



How Does Veil Piercing Work with LLCs?

Like a corporation, one of the major benefits associated with organizing your business as a limited liability company (LLC) is the ability it offers to protect members' personal assets from liability claims of 3rd parties and other LLC members. Still, LLCs are subject to veil piercing just like corporations. Because LLCs are relatively new, there is significantly less case law on LLC veil piercing than on corporate veil piercing. However, early court decisions suggest that LLCs will receive treatment similar to corporations, both in terms of the risk of veil piercing and the range of actions required to prevent a successful veil piercing.

Veil Piercing in an LLC Context

Generally speaking, veil piercing strategies are employed whenever there is no general partner with unlimited liability to pursue. A limited partnership, for example, has a general partner who is personally liable for all the partnership's actions, and limited partners who have limited liability but cannot participate in the management of the company. Since an LLC provides liability protection to all its members, veil piercing is the only avenue to "tag" the business owners with personal liability. Again, since the LLC is a relatively new business form, there have been fewer veil piercing court actions recorded in the case law.

Below are several references of what little case law exists on veil piercing for LLCs:

- Refer to Colo. Rev. Stat. 7-80-107 (veil piercing applied to LLCs)
- California Corp. Code sec. 1710(b) (equating LLC member liability to corporate shareholder liability)
- Illinois Rev. Stat. Ch. 805, para. 180/10
- Minn. Stat. Sec. 322b.303(s)
- N.D. Cent. Code sec. 10-32-29(3)
- Wis. Stat. Ann. Sec. 183.0304(2)

There also is relatively little case law addressing whether LLC members or managers are held to a standard of "fiduciary duties" (e.g. duty of disclosure, duty of care, duty of loyalty). However, LLC managers likely have fiduciary duties (similar to the duty of corporate directors to the corporation and its shareholders, and of general partners to limited partners) to members who do not perform management functions. Some state LLC statutes expressly cover the issue of fiduciary duties owed by members and managers. To pierce the corporate veil under Illinois law, however, requires meeting only two situations: when "unity of interest" and ownership between the parent and subsidiary exist and when "adherence to the fiction of separate corporate existence would sanction a fraud" *Van Dorn Co. v. Future Chemical and Oil Corp.*, 753 F. 2d 565, 569-70 (7th Cir. 1985) cited in *Hystro*, 18 F.3d at 1388-89.

The Stone v. Hobby Decision

In *Stone v. Frederick Hobby Associates II, LLC*, the court found that the "instrumentality and identity rules" could be applied, under the facts of the case, to "pierce the corporate veil" of an LLC and hold the individual members personally liable. The plaintiffs, husband and wife, were both physicians. The plaintiffs had entered into a sales agreement with the defendant Connecticut LLC in December 1999 to purchase a residence in Greenwich, Connecticut, for \$3,300,000. The home had been only partially completed at the time the sales agreement was

executed. The sales agreement contained certain express warranties concerning the condition of the premises, and provided for the completion of certain "punch list" items within 60 days of date after the date of the agreement.

The plaintiffs subsequently filed a lawsuit, alleging defects in the subject property, and that the defendant had failed to complete all the punch-list work. The plaintiffs further alleged the defendant had, on or near the closing date for the purchase of the premises, transferred substantially all of its assets, including the proceeds from the sale of the subject property, to another LLC and to private individuals, including the sole members of the original LLC.

After a court hearing, the court granted the plaintiffs' application for the statutory prejudgment remedy, and ordered disclosure of the assets of the defendant LLC members. In essence, the court "pierced the veil" of the defendant LLC.

The court further stated that "[t]he limitation on liability provided by incorporation or the formation of a limited liability company is not . . . without boundaries.". The court held that the same rationale that applies in connection with piercing the corporate veil also applies in the case of an LLC. The court stated further that "[t]he instrumentality and identity rules may be applied in order to 'pierce the corporate veil' of a limited liability company."

Turning to the facts of the case, the court found the defendants were the sole members of the LLC, and that the LLC office was located in a private home (although the LLC did not pay any rental for the space). The court also noted that the LLC never had any assets other than the residential property that the plaintiffs purchased from the LLC and which was now owned by the plaintiffs. Particular attention was paid to a statement made by an attorney for the defendant LLC members to the plaintiffs, "go ahead and sue us. There is no money in [the LLC]. Why do you think we set it up as an LLC in the first place?"

Conclusion

There is no apparent good reason why the "piercing the corporate veil" doctrine should not be applied to LLCs when the facts are comparable. Unless future case law suggests otherwise, the only prudent course for LLC owners to follow is to assume they will be held to the same compliance standards and practices as owners of corporations.

Other lessons from this case: establish a clear and separate identity for the LLC apart from its constituent members (including a separate office, stationery, books, and assets); clearly designate the LLC as the entity entering into and executing business agreements and contracts intended to bind and benefit the LLC; and don't "dare" potential plaintiffs to sue by arguing that "the LLC doesn't have any money or assets you can reach, and that's the reason we formed it."

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