PIERCING THE VEIL OF THE SINGLE MEMBER LIMITED LIABILITY COMPANY

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Executive Summary:

Single member limited liability companies are popular alternatives to corporations and sole proprietorships because they offer flexible tax treatment and protection from personal liability. Recent cases, however, have exposed members of single member LLCs in various states to personal liability in a variety of contexts. In this course, we will examine the factors courts consider in deciding to pierce the LLC veil to apply alter ego liability as well as strategies to avoid piercing.¹

I. INTRODUCTION

Limited liability companies (LLCs) are relatively new vehicles meant to allow greater flexibility and less formality than corporations. LLCs have some characteristics of a partnership and some of a corporation; these unique tax considerations can blur the line between their members and the entity. See, e.g., Delaware Limited Liability Company Act, Del. Code Ann. Tit. 6, §§ 18-101 – 18-1109. Because LLCs are largely creatures of contract, members can contractually agree to specific terms, conditions and limitations (including limitations on liability and, conversely, waivers of limited liability) through the contract of the member or “operating” agreement.” Due to this hybrid nature, and the relative newness of LLC enabling statutes, the case law on veil-piercing of a limited liability company is somewhat inconsistent. And, as the reader will see, finding a bright-line rule is difficult. “There is a consensus that the whole area of limited liability, and conversely of piercing the corporate veil, is among the most confusing in corporate law.” See Frank H. Easterbrook & Daniel R. Fischel, Limited Liability and the

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Corporation, 52 U. Chi. L. Rev. 89, 89 (1985). The same sentiment applies with respect to LLCs, and even more so with respect to single member LLCs.

A. History of the Doctrine

As we all recall from law school Corporations class, it is axiomatic that a shareholder, whether corporate or individual, is not liable for the debts of the corporation in which the shareholder owns shares. The ability to pierce the corporate veil, that is, to treat the debts or obligations of the corporation as debts or obligations of a shareholder or shareholders is a potent exception to that general rule. The term “piercing the corporate veil” was first coined by law professor Maurice Wormser in the early twentieth century. See Presser, Piercing the Corp. Veil § 1.5 (discussing Wormser’s scholarship).

Renewed attention to the doctrine of piercing the corporate veil has arisen because of several developments in business and in the law, one of which is the enactment of LLC statutes. The rights and responsibilities of corporations and LLCs have been the subject of great political debate over the last decade as the economy continues to experience fallout from multiple rounds of financial scandals. Increased regulatory scrutiny of business entities also plays a role in this debate. Due to the continuing weakness in parts of the economy, parties to litigation must look for as many sources as they can find to collect on judgments. Likewise, recent Supreme Court jurisprudence (Citizens United and Hobby Lobby) extended certain additional rights to corporations that previously were limited to natural persons. While these cases have not extended to LLCs (yet), they have re-ignited a debate about the role of artificial persons in our economy, society and culture. The important thing to remember is piercing is an exception.
B. Single Member LLCs

Single member LLCs are a popular alternative to sole proprietorships, and are now authorized in all states. *See Ribstein and Keatinge on Limited Liability Companies* (Nov. 2017), Section 4.3. A single member LLC is relatively simple to organize but, as a best practice, should always have a written operating agreement. In addition, consultation with a tax professional is critical because LLCs have unique tax considerations. Most Secretaries of State in the various states have useful web sites with checklists of fees, forms, and other registration requirements.

Since there is only one member in a single member LLC, there is no need to track capital accounts. The initial capitalization can either be in the form of services, property, or money. As a result, veil piercing is not often based on undercapitalization in the LLC context. *Ribstein and Keatinge*, Section 12.3  *Alter ego*, or the concept that the member/shareholder is one and the same as the LLC/corporation, is a frequent basis for disregarding the shield of limited liability. Thus single member LLCs are perceived as being more vulnerable to piercing the veil, and to some degree that may be true. The litmus test in any kind of piercing case, though, is equity. The veil will generally be maintained in the absence of fraud or some other wrongdoing. The facts are key, which is why the case law is not susceptible to bright-line rules.

Before jumping into the law, a note about terminology:

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<th>CORPORATIONS</th>
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II. THE OPERATING AGREEMENT

The subject of drafting operating agreements is a stand-alone course. Nevertheless, where considering veil piercing in the LLC context, one must note that even though written operating agreements are not required, they are a best practice. Oral agreements must typically be proven by clear and convincing evidence. Gap-fillers, typically a state’s LLC enabling act, are the default. Operating agreements should include provisions about the purpose of the LLC, the capitalization, formalities that are sensible (and that will be followed), and provisions for dissolution.

If the sole member of the LLC is a natural person, provision should be made for what will happen in the event of death or disability of the member. If the sole member is an artificial person, like another entity, that issue will obviously not arise. At least some courts have taken into consideration the fact that an LLC did not have a written operating agreement as part of the veil piercing analysis, although there is no case law that this author has located allowing the veil to be pierced on that basis alone.

The operating agreement should specify the management structure. Will the LLC be member-managed? Or will there be other provision for management? What duties will the manager have, and how will those be different from the member’s duties (if they are)?

Delaware courts, and most other courts, interpret LLC governance in conformity with the provisions of the operating agreement. Fiduciary duties, indemnification, and advancement, transfer of interests, and similar topics all may be adapted to meet the needs of the business and the member. Tax treatment (that is, whether the LLC is treated as a corporation or a disregarded entity) should not affect piercing, although at least one court has considered it. See Thomas Rutledge, “Piercing the LLC Veil-Is Tax Classification a Relevant Characteristic?”, Journal of
The flexibility regarding governance and taxation is a major advantage of LLCs, and so utilizing a permitted structure should not serve as a basis for piercing.

If the LLC is formed under Delaware law, Delaware courts will interpret the operating agreement in accordance with the objective theory of contract—that is, enforcing the contract as written and only looking to extrinsic evidence in the case of an ambiguity or contradiction.

III. PIERCING THE LLC VEIL

The case for piercing the LLC veil is virtually identical to that for piercing the corporate veil. See Martin v. Spring Break ’83 Prod., LLC, 797 F. Supp. 2d 719, 724-25 (E.D. La. 2011); Kaycee Land & Livestock v. Flahive, 46 P.3d 323 (Wyo. 2002); In re Secs. Investor Prot. Corp. v. R.D. Kushnir & Co., 274 B.R. 768 (N.D. Ill. 2002) (interpreting Illinois corporate law and LLC statutes to permit application of corporate veil piercing to LLCs); In re Gilbert, 2007 WL 397018 (Bankr. D. N.H. 2007) (unreported opinion) (even in the absence of any New Hampshire statute addressing the issue, laws granting the same limited liability to corporations as to LLCs indicate the same corporate veil piercing factors should equally apply to LLCs, in this case a single member LLC). Corporations and LLCs are formed with the same goal in mind – to limit the liability of their investor(s). Because corporations are created under a legal fiction that they are a completely separate entity which acts independently from the individual person, courts acknowledge the injustice of respecting this legal divide by immunizing those who have failed to operate the corporation as a separate entity. As such, a plaintiff is permitted to pierce the corporate veil when those legal boundaries are no longer respected to the point that the corporation and its owner become alter egos of each other and/or to redress a fraud or other injustice.
LLCs operate under this same legal principle of separateness, and thus, the Wyoming Supreme Court could “discern no reason, in either law or policy, to treat LLCs differently than we treat corporations.” In many jurisdictions, courts have begun applying this alter ego liability to LLCs so as to disregard “the fictional façade” of separateness and hold those individuals doing business under the guise of an LLC liable for its obligations. See Bronstein v. Cromwell, Weedon & Co., No. B191738, 2007 WL 969559, at *8 (Cal. App. 2d Dist. 2007), unpublished/noncitable (assuming alter ego principles applied to a Delaware LLC); see also Prospect Energy Corp. v. Dall. Gas Partners, LP, 761 F. Supp. 2d 579, 592 (S.D. Tex. 2011) (noting that Texas permits application of principles of piercing the corporate veil and alter ego to pierce the liability shield of LLCs); Filo Am., Inc. v. Olhoss Trading Co., LLC, 321 F. Supp. 2d 1266, 1268 (M.D. Ala. 2004) (concluding that, under Alabama law, it is possible to “pierce the veil” of an LLC in some situations).

A. Statutory Provisions

Some state legislatures have given courts express permission to apply corporate rules in the context of LLCs by specifically integrating corporate law doctrines into their LLC statutes. Minnesota, Colorado, California, Hawaii, North Dakota, Wisconsin, and Washington all have or had statutes that specify the conditions and circumstances under which the corporate veil of a corporation may be pierced also apply to LLCs. See MINN. STAT. § 322C.0304 Subd. 3 (“Piercing the veil. Except as relates to the failure of a limited liability company to observe any formalities relating exclusively to the management of its internal affairs, the case law that states the conditions and circumstances under which the corporate veil of a corporation may be pierced under Minnesota law also applies to limited liability companies.”) (West 2014); COLO. REV. STAT. ANN. § 7-80-107 (West Supp. 1993); N.D. CENT. CODE § 10-32-29(3) (1995); WIS. STAT.

B. Common Law/Equity

Other states codify the principle of limited liability but allow common law and/or equity to dictate when the principle will be set aside. Section 18-303 of the Delaware LLC Act states that the “debts, obligations and liabilities of a limited liability company, whether arising in contract, tort or otherwise, shall be solely the debts, obligations and liabilities of the LLC.” Section 18-303 goes on to state that no member or manager shall be “obligated personally for any such debt, obligation or liability . . . solely by reason of being a member or acting as a manager” of the LLC. Under Section 609(a) of the New York Limited Liability Act, by default, members, managers, or other agents of a New York LLC are not liable for the debts or obligations of the company, whether arising in contract or tort. A party attempting to disregard the veil between an LLC and its agents carries a heavy burden. See, e.g., 501 Fifth Ave. Co. LLC v. Alvona LLC, 973 N.Y.S.2d 137, 138 (App. Div. 1st Dept. 2013); Merrell-Benco Agency LLC v. HSBC Bank USA, 799 N.Y.S.2d 590, 593 (App. Div. 3d Dept. 2005) (veil not pierced between parent and subsidiary LLCs).

Massachusetts recognizes the separate legal personality of an LLC unless sufficient facts exist to warrant disregarding the LLC form and attaching liability to its individual members, officers or agents. See XXII Mass. Gen. Laws Ch. 156C, Section 22 (“Except as otherwise provided by this chapter, the debts, obligations and liabilities of a limited liability company, whether arising in contract, tort or otherwise, shall be solely the debts, obligations and liabilities of the limited liability company; and no member or manager of a limited liability company shall be personally liable, directly or indirectly, including, without limitation, by way of
indemnification, contribution, assessment or otherwise, for any such debt, obligation or liability of the limited liability company solely by reason of being a member or acting as a manager of the limited liability company.”).

Until recently, there was no federal or state decision under Pennsylvania law permitting the veil-piercing of a limited liability company, although commentators noted “that in the appropriate case the doctrine of piercing the corporate veil will be applied to a limited liability company.” 15 Pa. C.S.A. § 8904, Committee Comment, 1994. In 2009, however, a bankruptcy court in the Middle District of Pennsylvania held that members of an LLC could be held liable for the LLC’s debts under a standard alter ego veil-piercing analysis. See In re LMcD LLC, 405 B.R. 555, 560, 564-65 (Bankr. M.D. Pa. 2009) (also concluding that the veil could be pierced under a single entity theory but acknowledging that Pennsylvania’s highest court has not adopted such a theory). Likewise, a federal court held LLC piercing may be appropriate in certain circumstances. See Klein v. Weidner, 2010 U.S. Dist. LEXIS 14230 at **21-22 (E.D. Pa. Feb. 18, 2010).

In a non-precedential decision, the Pennsylvania Superior Court stated that “veil-piercing principles apply to limited liability corporations” but acknowledged that “[c]ertain corporate formalities may be relaxed or inapplicable to limited liability corporations” and that “[a]n LLC does not need to adhere to the same types of formalities as a corporation.” Walmsley v. Ehmann, No. 1845 EDA 2009, slip op. at 14, 16-17 (Pa. Super. Feb. 28, 2012) (holding that LLC’s “lack of selective corporate formalities did not justify” piercing the corporate veil). The “alter ego” theory is the typical way in which the doctrine of piercing the corporate veil is applied. Pennsylvania courts apply a totality of the circumstances test when determining whether to pierce the corporate veil on an “alter ego” theory.
The Second Circuit applied Delaware corporate law to a single-member LLC to note that an analysis under the alter ego theory must start with an examination of factors that reveal how the corporation operates and the particular defendant’s relationship to that operation, which include inquiring whether there was adequate capitalization, whether the business was solvent, and whether dividends were paid. See NetJets Aviation, Inc. v. LHC Commc’ns, LLC, 537 F.3d 168, 176-77 (2d Cir. 2008). According to the court, in addition to showing a mingling of the operations of the entity, a prevailing plaintiff must also demonstrate an overall element of injustice or unfairness. Id. at 177.

A claimant in New Jersey must prove both that an LLC is so dominated by its member that there is no separate existence and that the LLC member abused its privilege of incorporation to cause an injustice. See Beauf Enters. Fla., Inc. v. Villa Pizza, LLC, No. CIV. A. 07-2159 PGS, 2008 WL 2565008, *11 (D.N.J. June 25, 2008) (applying New Jersey Law); RNC Systems, Inc. v. MTG Holdings, LLC, 2017 WL 1135222 at *5 (D.N.J. March 27, 2017) (denying summary judgment because there were factual issues as to whether the veil should be pierced). The New Jersey Superior Court, Appellate Division, affirmed per curiam a trial court’s decision to pierce the veil between a single member LLC and its member where the LLC had no employees and its only purpose appeared to be shielding its member from liability on a commercial lease. 701 Penhorn Ave. Assocs., Inc. v. J. Fanok Holdings, LLC, No. A-2921-11T3 (unpublished op., Feb. 28, 2013). The LLC had no employees, no assets, and no income; its sole purpose was to provide space for a corporation also owned by the sole member of the LLC. None of the intercompany transactions were documented. Finally, the sole member concealed the purpose of the transactions from the lessor and made false and misleading statements regarding the business. There was, in the court’s word, “clear and convincing evidence” of fraud.
and abuse of the statute.

California has applied the alter ego theory to LLCs when owners treat business assets as their own and add or withdraw capital at will, when they hold themselves out as being personally liable for their business debts, or when they provide inadequate capitalization and actively participate in the conduct of the business’s affairs. See Bronstein v. Cromwell, Weedon & Co., 2007 WL 969559, at *8, unpublished/noncitable (applying corporate law doctrine to LLCs).

Interesting single member LLC cases have also been decided in Kentucky, Michigan, and Colorado. While Michigan law appears to analogize LLCs to corporations for this purpose, Florence Cement Co. v. Vittraino, 807 N.W. 2d 917 (Mich. App. 2011), the Michigan Court of Appeals held that a single member of an LLC holding himself out as interchangeable with the LLC was insufficient justification for piercing the veil. See TGINN Jets, LLC v. Hampton Ridge Properties, LLC, 2013 WL 4609208 at *9 (Mich. App. Aug. 29, 2013). The Kentucky case actually involved an Ohio LLC, and hence the application of Ohio law. Howell Contractors, Inc. v. Berling, 2012 WL 5371838 (Ky. Ct. App. Nov. 2, 2012). Because Ohio requires strict proof of fraud to pierce the veil, the veil was not pierced. However, the Kentucky court also considered Kentucky law and reached the same conclusion. See also Thomas Rutledge, Piercing the Veil – The Kentucky Court of Appeals Discusses Choice of Law and Applies Inter-Tel (Nov. 6, 2012), Kentucky Business Entity Law Blog, located at www.kentuckybusinessentitylaw.blogspot.com. In another Kentucky decision, Rednour Properties, LLC v. Spangler Roof Services, LLC, No. 2009-CA-001159-MR, 2011 WL 2535330 (Ky. App. June 10, 2011, modified July 8, 2011), the veil of a single member LLC was pierced on the basis that:
We hold that there is substantial evidence to support the Circuit Court’s decision to pierce the corporate veil in this action. While the record establishes the corporate existence of the entities at issue (Rednour Blake and Rednour Properties, which both list Rednour as the registered agent), it is obvious that these entities were “dummy” corporations [throughout, the Court of Appeals refers to LLCs as “corporations”] designed to protect Rednour from personal liability. Rednour is the sole member and agent of these companies as well as several others, at least one of which is a subsidiary of another LLC, and Rednour admits to having set up the LLCs for tax purposes. Under these circumstances, we aren’t able to discern any difference between Rednour and his various LLCs.

Disregarding the typical choice of law approach, i.e. that the law of the state of formation applies to the piercing question, the Colorado Court of Appeals decided the case of Martin v. Freeman, 2012 WL 311660 (Colo. App. Feb. 2, 2012) under Colorado law as opposed to Delaware law, pursuant to which the LLC had been formed. The decision to pierce the veil was controversial because it was principally based on failure to observe formalities. Furthermore, commentators agreed that Delaware law would have produced a different result. See Francis Pileggi, Delaware Corporation & Commercial Litigation Blog, located at www.delawarelitigation.com.

In addition to the foregoing cases, there are numerous other LLC veil piercing cases.

C. Fraud

Some courts are moving away from the idea that fraud should be required to pierce the LLC veil. The trend instead seems to be to either limit a fraud finding requirement to very specific fact scenarios or to impose liability when there are circumstances indicating a substantial injustice or some sort of inequitable purpose. At least one court has indicated that a fraud finding is a prerequisite for the imposition of alter ego liability on an LLC member. In Interplan Architects, Inc. v. C.L. Thomas, Inc., the Southern District of Texas expressed that “application of the alter ego theory in Texas requires a showing that the owner caused the corporation to be
used for the purpose of perpetrating and did perpetrate an actual fraud on the obligee primarily for the direct personal benefit of the owner.” No. 4:08-CV-03181, 2010 WL 4366990, at *52 (S.D. Tex. Oct. 27, 2010) (applying standards from corporate statutes to LLCs). The court concluded that the plaintiff did not offer any evidence to show the LLC was created for the purpose of wrongful conduct, thus precluding personal liability under the alter ego theory. *Id.*

Maryland has carved out a specific scenario when fraud is a requirement. In *Serio v. Baystate Props., LLC*, the court held that, in the absence of fraud, the LLC veil will not be pierced to redress the breach of a contractual obligation when the party seeking to pierce the shield has a prior business relationship with the company. 60 A.3d 475, 488 (Md. Ct. App. 2013). *Serio* involved a single member LLC. The court reversed an earlier determination permitting piercing to avoid an inequitable result, and instead found that situations involving the fact pattern explained above do not result in “exceptional circumstances” that justify the imposition of personal liability on an LLC member. *Id.*

According to other courts, the presence of some type of fraud is simply a significant factor to consider in determining whether to pierce the LLC veil. California imposes personal liability under the alter ego doctrine when the business form is used to perpetuate a fraud, circumvent a statute, or accomplish some other wrongful or inequitable purpose. *Sakata v. Cook*, No. F046552, 2006 WL 164915, at *3 (Cal. App. 5th Dist. Jan 24, 2006). Even though the *Sakata* court stated that no one characteristic governs its analysis, these factors indicate that in California, fraud - or at least a fraudulent purpose - is a strong determinant of whether personal liability will be imposed on an LLC’s members.

This trend of treating fraud as merely a factor as opposed to a requirement seems to be an effort by courts and state legislatures to reach more equitable results. Instead of requiring a
finding of actual fraud, courts have begun to impose liability under an alter ego theory when an “overall element of injustice or unfairness” is present. For instance, in Martin v. Freeman, the Colorado Court of Appeals held a showing that the corporate form was used to defeat a creditor’s rightful claim is sufficient to pierce the LLC’s veil. 272 P.3d 1182, 1185-86 (Colo. App. 2012). No further proof of wrongful intent or bad faith was required. Id. at 1186; see also Estate of Hurst ex rel. Cherry v. Moorehead I, LLC, 748 S.E.2d 568, 577 (N.C. Ct. App. 2013) (a finding of actual fraud is not required so long as the sole member used his control over the entity to commit fraud or wrong, to perpetuate the violation of a statutory or other positive legal duty, or a dishonest and unjust act in contravention of the plaintiff’s legal rights); SR Inter. Bus. Ins. Co., Ltd. v. World Trade Ctr. Props., LLC, 375 F. Supp. 2d 238, 243-44 (S.D.N.Y. 2005) (injustice or unfairness can be shown in New York through factors such as contravention of law or contract, public wrong, or other equitable considerations); but see Taurus IP v. DaimlerChrysler Corp., 519 F. Supp. 2d 905, 919 (W.D. Wis. 2007) (injustice alone cannot serve as grounds to pierce the LLC veil), aff’d sub nom, 726 F.3d 1306 (Fed. Cir. 2013).

In contrast, the certified question in Wyoming’s Kaycee Land & Livestock was whether a court may pierce the LLC in the absence of fraud. 46 P.3d at 324. The court expressly assumed that it is permissible to pierce an LLC’s veil when fraud is found. Id. at 328 Thus, it appears that Wyoming permits the application of a “fraud” theory as a separate means of imposing liability on an LLC’s members in addition to the alter ego theory.

Similarly, in a Texas bankruptcy case, the court found that evidence showing a member solely controlled the LLC and commingled funds was probably insufficient to pierce the LLC veil under an alter ego theory, but it did find evidence to hold the member personally liable for perpetuating fraud after he used the LLC to make a fraudulent transfer. In re Pace, 456 B.R.
253, 278 (Bankr. W.D. Tex. 2011). Accordingly, even though the plaintiffs could not establish personal liability under the alter ego theory, they were able to do so under an alternate fraud theory. *Id.*

In other words, a clear pattern about which corporate veil piercing factors are most applicable in the context of LLCs has yet to emerge. This is likely due to one of the LLC’s major benefits – they simply require less formality than corporations. Accordingly, numerous courts have held that failure to follow corporate formalities is not a factor when determining whether to pierce the LLC veil. See *NetJets Aviation, Inc.*, 537 F.3d at 178 (applying Delaware law to note that less emphasis is placed on whether the LLC observed internal formalities); *D.R. Horton Inc.—N.J. v. Dynastar Dev., LLC*, No. MER-L-1808-00, 2005 WL 1939778, *31 (N.J. Super. Ct. Law Div. Aug. 10, 2005) (failure to observe corporate formalities should not be a basis to pierce the LLC veil; additionally, less weight should be afforded to the elements of domination and control because the LLC statute specifically authorizes managers and members to operate); *Pinebrook Prop. Ltd. v. Brookhaven Lake Prop. Owners Ass’n*, 77 S.W.3d 487, 499 (Tex. App. 2002) (failure to follow formalities is not a factor in determining alter ego); *Filo Am., Inc. v. Olhoss Trading Co. LLC*, 321 F. Supp. 2d 1266, 1269-70 (M.D. Ala. 2004) (applying Alabama law to note that some corporate factors may not apply to LLCs); *Flores v. DDJ, Inc.*, No. 199 CV 5878 AWI DLB, 2007 WL 4269259, at *8 (E.D. Cal. Nov. 30, 2007) (failure of the LLC members to hold meetings or observe formalities is not a factor).

D. Other Factors Besides Fraud

A myriad of different factors have emerged as relevant to determining whether an LLC member is operating the business as an alter ego. The Texarkana Court of Appeals considered the following evidence as proof of an alter ego where the LLC had a single member: the payment
of alleged corporate debts with personal checks or other commingling of funds; representations that the individual will financially back the corporation; the diversion of company profits to the individual for the individual’s personal use; inadequate capitalization, and other failure to keep corporate and personal assets separate. Arsenault v. Orthopedics Specialist of Texarkana, No. 06-07-00022-CV, 2007 WL 3353730, at *2 (Tex. App. Nov. 14, 2007).

IV. PLAINTIFF STRATEGIES FOR PIERCING THE VEIL

Historically, piercing the corporate veil was a remedy utilized by a successful plaintiff to collect a judgment where the corporate defendant was judgment-proof and the shareholders, officers, and/or directors had assets. For example, the 6th Circuit Court of Appeals, in Phaedra Spradlin v. Beads and Steeds Inns, LLC (In re Howland), __ Fed. App’x __, No. 16-5499, 2017 WL 24750, 2017 U.S. App. LEXIS 222 (6th Cir. Jan. 3, 2017) found that as Kentucky utilizes the “vicarious liability” theory of piercing, it is a remedy. See Boxer F2, L.P. v. Bronchick, 2018 WL 503429 at *5 (10th Cir. Jan. 22, 2018). Motions to pierce the veil typically would be filed in connection with efforts to execute upon a judgment. See also Forever Green Athletic Fields, Inc. v. Lasiter Constr., Inc., 384 S.W.3d 540, 2011 1784350 at *19 (Ark. App. 2011); United States v. All Meat & Poultry Prods. Stored at Lagrou Cold Storage, 740 F. Supp. 2d 823, 833 (N. D. Ill. 2007).

In the current environment, however, plaintiffs often assert entitlement to veil-piercing at the complaint stage. In jurisdictions where the concept is seen as a separate claim, plaintiffs may file a complaint against an LLC and members or related entities in one action. See Saidawi v. Giovanni’s Little Place, Inc., 987 S.W. 2d 501, 504 (E.D. Mos. App. 1999). Additionally, plaintiffs may file a separate suit against individuals to collect a judgment against an LLC.
**Why Would a Plaintiff Want to Pursue Veil-Piercing as a Strategy?**

A. Only source of collecting debt  
B. Deep pockets  
C. To avoid consequences of bankruptcy  
D. Jurisdictional strategy (i.e., to defeat diversity jurisdiction or to establish jurisdiction)  
E. To expand discovery sources (Fed. R. Civ. P. 34)  
F. To exert pressure/encourage settlement  
G. How do you find out whether it’s viable before filing suit?  
1. Talk to your clients; find out industry scuttlebutt  
2. Internet resources: News sources, Google, Facebook, Twitter, etc.  
3. Dunn & Bradstreet search  
4. EDGAR for publicly traded corporations  
5. Press coverage of corporation and shareholders  
6. Disgruntled former employees  
7. Surveillance  
8. Asset searches  
9. Judgment searches  
10. UCC filings  
11. Department of State resources  
12. In state court, consider pre-complaint discovery to ascertain the corporate structure early on and frame pleadings accordingly  

Even before the *Twombly* and *Iqbal* decisions, it was important to include as much

On the other hand, the court in Blair v. Infineon Technologies A.G., 720 F. Supp. 2d 462 (D. Del. 2010), denied the defendant-corporation’s motion to dismiss because plaintiff sufficiently pled (1) the factors of the “single entity” test under the alter ego doctrine and (2) the requisite fraud or injustice prong by alleging the defendant’s misdirection of funds, exercise of crippling control, and siphoning profits from the subsidiaries. Id. at 472-473. While the court did not explicitly define “crippling control,” it held that allegations that the parent company carried out the subsidiaries’ management and corporate functions, provided the subsidiary with general support services, reported the subsidiaries’ earnings and losses on consolidated financial statements and counted the subsidiaries’ employees in its annual report was sufficient to defeat a motion to dismiss. Id. at 472. Similarly, in Laguna v. Coverall North America, Inc., 2009 WL 5125606 at *3 (S.D. Cal. 2009), the court denied a motion to dismiss a complaint which included specific facts about the defendant officer’s misuse of the corporate form and even cited to deposition testimony. Not surprisingly, Twombly and Iqbal have made it easier for defendants to
knock out these claims on motions to dismiss. At the same time, courts seem to be liberally granting leave to amend as the standards continue to be fleshed out. The best course for a plaintiff is thus to include as much factual detail in the complaint as possible.

**What kind of discovery should be taken?**

Sample interrogatories are available at 114 Am. Jur. Proof of Facts 3d 403. Interrogatories may be a helpful way to get historical information about members, managers, accountants, other professionals, general LLC finances and operations, and to “follow the money.” Sample document requests are available at 114 Am. Jur. Proof of Facts 3d 403. Relevant documents include bank records, tax returns, LLC records, logos, marketing materials, real estate records, loan records, meeting agendas, meeting minutes, expense reports, requests for reimbursement, evidence of distributions, payments, employment agreements, etc. Depositions generally can be very helpful to establish claims. Generally, it is preferable to conduct depositions after written discovery has been completed. It may be helpful to consult with a forensic accountant prior to taking the deposition to address issues that are important to include in the expert report. Some deponents and issues include:

1. Accountants and other professionals
2. Employees (especially bookkeepers and family members)
3. Members
4. 30(b)(6) deposition
   a. commingling
   b. loans to or from LLC; ditributions
   c. creation of successor LLCs or other entities to avoid liability
   d. guaranties of loans
Summary Judgment/Trial Issues

Summary judgment often is difficult in piercing the LLC veil cases due to the fact intensive nature of the claims and defenses. A plaintiff should try to gather as much evidence as possible to create issues of fact to defeat summary judgment motions. Typically, because of its origins in equity, veil-piercing is for resolution by a judge, not a jury. Likewise, it is typical that the burden of proof lies with the party seeking to pierce the veil. While some courts have required a showing of a preponderance of the evidence to pierce the corporate veil, the prevailing view, especially recently, has been to require a showing of clear and convincing evidence. *Trustees of the Nat’l Elevator Industry Pension, Health Benefit and Educational Funds v. Lutyk*, 332 F.3d 188, 194 and 198 (3rd Cir. 2003) (finding evidence required to pierce the corporate veil must be clear and convincing); *Siematic Mobelwerke GMBH & Co. KG v. Siematic Corp.*, 643 F.Supp.2d 675, 695 (E.D. Pa. 2009) (requiring plaintiff seeking to pierce the corporate veil to carry its burden of proof by clear and convincing evidence); *MLEA, Inc. v. Atlantic Recycled Rubber Inc.*, 2005 WL 1217190 at *3 (E.D. Pa. 2005) (noting “because veil-piercing involves an overlay of fraud, a claim which would pierce corporate protection must be shown by clear and convincing evidence”); *but see Plastipak Packaging, Inc.*, 75 Fed. App’x at 90 (holding alter ego liability must be established by a preponderance of the evidence, not by clear and convincing evidence); *In re RBGSC Investment Corp.*, 242 B.R. 851, 860 (Bankr. E.D. Pa. 2000) (ruling factors in determining whether to pierce corporate veil must be proven by preponderance of evidence).

Trials often turn on expert testimony. A forensic accountant is invaluable in assisting
with reviewing documents and offering an opinion on whether the LLC and its members are alter egos.

**Key Cases for Piercing the LLC from the Plaintiff’s Perspective**

Other key cases for piercing the veil from the plaintiff’s perspective are described below. In *301 Clifton Place LLC v. 301 Clifton Place Condominium Ass’n*, 783 N.W.2d 551 (Minn. Ct. App. 2010), the Minnesota Court of Appeals looked to Nevada law to approve the trial court’s imposition of the alter ego theory in light of evidence that the developer commingled funds between LLC accounts and his personal accounts, the developer treated LLC funds as his own, the LLCs were not adequately capitalized, and the developer was the only member of the LLCs receiving distributions. Under these circumstances, refusing to breach the legal separateness would allow the LLCs to breach warranties, commit fraud, and breach a contract without compensating the plaintiff, a result that satisfied Nevada’s injustice requirement.

In *Taurus IP, LLC v. DaimlerChrysler Corp.*, 726 F.3d 1306 (Fed. Cir. 2013), the court applied Wisconsin law to find that the “unjust act” requirement of an alter ego theory was satisfied when an owner sought to use an LLC to impermissibly assert a patent in an attempt to controvert the plaintiffs’ legal rights under a settlement agreement. Further, the managing member of the LLC had complete domination over all aspects of the LLC so that there was no separate mind, will, or existence of its own.

In *McCarthy v. Wani Venture, A.S.*, 251 S.W.3d 573 (Tex. App.—Houston [1st Dist.] 2007, pet. denied), the court of appeals approved of the determination to pierce the LLC veil based on the jury’s findings that a one-third owner of the LLC perpetrated an actual fraud when she knew of, but did nothing to stop, the fraudulent transfer of funds from one entity to another. The court also disproved of her direct personal benefit from the fraud, as she willingly received
numerous benefits, including health insurance, salary, and interest payments for her role as an owner.

In *Great Neck Plaza, L.P. v. Le Peep Rests., LLC*, 37 P.3d 485, 489-90 (Colo. App. 2001), the court found sufficient evidence to support an alter ego finding in a garnishment action based on evidence of mutual ownership, the transfer of assets between entities that indicated an attempt to insulate assets from judgment creditors, and the fact that no one other than the manager was entitled to the LLC’s profits or income.

V. **DEFENSE STRATEGIES**

Piercing the veil is an exception to the general rule of limited liability for members of LLCs. Because plaintiffs carry a heavy burden to establish that veil-piercing is justified, defendants facing attempts to pierce the LLC veil should attempt to eliminate the claim as early as possible. If motions to dismiss or preliminary objections are unsuccessful, defendants are well served by pursuing a discovery strategy that minimizes the burden on the LLC or member and demonstrates that the requisites for veil-piercing are not present. If the claim goes to trial, it is critical to carefully manage the testimony of insiders and expert witnesses. Below, we address how defendants should approach the pleading, discovery and trial stage when facing an attempt to pierce the LLC veil.

**Strategy Considerations for Defendants**

A. Should you remove to federal court?

B. Is there jurisdiction over all the defendants? If not, can you have the case dismissed as to the ones where there are insufficient contacts?

C. Should you have separate counsel for the separate entities?

1. Ethically, will depend on whether the entities are adverse to each other or
are potentially adverse.

2. Appearance-wise, it may be a good idea to have separate counsel.

3. Tension if your firm or you worked on the LLC documents

D. Use a Joint Defense Agreement?

1. Appearance may still be a problem, though

2. Saves time and expense

3. Share expenses of a forensic accountant/expert?

E. Choice of law: generally, unless case involves enforcement of a federal statute (CERCLA, Medicare fraud, etc.) it will be law of state of formation of LLC unless choice of law rules provide otherwise.

**Filing a Motion to Dismiss Is Almost Always A Good Idea**

Because piercing the LLC veil is an extraordinary remedy and generally disfavored, it is almost always worth it to try to eliminate it from the case as early as possible, either by a motion to dismiss or sometimes, a motion for judgment on the pleadings.

**Defenses**

Since veil-piercing is a remedy and not a cause of action, there are not, technically, defenses to it. However, here are some arguments that have been successfully used to avoid application of the doctrine. Just as the application of the doctrine is fact-specific, so are the defenses.

**Tort Claims vs. Contract Claims**

Defendants should be mindful of the different strategies applicable to attempts to pierce the veil in tort (involuntary creditor) as opposed to contract (voluntary creditor) claims. Specifically, involuntary creditors are typically more successful in asserting this equitable
doctrine because, unlike voluntary creditors, they cannot investigate, do due diligence, or charge a higher interest rate or fees, just to name a few examples.

**Requisites for veil piercing are not present**

Since plaintiff bears the burden of proof to show that the veil should be pierced, defendants should argue that the “elements” are not present. For example, defendants might argue that veil-piercing is not warranted because there was no fraud or inequity, there was adequate capital, and/or the LLC is solvent and can pay any judgment. If the plaintiff has unclean hands or the equities do not favor veil-piercing, develop the facts to support that argument. The exact contours of this defense will be very fact-intensive. In short, LLCs are not subject to veil-piercing just because they are poorly run or do not have sufficient funds to pay creditors.

**“Assumption of Risk” or Estoppel-Type Arguments**

At the summary judgment stage, if plaintiff was substantially aware of the factors leading to alter ego liability at the time of the transaction, it may be held to have, in essence, assumed the risk. *See Wheeling-Pittsburgh Steel Corp. v. Intersteel, Inc.*, 758 F. Supp. 1054, 1060 (W.D. Pa.) (“If after reviewing the financial statements, [plaintiff] was concerned that the corporation it was dealing with lacked substance or was a mere ‘shell,’ as a voluntary creditor it could have insisted that the [individual defendants] personally guarantee the performance of the corporation.”). *See also Advanced Tel.*, 846 A.2d at 1281-2 (affirming trial court’s holding that where plaintiff knew it was dealing with a limited liability company with limited assets, it could not later attempt to impose liability beyond what it had originally agreed to impose).

This defense most persuasively applies in the contract as opposed to the tort context. Some commentators have questioned the fairness of imputing a duty of due diligence on all
voluntary creditors, specifically employees or trade creditors who may have less opportunity to conduct due diligence.

Statute of Limitations

The statute of limitations is whatever the statute of limitations is for the underlying claim (e.g., breach of contract or negligence). Courts in other jurisdictions have held that a complaint filed against a subsidiary will toll the statute of limitations on claims against the parent or owner if it later develops that the subsidiary and parent or owner are “alter egos” of each other. See, e.g., Wm. Passalacqua Builders, Inc. v. Resnick Developers South, Inc., 933 F.2d 131, 142-43 (2d Cir. 1991); Matthews Constr. Co. v. Rosen, 796 S.W.2d 692 (Tex. 1990).

Proximate Causation

Although not technically a defense, one way to defend against piercing the LLC veil in the parent/subsidiary context is to show that the control of the subsidiary by the parent did not cause the harm to the plaintiff. See Wheeling-Pittsburgh Steel Corp., 758 F. Supp. at 1060. Alternatively, defendant might argue that veil-piercing is not warranted because the plaintiff has an adequate remedy without having to avail itself of this drastic remedy. See Hambleton Bros. Lumber Co. v. Balkin Enters., Inc., 397 F.3d 1217 (9th Cir. 2005).

Effective Discovery Tactics for Defendants

Defending against attempts to pierce the LLC veil must include an effective discovery strategy--both in requesting discovery and responding to it. Defendants must be mindful of what subjects are relevant for discovery to avoid plaintiff embarking on a fishing expedition. Defendants must also be aware of common plaintiffs’ tactics such as retention of forensic accountants to probe financial records, threatened exposure of confidential business information, and depositions of members. Defense counsel must advise the client of these possibilities early
in the case, and work to mitigate damage or inconvenience to the client.

Defendants can also employ pro-active discovery strategies to force plaintiffs to articulate the basis of their theory that veil-piercing is warranted and to show that plaintiffs' conduct renders the doctrine inapplicable (e.g. waiver, estoppel, failure to exercise due diligence). Because cases are won or lost on the facts elicited during discovery, defense counsel places the member-defendant in peril if these issues are not addressed until trial.

**E-Discovery, Litigation Holds and Documents**

Before even getting to the discovery stage (or, if in state court, potentially in pre-complaint discovery), defense counsel should instruct his or her client to preserve both electronic and paper records. Common and statutory law requires such preservation efforts. In addition, the consequences of destruction of electronic records, other than as part of a regular, documented data retention policy, can be dire, in light of the amended Federal Rules of Civil Procedure concerning discovery of “electronically stored information.”

Early on, defense counsel should begin negotiating with plaintiff’s counsel the terms of an appropriate confidentiality agreement. Such an agreement might require certain documents to be filed under seal with the court, or require that documents be viewed only by counsel and not by plaintiff. Especially if the subject matter of the case is a contract as opposed to a tort, a defendant will want to take steps to preclude an adversary or perhaps a competitor to have access to sensitive documents so an attorney’s or expert’s eyes only agreement is preferable. Even so, a confidentiality agreement that allows the parties access to the materials is better than none at all.

Regarding informal discovery and investigation, plaintiff may be doing any or all of the following to build plaintiff’s case: interviewing former employees, surveillance, and asset or judgment searches. Defendant should be aware of what harmful information plaintiff may be
able to dig up through such methods and defuse the information to the extent possible.

In terms of written discovery, plaintiff will seek wide-ranging information about the LLC’s formation, finances at inception and on an ongoing basis (e.g. tax returns, banking documents, loan documentation), insurance policies and other business records. Plaintiff may also look for information about members, accountants, and other professionals involved in the formation and operation of the LLC. In responding to such interrogatories, a defendant in a federal case should consider utilizing Federal Rule of Civil Procedure 33(d), which permits parties to respond to interrogatories by making available responsive documents. Such an approach may decrease the burden on defendant.

Likewise, defendant may approach burdensome document requests in a few different ways. For example, some of the information sought by plaintiff may be publicly available or available from other sources. Some information may not be discoverable, e.g., if capitalization at inception is the inquiry, information about capitalization at later dates is not pertinent. Similarly, discovery requests may cover a much longer time period than necessary. In short, assuming defendant has a good faith basis for lodging such objections, the discovery strategy should be to attempt to limit the scope and time frame of requests and to hold plaintiff, to the extent possible, to the theory for piercing the veil that is pled in the complaint.

Plaintiff is likely to depose accountants and/or bookkeepers, members and possibly employees. In federal court, plaintiff may use a 30(b)(6) deposition, requiring the LLC defendant to identify and produce the individual with knowledge of, for example, LLC records, potential commingling of funds, loans transactions, improper transfers or creation of successor entities, distributions and capitalization. The LLC defendant’s best course of action is to try to limit the scope of the questioning as much as possible, as always observing the strictures of the
procedural and ethical rules.

**Use of Experts in Defending the Veil-Piercing Case**

In addition, depending on the amount at stake and the nature of the claim, a plaintiff may retain a forensic accountant to analyze defendant’s financial records. Whether defendant will want to retain an expert to respond, or to instead discredit plaintiff’s expert by other means, is a decision that should be carefully considered.

As set forth above, defendant’s goal in responding to discovery is damage control. However, a pro-active approach by defendants to discovery from plaintiff is also part of effective discovery tactics in piercing the corporate veil cases. Such discovery might include, depending on the facts, the following subjects. What is plaintiff’s factual basis for asserting that the LLC veil should be pierced? In a contract (as opposed to tort) case, what were the circumstances of the transaction and what exactly was the claimed misrepresentation or fraud?

One of defendant’s key defenses may be waiver, estoppel or unclean hands. Discovery targeted to establishing such a defense might address the following questions:

1. Did plaintiff conduct appropriate due diligence to find out information about the LLC’s finances?
2. Similarly, did plaintiff have any interactions with the member or affiliate of the LLC that would have put plaintiff on notice about the relationship prior to entering the transaction?
3. Did plaintiff agree to any forbearance agreements or restructuring of debt at a later date that might constitute grounds for asserting these defenses?

In addition, defendant may have counterclaims or affirmative defenses that will guide other discovery requests to plaintiff.

A well-considered discovery strategy is key to defending an attempt to pierce the
corporate veil. Counsel for a defendant will want to use every tool at his or her disposal to keep
discovery focused on facts relevant to the theory of veil-piercing asserted by plaintiff and the
actual transaction or incident. Otherwise, plaintiff may turn the discovery process into a
burdensome fishing expedition into defendant’s business designed to encourage settlement.

**Trial Tips**

There is no constitutional right to a jury trial regarding veil-piercing issues; it is a
question of equity and therefore a question for the court. In practice, sometimes claims do end
up going to a jury if the facts are so interrelated with a jury question. Defendants obviously want
to avoid that scenario because the issues can be confusing to a jury, there may be bias against
LLCs. Accordingly, they may want to move to bifurcate the trial so that the jury will evaluate
the merits of the underlying claim before the court reaches the issue of whether the veil should
be pierced.

Expert testimony can be critical in these cases. Consider filing a Daubert (federal) or
Frye (Pennsylvania) challenge to plaintiffs’ expert in factually appropriate cases. Economic
testimony is susceptible to these kinds of challenges. See, e.g., *Concord Boat Corp. v.
Brunswick Corp.*, 207 F.3d 1039, 1056-57 (8th Cir.), cert. denied, 531 U.S. 979 (2000)
(exclusion warranted where economic expert, although qualified, had not considered all relevant
facts in relevant market when performing market share analysis); *Target Market Publishing v.
ADVO. Inc.*, 136 F.3d 1139, 1143 (7th Cir. 1998) (where economic expert's projections of lost
profits was unsupported and based on mere speculation, district court properly excluded
proposed testimony); *Boucher v. United States Suzuki Motor Corp.*, 73 F.3d 18, 21-22 (2d. Cir.
1996) (testimony based on conjecture and faulty assumptions should be excluded); *Total
Appx. 511 (applying Daubert to exclude economic expert whose opinions ignored key facts in the record).

On the defense side, experts can be employed to assist with cross-examination of plaintiffs’ experts, to testify about the capitalization of the entity, or to testify about the business practices of the particular industry. Careful preparation of the managing member for trial is critical. The demeanor and perceived forthrightness of this key witness is highly influential in these cases. With regard to appellate issues, defendants may have difficulty prevailing on appeal from an adverse decision because the trial court decision is so fact-intensive. However, some defendants have been successful in overturning trial court decisions to pierce the veil, especially where the facts are not egregious and/or the equities do not favor it.

**Key Cases for Defendants**

In the case of *In re Steffner*, 479 B.R. 746 (Bankr. E.D. Tenn. 2012), the court found that piercing the LLC veil was not warranted under Tennessee law in a situation where multiple transfers were made between separate LLCs, but both companies maintained internal counting records to document the transfers and the reasons for them. In light of this documentation, there was no evidence that the LLC was a sham or a fraud. Further, because each company had separate assets and was separately capitalized, there was no evidence that corporate formalities were not observed or that the LLCs were used for an improper purpose.

In *Penhollow Custom Homes, LLC v. Kim*, 320 S.W.3d 366 (Tex. App.—El Paso 2010, no pet.), the court reversed a jury’s alter ego finding in the absence of any evidence showing the LLC and its owner had ceased operating as separate entities. Even though the sole shareholder had complete control over the LLC, mere control and ownership of all the stock was an insufficient basis for ignoring the LLC fiction.
In *Tom Thumb Food Mkts., Inc. v. TLH Props.*, 1999 WL 31168 (Minn. App. 1999) (unpublished), the Minnesota Court of Appeals found that the plaintiff failed to establish the element of injustice or fundamental unfairness necessary to pierce the veil, even though the plaintiff relied on misrepresentations made by the member of the LLC regarding the ownership of a piece of property. The court found that the LLC member did not intend for his statements to mislead the plaintiff and that there was no indication the LLC was created to perpetuate a fraud.

In *Martin v. Spring Break 83 Prod., LLC*, 797 F. Supp. 2d 719 (E.D. La. 2011), the court declined to pierce the LLC veil under Louisiana law after considering the totality of the circumstances. The plaintiffs failed to present any evidence applicable to any of Louisiana’s five piercing factors: commingling; failure to follow formalities; undercapitalization; failure to provide separate bank accounts; and failure to regularly hold meetings.

The court in the case of *In re Osorno*, 478 B.R. 523 (Bankr. D. Mass. 2012), found that, even in light of common ownership and somewhat questionable expenditures, the plaintiffs failed to establish that the debtor was the alter ego of either of his two LLCs based on evidence that the LLCs maintained separate book and records, the debtor could not exercise pervasive control over either entity, neither entity was thinly capitalized or insolvent at the time of the transaction at issue, and the LLCs kept records explaining all their expenditures.

VI. CONCLUSION/LIMITING VEIL PIERCING

The safest course for single member LLCs is not all that different from the advice given to shareholders of closely-held corporations. The LLC should have a written operating agreement. The single member should document transfers of funds, and avoid commingling of LLC assets and personal assets. The member should not utilize the LLC to avoid creditors or perpetrate fraud. Unlike corporations, however, LLCs need not maintain the level of formality in
terms of board meetings, minutes, and the like. As the jurisprudence on LLC veil piercing grows, it is likely that courts will continue to look to the law of piercing the corporate veil to conduct their analyses. At the same time, the application of veil-piercing in any context remains exceedingly fact-intensive and fact-dependent. Therefore, bright line rules remain elusive.