



Creating a Strong Company Veil

The primary reason business entities are pierced is because they are considered the alter ego of their owners. That is to say, the business entities are viewed as simple extensions of their individual owners. The factors that lead a court to conclude that a business is simply its owner's alter ego are numerous. Some of those factors are listed below, together with the actions you should take to avoid them.

Commingling Funds

Commingling is defined as the sharing or pooling of personal and business assets, or the sharing or pooling of assets of one business with that of another. Review your company and personal practices of handling money for last year. Did you do any of the following?

- Deposit of corporate moneys into personal rather than corporate accounts (or vice versa).
- Pay personal obligations with company funds (or vice versa).
- Fail to set up and maintain separate company bank accounts for your different companies.
- Fail to make payments to the company for its services.
- Pay yourself personally for company services or goods, rather than the company.
- Fail to properly document loans made to or by any company divisions, subsidiaries, shareholders, officers or directors.
- Fail to subordinate loans to or from shareholders, directors, officers or subsidiaries, to loans from third parties.
- Fail to conduct such loans in an arms-length fashion.

It is critical you adjust your practices and policies to prevent these actions from occurring.

Unauthorized Diversion of Funds

This action is defined as a transaction involving company property that occurs without regard to formal corporate procedures, or putting company property to other than company uses. In most cases, unauthorized diversions occur where company owners enter into personal transactions with the business, to the business' disadvantage, without the approval of the company's stockholders or directors. Next time you are considering using company property in a way that may benefit you personally, consider the following questions:

- Is the movement of company property occurring in the context of formal company action, i.e. properly noticed company meetings where the movements of assets are discussed as well as the consequences of those movements?
- Will those movements disadvantage known creditors? If so, subrogate your personal interests in the transaction to those of known creditors.
- Will those transfers disadvantage the transferring company or hamper its ability to do business? If so, do not engage in the transfer, or change its configuration so that the transferring company is not hampered.
- Are the company's officers and directors actually functioning in their official capacities?

- Are company meetings involving shareholders and directors actually being convened and attended by the appropriate individuals who are authorized under the company bylaws to make relevant decisions? Contact your Governance Specialist to accomplish this.

Use the above questions in your shareholder and director meetings as a simple guide to help you avoid diverting company property in an unauthorized way.

Personal Guarantees

The third issue to review is whether you have held yourself out as a personally responsible for your company's debt. This doesn't involved signing or refusing to sign personal guarantees for your company obligations. It specifically involves inadvertently giving someone who deals with your business the impression that you, personally, will be responsible for your company's obligations. You want to avoid doing so at all costs. Consider the following guidelines anytime you enter into contract negotiations or have client communications:

- When you are negotiating a contract, always inform the other contracting party that they are dealing with a corporation, limited liability company or partnership.
- Never state (or even imply) verbally or in writing that you have any personal responsibility for your company's obligation. Do not tell a vendor or client that "you will personally see to it that the company's obligations are fulfilled".
- If you have made these types of verbal or written representations, send a letter to your client or vendor client or vendor clarifying that your representations were made in your official capacity, not in your personal capacity. For example: "I, as company president, will do all I can to ensure that the company performs".
- Always sign contracts, purchase orders, and other company transaction documents in your professional capacity as an authorized company agent, i.e. president, vice president, director, manager, etc. On any contract, always write down your company title and company name next to your personal name and signature.
- Be sure you have company authority to enter into the transaction or sign contracts. Check your company's bylaws or operating agreement for this information.
- Be sure you have company authorization to sign contracts that bind the company. Check your company's bylaws or operating agreements, as well as company resolutions, regarding the relevant transaction.

Company Stock

Have you authorized and issued stock in your company? Surprisingly, the majority of private companies have failed on at least one of these actions. Not surprisingly, failing to authorize and issue stock has been a frequent justification for courts to pierce company veils. Make sure that your company has authorized stock (check your articles of incorporation) and that the stock has been issued. Additionally, make sure that your stock ledger is up to date and accurately reflects the current stockholder status of all company owners. Additionally, do the following if you have not authorized or issued stock:

- If you are an LLC, and your state doesn't require issuance of membership units, do it anyway. This will clarify ownership issues and avoid confusion.
- Make sure to issue your company's stock in a properly noticed directors' meeting. Contact your Governance Protection Specialist to schedule and properly document this meeting.

- Acquire and complete physical stock certificates to accurately reflect the company's stock ownership as discussed in the directors' meeting.
- Document the consideration paid for the stock and keep that documentation in your corporate records.
- Keep a stock ledger, recording all of the stock transfers of the company's stock. Keep the ledger in your company's records and keep it current. It should reflect the shareholder's name, the number of shares transferred, the type of share, the date of transfer, the consideration paid for the stock and the stock certificate number.
- Give the physical stock certificates to the shareholders.

Maintain Corporate Records

This issue is almost always cited as a factor in a court determining that a company is the alter ego of its owners. What should you do? Review your company record keeping practices from previous years. They can probably use some improvement. Improvement will be easy if you use the expertise of your Governance Specialist. We will help you to conveniently and quickly do the following:

- Convene regular director and shareholder meetings. Don't hold only one shareholder or director meeting per year. Truthfully, what corporation or LLC can legitimately claim that they handle all significant business issues in one or two meetings a year? Significant business issues arise continuously. Use your corporate structure to address and determine those issues, and formalize decisions in a properly called special meeting.
- Follow strict protocol in noticing and convening your director and shareholder meetings, especially if your company is comprised of only a few shareholders. Remember, the fewer the shareholders, the greater the risk of veil piercing.
- Prepare an agenda for your meetings, acquiring input from all directors and shareholders about the business issues that need to be raised and discussed.
- When making business decisions, address the important factors related to those decisions. If you are a majority shareholder and president of the company, solicit input from your board and other shareholders. Encourage their involvement and participation. By doing so, you can overcome claims of domination over the company. Have an active decision-making board of directors, and document that activity.
- If you own more than one company, be sure to conduct separate meetings for the separate companies. Don't intermingle one company's meeting with that of another. Maintain the separateness that you intended to create when you organized your separate companies. Prepare and send separate notices, hold meetings at separate times, prepare separate and distinct agendas, record those meetings with separate minutes and relevant and specific resolutions. Then have the board act on those resolutions.
- Include independent professionals on your board who can provide valuable input.
- Maintain separate books and records for each company.
- Maintain separate bank accounts for each company.
- Create a trail of evidence through your use of company meetings, minutes and resolutions that you can do regard and highly respect the individuality of the business entities that you operate.

Conclusion

Each year, near the anniversary of your enrollment date, we will schedule an annual review with you. During this phone conference, our Governance team will help you determine the current status of your company veil and suggest action items that will keep you on track. In the meantime, we encourage you to review your business practices in each of the aforementioned areas. The guidelines provided and reviewed for you here will help you keep your company's veil strong by recognizing and respecting it.

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

