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Legal Spotlight

Piercing the Corporate Veil

When LLC's Fail to Limit Liability

Mark D. Changaris, Partner
Berg, Hill, Greenleaf & Ruscitti, LLP
mdc@bhgrlaw.com

Generally, a duly formed limited liability company is treated as a separate legal entity, unique from its officers, directors, and members. Like every rule, however, there is an exception. And this exception may permit creditors to pierce the protective veil of a LLC and hold its owners responsible for LLC debts.

Veil Piercing is an Extraordinary Remedy

Courts describe veil piercing as an "extraordinary remedy" that is only justified in limited circumstances. Under this doctrine, courts may disregard the shield the LLC form would normally provide its members when: (1) the entity is "merely the alter ego" of the member; (2) the LLC form is used to perpetuate a wrong; and (3) disregarding the legal entity would achieve an equitable result.

Steps to Reduce Chances of Veil Piercing

There is no bright line rule for when a Court will pierce the veil and hold members responsible for LLC debts. However, there are steps you can take to reduce the chances of having the veil pierced.

Maintain Corporate Formalities

It is important for the LLC to maintain corporate formalities through having a binding operating agreement, conducting regular meetings, documenting meetings with meeting minutes, authorizing LLC action by written consents, and filing appropriate business tax returns.

Do Not Commingle Funds

It is critical that the LLC does not commingle funds or assets with its members. All LLC assets should be titled in the LLC name. All LLC debts should also be in the LLC name and personal guarantees should be minimized. The LLC should also maintain separate bank accounts from its members, and be sure to maintain separate books, records, and accounting data. LLC funds should never be used for non-LLC purposes.

Do Not Use the LLC to Shield Wrongdoing

Courts piercing the corporate veil do so under principles of equity and fairness. If the LLC is being used to shield a member's fraud or other wrongdoing, courts will be much more likely to pierce the veil.

Adequately Capitalize the Business

One of the factors the Courts look to is whether the LLC is adequately capitalized. Thus, to lessen the likelihood of piercing the veil, LLC's should be sufficiently capitalized for the business they are performing. Care should be taken to avoid the LLC taking on liabilities far in excess of the assets or earning potential of the LLC.

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