, but also of your personal estate. We will look first to how courts define overlap and its factors. Second, we will review a case study that demonstrates the application of overlap. Finally, we will propose some guidelines that will help you avoid overlap and keep the protective veils of your business entities strong.

In today’s world of asset and wealth accumulation, business owners often seek protection of their assets by establishing multiple business entities to own and operate those assets and related business interests. Although not flawed in concept, these vertical assets and business arrangements can spell disaster in practice.

Overlap cases, by definition, are lawsuits where multiple, related business entities are sued by a common plaintiff. In most cases, the relation between the business entities appears to be quite strong. That relation may involve a parent/subsidiary organization or can involve companies that have similar ownership and governing bodies. More specifically, however, the courts find multiple factors that seem to join or merge the different companies in a way that cause the separation between the entities to disappear. Some of those factors include:

- Common ownership;
- Common or interlocking officers;
- Common or interlocking directors;
- Common personnel;
- Common office space;
- Common address and telephone numbers;
- Financing of subsidiary by parent;
- Informal inter-company loans;
- Filing of consolidated tax returns;
- Whether common directors act independently in the differing companies’ best interests.

Ultimately, the courts look to see if one corporation totally dominates the others to the extent that there is no separate corporate existence.

Case Study

In the case of Litchfield Asset Management Corp v. Howell, the plaintiff sued Howell’s corporation for breach of contract and obtained a judgment in the amount of \$657,000. Howell appealed the judgment, and in the meantime, established two new limited liability companies: Mary Ann Howell Interiors & Architectural Design, LLC (“Design”), and Antiquities Associates, LLC (“Antiquities”). Howell retained 97% and 99% ownership in the new companies, while her husband and daughter owned the remaining portions. Howell capitalized both Design and Antiquities with property and proceeds from her prior business.

Later, the plaintiff sued Design and Antiquities alleging that they had been established as “mere shells” to promote injustice and prevent the plaintiff from collecting on the judgment. Moreover the plaintiff claimed that Design and Antiquities were the alter egos of Howell and pressed the court to pierce their company veils.

Result

The court found Howell personally liable for the debt of her former company and allowed the plaintiff access to the assets of Design and Antiquities as well. The facts the court found relevant include the following:

1. Howell was general manager of both companies;
2. Neither company had employees;
3. Those who provided services for the companies were independent contractors;
4. Both companies operated out of a loft space above the garage at Howell's residence;
5. Neither company paid rent for the space;
6. Howell exercised complete control over the policies, finances and business practices of the companies;
7. There was no indication that Howell's husband or daughter participated in the companies in any significant way;
8. Howell had never drawn a salary;
9. Howell used company funds for many personal expenses; and,
10. Although the companies maintained separate bank accounts, payments to one company were deposited into the other's account without corresponding reimbursement.

The court noted this fact pattern as "not especially novel or uncommon". It also emphasizes that this case presented a "reverse pierce" remedy. This type of remedy exists when the creditor of an individual debtor is seeking to reach the assets of an entity controlled by that debtor. Remember, the Litchfield case had two important stages. First, the plaintiff successfully pierced the veil of Howell's first company and obtained a judgment against Howell personally. The second stage occurred when the plaintiff pierced the two LLCs, allowing the LLC assets to be regarded as Howell's personal property and available to satisfy the judgment against her. Undoubtedly, Howell was devastated to learn that her corporation and two LLCs provided no limited personal liability.

Reverse piercing is extremely relevant because the veils of your companies can be pierced to satisfy judgments against you personally, whether that judgment resulted from your personal conduct or from the conduct of another business you own. Significantly, the Connecticut Court of Appeals in the Litchfield case emphasized that there is a "growing recognition of the doctrine of reverse piercing of the corporate veil".

Action Items

So what should you do if you are an owner of multiple businesses? Here are some suggestions:

- Enroll them with Corporate Assistance and let us help you keep the rules.
- Make sure your companies are properly capitalized individually and independently.
- If your companies share officers and directors, make sure that all officers and directors are functioning in those capacities. This means that they are convening timely meetings to discuss and resolve significant business issues.
- Keep proper records of all director and shareholder meetings. These records should include minutes and resolutions of all items discussed in those meetings.
- Don't think that having merely one shareholder and director meeting a year is going to persuade a court or jury that your companies acted independently of each other. This also applies to LLCs.

Convene regular special meetings of shareholders and directors to handle the business decisions that frequently occur to document these decisions.

- Maintain separate payrolls for your separate businesses.
- Do not share employees between your companies. If your companies must share employees, make sure that their wages are paid from the different companies that they work for. Have current, written Employee Lease Agreements for any shared employees. Don't have one company pay wages to an employee when that employee works for another, related company.
- Maintain separate insurance policies for your separate companies.
- Be able to demonstrate that each of your businesses are autonomously managed and operated on a day-to-day basis. You can do this by making sure that company officers and directors act in the best interest of the company.
- Do not share office space between your companies. If you need to share office space, be sure that each company pays its proportionate share of the rent.
- Do not share phone numbers between two or more businesses. If you must, make sure each business has a separate line for individual company access.
- Ensure that your board of directors functions as a body so that you cannot be accused of exercising complete control over the policies, finances and business practices of all of your business concerns. You can do this by convening regular director and shareholder meetings where these issues are discussed and voted on, and recorded in those meetings. Remember, the task is to demonstrate that each business entity has a mind and existence of its own that is separate from yours.
- Make sure that your companies deal with each other at arm's length. If you are going to allow inter-company loans, document the loans with notes, security agreements, personal guarantees and related documents. Then make sure payment schedules are followed.
- Keep separate financial books for each company.
- Keep separate bank accounts for each company and honor the money, property and accounts receivables of each company as its own.
- File separate tax returns for each company.
- Do not allow one company to use the property of another as if it were its own.
- Pay yourself a salary and/or make and receive distributions from each company.
- Don't use company funds to pay personal expenses.

This is not an exhaustive list, but it is sufficient to inform you of a number of pitfalls to avoid. Keep your companies separate and honor them as different and distinct legal entities even though you may be the majority or sole owner. We are committed to helping you keep these rules. If you will perform the action items we provide, you are well on your way to avoiding the result that Howell experienced.

Material discussed is meant for general illustration and/or informational purposes only and is not to be construed as tax or legal advice. Although the information has been gathered from sources believed to be reliable, please note that individual situations can vary.

For additional information visit www.CorporateAssistanceLLC.com on the web or call 877-800-8345 toll free.