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Will Your Veil Be Pierced? How Strong Is Your Entity's Liability Shield? — Piercing the Veil, Alter Ego, Ego, and Other Bases for Holding an Owner Liable for Debts of an Entity

Allen Sparkman∗

I. INTRODUCTION

Courts, commentators, and attorneys describe corporations and limited liability companies as limited liability entities, but limited liability is not always the end result. While debts of a separate legal entity ordinarily would not be considered those of the owners[1] even if the statutes applicable to these entities did not contain limitations on the owners of the entities,[2] exceptions exist. For example, courts developed piercing the veil in corporate cases over a century ago as an equitable remedy to prevent perceived misuses of the corporate form.[3] In the corporate context, courts

∗ Sparkman + Foote LLP, Houston, TX and Denver, Colo., © The Author October 19, 2015. The author thanks Herrick K. Lidstone, Jr., of Burns, Figa & Wills, P.C., in Denver, Colorado, for his helpful and thoughtful comments. Any mistakes are of course the responsibility of the author.

1. BAYLESS MANNING & JAMES G. HANKS, JR., LEGAL CAPITAL 16-17 (4th ed. 2013).

2. *See, e.g.*, 6 DEL. CODE § 18-303:

(a) 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 obligated personally 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.

(b) Notwithstanding the provisions of subsection (a) of this section, under a limited liability company agreement or under another agreement, a member or manager may agree to be obligated personally for any or all of the debts, obligations and liabilities of the limited liability company.

3. *See* United States v. Milwaukee Refrigerator Transit Co, 142 F. 247, 255 (E.D. Wis. 1905) ("A corporation will be looked upon as a legal entity as a general rule, and until sufficient reason to the contrary appears; but, when the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime, the law will regard the corporation as an association of persons."). A notable early veil-piercing case arose in Berkey v. Third Ave. Railway Co., 244 N.Y. 84, 155 N.E. 58 (1926). Plaintiff was injured on a street car operated by Forty-Second Street Railway Co., but she sued Third Avenue Railway Co., which owned substantially all of the stock of Forty-Second Street Railway Co. Although the court declined to pierce the corporate veil of Forty-Second Street Railway Co., which had its own bank accounts and employees as well as assets in excess of its

may pierce the veil where a subsidiary corporation is merely an alter ego or agent of the corporate parent, where the corporation is merely the alter ego of the shareholder, or where the corporate shield is being used to defraud creditors.[4]

An owner of an entity may also incur direct liability for debts of the entity or otherwise become liable on grounds other than veil piercing or alter ego. These grounds, which will be discussed later in this Article, include acting in the name of an unformed entity,[5] acting for an undisclosed principal,[6] liability to return improper distributions,[7] liability for unpaid employment taxes,[8] liability under other federal and state statutes,[9] and liability for one's own actions and the actions of agents.[10]

The author was prompted to write this Article in part by his experiences as an expert witness in veil-piercing cases. The author's research did not find any analysis of veil-piercing cases that appeared aimed at assisting practicing attorneys who needed a resource to help them

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liabilities, Judge Cardozo (who wrote the opinion) stated "[w]e say at times that the corporate entity will be ignored when the parent corporation operates a business through a subsidiary which is characterized as an 'alias' or a 'dummy.'" 155 N.E. at 61. Senter Construction Company, Inc. v. Deka Investments, LL*C*, 2013 WL 3272487 at *7 (Ill. Ct. App. June 24, 2013) ("The doctrine of piercing the corporate veil is an equitable remedy that permits a court to impose liability on an individual or entity that uses a corporation merely as an instrumentality to conduct that individual's or entity's business.").

4. Great Neck Plaza v. Le Peep Rests., 37 P.3d 485, 490 (Colo. App. 2001). *See also* Fish v. East, 114 F.2d 177 (10th Cir. 1940). In determining whether the subsidiary was an alter ego or a mere instrumentality, FREDERICK J. POWELL, PARENT AND SUBSIDIARY CORPORATIONS, LIABILITY OF A PARENT FOR THE OBLIGATIONS OF ITS SUBSIDIARY (Chicago, Callahan & Company 1931) listed eleven factors that should be assessed:

(a) Does the parent own all or most of stock of the subsidiary?
(b) Do the parent and subsidiary corporations have common directors or officers?
(c) Does the parent corporation finance the subsidiary?
(d) Did the parent corporation subscribe to all of the capital stock of the subsidiary or otherwise cause its incorporation?
(e) Does the subsidiary have grossly inadequate capital?
(f) Does the parent pay the salaries and other expenses or losses of the subsidiary?
(g) Does the subsidiary do no business except with the parent or does the subsidiary have no assets except those conveyed to it by the parent?
(h) Is the subsidiary described by the parent (in papers of statements) as a department or division of the parent or is the business or financial responsibility of the subsidiary referred to as the parent corporation's own?
(i) Does the parent use the property of the subsidiary as its own?
(j) Do the directors or executives fail to act independently in the interest of the subsidiary, and do they instead take orders from the parent, and act in the parent's interest?
(k) Are the formal legal requirements of the subsidiary not observed?

5. *See infra* notes 632-38 and accompanying text.
6. *See infra* notes 639–54 and accompanying text.
7. *See infra* notes 632–38 and accompanying text.
8. *See infra* notes 672–85 and accompanying text.
9. *See infra* notes 687–88 and accompanying text.
10. *See infra* notes 687–97 and accompanying text.

advise clients on how to avoid being subject to a successful veil-piercing claim or who needed a resource to help them pursue or oppose a veil-piercing claim.[11] This Article draws from materials prepared for a program presented at the 2014 Annual Meeting of the Business Law Section of the American Bar Association. The program was titled "Piercing the Unincorporated Veil" and was sponsored by the Committee on LLCs, Partnerships and Unincorporated Entities. The program was chaired by Professor Stephen B. Presser of the Northwestern University College of Law, and the additional panelists were Elizabeth S. Fenton[12] and Thomas E. Rutledge.[13] The program materials included a 100 plus page summary of LLC veil-piercing cases prepared by Professor Elizabeth Miller of Baylor University School of Law from her comprehensive summaries of LLC cases that she has prepared for many years.

This Article focuses on limited liability companies. This Article also discusses corporate cases to an extent because courts developed the veil-piercing and alter ego doctrines in corporate cases and much of the reasoning in corporate veil piercing and alter-ego cases will be applicable to limited liability companies as well. Veil piercing claims also arise in what are known as reverse veil piercing cases. This Article discusses reverse veil-piercing cases after discussing traditional veil-piercing.[14]

II. VEIL PIERCING IN GENERAL

Some commentators have asserted that veil piercing "seems to happen freakishly. Like lighting, it is rare, severe, and unprincipled."[15] Indeed, Stephen Bainbridge thought veil piercing as applied by the courts to be so "rare, unprincipled, and arbitrary" that it should not be applied to LLCs and

11. In the course of working on this Article, the author found an excellent recent article reporting on the use of modern quantitative machine learning methods to analyze the full text of 9,380 judicial veil-piercing opinions. Jonathan Macey & Joshua Mitts, *Finding Order in the Morass: The Three Real Justifications for Piercing the Corporate Veil*, 100 CORNELL L. REV. 99 (2014). Macey and Mitts will doubtless be cited in many briefs in veil-piercing cases in the future and will be referred to in this Article at several points.

12. Ms. Fenton practices law with Saul Ewing LLP in Wilmington, Delaware.

13. Mr. Rutledge practices law with Stoll Keenon Ogden PLLC in Louisville, Kentucky.

14. *See infra* notes 601-32 and accompanying text.

15. Frank H. Easterbrook & David R. Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89, 89 (1985). Macey and Mitts state: "Large swaths of veil-piercing doctrine make no sense and do not promote any sensible policy goals such as limiting opportunistic risk-taking." Macey & Mitts, *supra* note 11, at 106. As to how veil-piercing doctrine is applied in practice, however, Macy and Mitts assert that "judges have in fact decided veil-piercing cases in a highly-disciplined and structured way when one analyzes the actual outcomes of the cases in isolation from the reasoning displayed in the decisions themselves." *Id.*

should be abolished in the corporate context.[16] Although Professor Bainbridge presented cogent arguments, he faced a Sisyphean task in attempting to dissuade courts from extending veil-piercing to LLCs — even more so was his attempt to see veil-piercing abolished in the corporate context. More recently, Jonathan Macey and Joshua Mitts[17] have argued that their analysis shows that, although the rationales stated by courts in veil-piercing cases may be confusing and contradictory,[18] the actual results can be classified into three categories of cases that they believe are appropriate for veil-piercing. Macey and Mitts argue that their analysis shows that whatever rationale may have been stated in opinions, "the entire universe of piercing cases can be explained as judicial efforts to remedy one"[19] of three problems:

- Courts pierce the corporate veil "to bring corporate actors' behavior into conformity with a particular statutory scheme;"[20]
- Courts "also pierce to remedy what appears to be fraudulent conduct that does not satisfy the strict elements of common law fraud;"[21]
- The third ground on which courts pierce the corporate veil is "the promotion of what" Macey and Mitts term "accepted bankruptcy values."[22]

Macey and Mitts further state:

> [W]e believe that our taxonomy can produce a coherent account of veil-piercing cases, and are thus more optimistic than Stephen Bainbridge, who famously called for the abolishment of the doctrine. Unlike Bainbridge, we believe that there are strong public policy rationales for retaining veil piercing in certain situations. We hesitate to conclude that a century of jurisprudence represents a colossal mistake

16. Stephen M. Bainbridge, *Abolishing LLC Veil Piercing*, 2005 ILL. L. REV. 77, 78 (2005) (hereafter "Bainbridge LLCs") and Stephen M. Bainbridge, *Abolishing Veil Piercing*, 26 J. CORP. LAW 479 (2001) (hereafter, "Bainbridge Corporations").

17. Macey & Mitts, *supra* note 11.

18. *Id.* at 100 ("[W]e argue that there is a rational structure to the doctrine of corporate veil piercing not only in theory, but in practice as well. Our idea is that, despite the fact that courts are inarticulate to the point of incoherence in their reasoning in particular 'piercing' cases, a rational taxonomy can be derived from this morass.").

19. *Id*. at 101.

20. *Id*.

21. *Id.*

22. *Id*.

> on the part of the courts in all 50 states. Rather, we suggest that three public policy rationales provide a systematic justification of veil piercing and that courts regularly decide in accordance with these rationales, even if they do not say so expressly.[23]

This Article posits that case analysis shows that, although veil piercing may be rare and severe, as Macey and Mitts argue,[24] there are principles that are, or should be, applied by courts in these cases.

Veil piercing should be rare because limited liability and the separateness of entities and their owners are intended purposes of corporate and limited liability company statutes. An observation by an early corporate commentator is equally applicable to corporations and limited liability companies today:

> The policy of our law to-day sanctions incorporation with the consequent immunity from individual liability. It follows that no fraud is committed in incorporating for the precise purpose of avoiding and escaping personal responsibility. Indeed, that is exactly why most people incorporate, and those dealing with corporations know, or at least are presumed to know, the law in this regard.[25]

Veil-piercing may be severe, as in *Federal Trade Commission v. Bronson Partners, LLC*,[26] which held the defendants jointly and severally liable for $1,942,325 in restitution and *Martin v. Freeman*[27] and *Axtmann v. Chillemi*,[28] which are opinions standing for the dubious proposition that an entity's capitalization must at all times be sufficient to allow the entity to respond to large claims that could not have been reasonably foreseen when the entity was formed.

As this Article discusses above and in its analysis of cases below, veil-piercing claims succeed when the entity is nothing more than the alter ego

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23. Macey & Mitts, *supra* note 11, at 113.

24. *Id*.

25. *See* I. MAURICE WORMSER, DISREGARD OF THE CORPORATE FICTION AND ALLIED CORPORATE PROBLEMS 18 (1927).

26. Federal Trade Commission v. Bronson Partners, LLC, 674 F. Supp. 2d 373 (D. Conn. 2009), discussed *infra* notes 238-40 and accompanying text. *See also* United States v. Jon-T Chemicals, Inc., 768 F.2d 686 (5th Cir. 1985), discussed *supra* notes 121-36 and accompanying text (holding a parent corporation liable for a $4,787,604.20 debt of its subsidiary).

27. Martin v. Freeman, 272 P.3d 1182 (Colo. App. 2012), discussed *infra* notes 272-80 and accompanying text.

28. Axtmann v. Chillemi, 740 N.W.2d 838 (N.D. 2007), discussed *infra* notes 312-29 and accompanying text.

of the owner and has been wrongfully used to the detriment of third parties. However, a person who establishes an entity and respects its existence may properly use the entity to protect the founder from personal liability from the entity's obligations and, in some cases, accomplish a purpose that the person could not achieve individually. Courts recognize that someone who forms a limited liability company to avoid personal liability is pursuing a legitimate business goal[29] and that a person who creates a limited liability company to minimize tax liability is not pursuing a nefarious purpose but is taking advantage of legally available tax planning opportunities to lower the person's tax liability.[30]

On the other hand, an entity will be ignored if it is a sham formed for the fraudulent and illegal purpose of evading a judgment creditor.[31]

Several federal tax benefits are available to corporations but not to other entities.[32] Wormser[33] described an interesting 1908 case, *People's Pleasure Park v. Rohlede*,[34] in which a creative attorney used a corporation to avoid racially motivated deed restrictions:

> In *People's Pleasure Park Co. v. Rohlede*, a large tract of land was divided up into a number of lots, each deed of a lot containing a covenant providing that title to the real estate should never pass into a person or persons of African descent or into a colored person or persons. Thereafter, a corporation was organized "composed exclusively of negroes." It took title to a number of the lots and proposed to establish an elaborate amusement park for colored people. The corporation knew, when it purchased the land, of the title restriction. Suit was brought in equity by an owner of other [adjoining] lots to have the deed to the corporation cancelled and set aside. The court rendered judgment for the

29. *See, e.g.*, MFP Eagle Highlands, LLC v. Am. Health Network of Ind., LLC, No. 1:07-cv-0424-DFH-WGH, 2009 WL 77679, at *10 (S.D. Ind. Jan. 9, 2009).

30. Thomas v. Bridges, 120 So.3d 338, 342 (La. App. 2013). *See* Macey & Mitts, *supra* note 11, at 129.

31. *See, e.g.*, Devan Lowe, Inc. v. Stephens, 842 So.2d 703 (Ala. Civ. App. 2002) (Commission based salesman for auto dealership formed LLC and requested that dealership begin paying commissions to the LLC. The testimony in the case did not show any reason for forming the LLC other than to attempt to avoid a garnishment action filed against the dealership with respect to the salesman's commissions.). *See also* Macey & Mitts, *supra* note 12-25 and cases discussed *infra* notes 336-71 and accompanying text.

32. For example, only C corporations may have tax-favored medical reimbursement plans (I.R.C. § 105 (2014)) or provide tax-free group life insurance (I.R.C. § 79 (2012)). Only corporations (C and S) may engage in tax-free reorganizations under I.R.C. § 368.

33. *See* WORMSER, *supra* note 25, at 26–27.

34. *People's Pleasure Park v. Rohlede*, 109 Va. 439, 61 S.E. 794 (1908) aff'd on reh'g, 109 Va. 439, 63 S.E. 981 (1909).

> corporation, holding that though all its members were negroes, yet the corporation was a legal personality entirely separate, apart and distinct from its stockholders, and that therefore the covenant was not breached. The court said, in effect, that the corporation was not colored, because it "is a person which exists in contemplation of law only, and not physically."

In addition to the case law and statutory provisions determining when veil-piercing is appropriate, this Article also looks at issues that do not appear to have been addressed much in the existing literature: (1) what state's law should apply to a veil-piercing claim and what effect, if any, does a contractual choice of law provision have on this analysis and (2) does imposition of the veil-piercing remedy depend on the existence of a causal relationship between the harm allegedly suffered by the plaintiff and the actions, or failure to act, that forms the basis for treating an entity as the alter ego of its shareholders or members? These issues are discussed below.[35]

III. FACTORS IMPORTANT IN LIMITED LIABILITY COMPANY VEIL-PIERCING/ALTER-EGO CASES

The cases discussed in this Article teach that the veil of a limited liability company may be pierced in unusual circumstances if:

(i) the owners of the LLC dominate the LLC to such an extent that there is no meaningful separation between the LLC and its owners;

(ii) the funds of the LLC and its owners are commingled to such a degree that it is not possible to determine what funds belong to which person; and

(iii) the owners favor themselves over third-party creditors when causing the LLC to make payments.[36]

The first two factors often accompany poor recordkeeping. If one person dominates an entity and doesn't have to seek approval of others, or ignores a requirement to seek approval,[37] he or she is probably not inclined to be concerned about recordkeeping. A person who fails to maintain accurate and separate financial records is more likely to fail to pay much

35. *See infra* notes 458-600 and accompanying text.

36. Liability is sometimes imposed on nonowners. *See infra* notes 65-82 and accompanying text.

37. *See* Tzovolos v. Wiseman,51 Conn. Supp. 532 (2007) *aff'd*, 300 Conn. 247 (2011), discussed *infra* notes 205-26 and accompanying text.

attention to properly documenting decisions of the LLC's owners or managers. Another factor in some cases that is usually related to the owners improperly favoring themselves over third-party creditors is often described as inadequate capitalization.[38] Note, also, that Macey and Mitts argue that, no matter what factors a court may discuss, all cases approving veil piercing may be classified in one of three categories.[39] Several of the cases discussed in this Article are relevant to more than one factor and are discussed under each relevant factor with cross-references.

In all cases, the factors determined to be present must have led to the harm suffered by the plaintiff.[40] Moreover, to hold a particular owner of an entity liable under a veil-piercing claim, the owner must have participated in or had knowledge of the conditions that established the factor justifying veil-piercing. *Provosty v. ARC Construction, LLC*[41] arose out of the following facts: Following Hurricane Katrina, in December 2006, Henry and Gloria Provosty entered into a construction contract with ARC Construction LLC ("ARC-LA"). ARC-LA was a Louisiana LLC formed to do construction work in Louisiana after Hurricane Katrina. ARC-LA had four members: (1) American Restoration Contractors, LLC, a Missouri LLC ("ARC-MO"), the members of which were Hyun Sung, Christopher P. Schmitt, Jamey Schmitt, and Richard Drevet; (2) Icehouse Capital Management, LLC; (3) Errol Glasser; and (4) Kestenbaum & Associates, LLC ("Kestenbaum"). The court affirmed the trial court's judgment piercing the veil of ARC-LA and imposing personal liability on its members other than Glasser and Kestenbaum. The court responded to plaintiffs' argument that the trial court erred in not imposing liability on Glasser and Kestenbaum as follows:

> Plaintiffs contend that the jury found that this was a closely held corporation[42] and that all of the members either committed the fraud or knew of the other members' fraud. While such a contention is a possibility, Glasser was not found liable for fraud and further operates over a thousand

38. Macey & Mitts, *supra* note 11 at 128, 139, 148.
39. *See supra* notes 17-23 and accompanying text.
40. *See* cases cited *infra* notes 499-600 and accompanying text.
41. Provosty v. ARC Construction, LLC, 119 So.3d 23 (La. App. 4 Cir. 2013).
42. Unfortunately, this use of the term "corporation" in reference to a limited liability company is too frequent in judicial opinions and even among practitioners, especially among attorneys who pursue and defend cases against limited liability companies. An LLC is not a "corporation" no matter how many corporate characteristics it may have. The distinction is important because, for example, corporate laws impose formalities that LLC statutes do not. Accordingly, a court that does not fully appreciate that it is dealing with an unincorporated entity such as an LLC may apply an erroneous analysis. For a particularly egregious instance, *see* Adams v. McFadden, 296 S.W.3d 743 (Tex. App. 2009), discussed *infra* notes 605-07 and accompanying text.

> miles away in New York. To assume that the jury found that Glasser knew of the fraud is speculative at best.[43]

The court further stated as to Glasser:

> There is no doubt in this Court's mind that the jury found that Christopher Schmitt, Jamey Schmitt, Richard Drevet, Matt LaMora, and IceHouse Capital, LLC through its Managing Member Marc Winthrop were heavily involved in ARC-LA's shell game and in defrauding their customers and that this alone warrants the piercing of the corporate veil. But based upon the initial investment of $500,000 by the New York members, no evidence that Glasser deliberately took money from ARC-LA, and no evidence introduced concerning what initial capital would be required to start up ARC-LA, there is no way reasonable minds from the Jury could have determined that Glasser undercapitalized ARC-LA.[44]

Also see *Estate of Hurst v. Moorehead*,[45] holding that the imposition of personal liability on a member of an LLC requires "a finding that [the member] . . . personally engaged in certain conduct, such as fraud or misrepresentation."[46]

In *Sun Nurseries, Inc. v. Lake Erma, LLC*[47] the accountant for the defendant LLC had evidently made several misrepresentations to the plaintiff, but plaintiff "presented no evidence to demonstrate that any of the individual defendants personally participated or cooperated in any of [the accountant's] representations or that they directed [the accountant] to make such representations with the intent to mislead [plaintiff]."[48]

Provosty and *Sun Nurseries* appear to be cases that Macey and Mitts would classify as cases properly decided because there was no frustration of reasonable creditor expectations — the creditors did not deal with the

43. *Provosty*, 119 So.3d at 34.
44. *Provosty*, 119 So.3d at 36.
45. Estate of Hurst v. Moorehead, 748 S.E.2d 568 (N.C. App. 2013)
46. *Id.* at 574. *See also infra* notes 598-600 and accompanying text, where an additional quote from the court's opinion explains this quote by adding that an actual fraud by the member is not required; "[r]ather, the requisite element for piercing the corporate veil under the instrumentality rule requires a finding that the individual member used his control over the entity 'to commit fraud *or wrong*, to perpetrate the violation of a statutory or other positive legal duty, *or a dishonest and unjust act in contravention of [the] plaintiffs' legal rights[.]*' *Id.* at 575, citing Glenn v. Wagner, 313 N.C. 450, 454, 329 S.E.2d 326, 330 (1958) (emphasis in original).
47. Sun Nurseries, Inc. v. Lake Erma, LLC, 730 S.E.2d 832 (Ga. App. 2012).
48. *Id.* at 838.

passive investors, and the passive investors were not shown to have any knowledge of or participation in the misdeeds.[49]

Smith v. Teel[50] denied plaintiff's attempt to pierce the veil of Kongo's L.L.C. ("Kongo's"), which operated a bar in Norman, Oklahoma. Plaintiff sought to impose personal liability on Stephen G. Teel and Jay Williams, the members and managers of Kongo's, for a wrongful death claim based on the death of plaintiff's spouse in a car accident when their car was hit from behind by a car driven by Regina Bedell immediately after she had been drinking at Kongo's for almost seven hours. The court held that Teel and Williams were not liable because plaintiff had not presented any evidence that either personally sold or served alcohol to Bedell, had knowledge that any Kongo's employees had served alcohol to a noticeably intoxicated person, or was even present on the night in question.[51]

Handam v. Wilsonville Holiday Partners, LLC[52] involved a former hotel employee who sued his former employer, Wilsonville Holiday Partners, LLC ("Wilsonville"), the hotel's manager, Lockhart Investments, LLC ("Lockhart Investments"), and his supervisor on several employment-related claims.[53] Plaintiff obtained a default judgment against Lockhart Investments on his unlawful discrimination claim and obtained a judgment at trial against Wilsonville on his wrongful discharge claim.[54] After the trial, plaintiff tried to enforce his default judgment against Lockhart Investments, but learned that Lockhart Investments had not been named on the liability policy covering the hotel and could not pay the judgment.[55] Plaintiff then tried to hold Patrick Lockhart ("Lockhart"), "Lockhart Investments's principal,"[56] personally liable for the default judgment against Lockhart. In response to plaintiff's veil-piercing claim, the court stated:

> [P]laintiff does not allege that Lockhart Investments was under capitalized. Instead, plaintiff alleges that Lockhart

49. Macey & Mitts, *supra* note 11, at 123 ("It is true that creditors are often harmed when a firm is insufficiently capitalized, but in the contractual setting, this risk can be expressly allocated to the corporations' principals by obtaining a personal guarantee of the debt. Protecting creditors in the contractual setting thus turns on preventing misrepresentations regarding shareholder involvement.").

50. Smith v. Teel, 175 P.3d 960 (Ok. Civ. App. 2007).

51. *Id.* at 965–66. This case appears to fail under Macey and Mitt's rubric of cases involving attempts to bring corporate actors' behavior into conformity with a particular statutory scheme. Macey & Mitts, *supra* note 11 at 4. In *Smith v. Teel*, however, because the individual defendants were not present and did not personally participate in the violation of liquor laws, the purpose of the liquor law would not have been served by imposing personal liability on them.

52. Handam v. Wilsonville Holiday Partners, LLC, 190 P.3d 480 (Or. App. 2008).

53. *Id.* at 483.

54. *Id.*

55. *Id.*

56. *Id.*

> acted improperly by failing to take a variety of actions-such as insisting that Lockhart Investments be listed as a named insured, inspecting the insurance policy and certificate of insurance, or insisting that the company's omission be corrected-that would have ensured that Lockhart Investments was listed on the hotel's insurance policy, and that Lockhart's "failure to act as alleged" harmed plaintiff. Although plaintiff's allegations might allow an inference that Lockhart followed poor business practices, those allegations do not allow an inference that Lockhart's conduct was "dishonest or deceitful" or intended to harm a third party. For that reason, the alleged conduct was not sufficiently improper to justify piercing the corporate veil to hold Lockhart personally liable for the default judgment against Lockhart Investments. The trial court did not err in dismissing that claim for failure to state a claim.[57]

Handam could be viewed as a case in which the court was saying that it did not need to protect the plaintiff from Lockhart's actions because those actions were not motivated by a bad motive and were not misrepresentations made by the defendant to the plaintiff.[58] It also appears from the opinion in *Handam* that the plaintiff may have been harmed by poor pleading.[59]

In answering a certified question from a trial court asking whether "West Virginia's version of the Uniform Limited Liability Company Act . . . . affords complete protection to members of a limited liability company," the Supreme Court of Appeals of West Virginia in *Kubican v. The Tavern, LLC*[60] said no, the veil of an LLC may be pierced in appropriate circumstances. In Kubican, plaintiff sued The Tavern, LLC, d/b/a Bubba's Bar and Grill ("Bubba's") and asserted a veil-piercing claim against the two individual members of Bubba's for damages suffered in an altercation that allegedly took place at Bubba's.[61] The court's opinion provides a comprehensive review of much of the jurisprudence and legal commentary in the LLC veil-piercing context, and adopts the following test for West Virginia:

57. *Handam*, 190 P.3d at 484.
58. *Accord* Macey & Mitts, *supra* note 11, at 123–30.
59. *Handam*, 190 P.3d at 484–87 (discussing that the plaintiff's claim that Wilsonville was contractually liable for the judgment against Lockhart Investments was barred by claim preclusion).
60. Kubican v. The Tavern, LLC, 752 S.E.2d 299 (W.Va. 2013).
61. *Id.* at 302.

> [T]o pierce the veil of a limited liability company in order to impose personal liability on its member(s) or manager(s), it must be established that (1) there exists such unity of interest and ownership that the separate personalities of the business and of the individual member(s) or managers(s) no longer exist and (2) fraud, injustice or an inequitable result would occur if the veil is not pierced. This is a fact driven analysis that must be applied on a case-by case basis, and, pursuant to W.Va. Code § 31B-3-303(b), the failure of a limited liability company to observe the usual company formalities or requirements relating to the exercise of its company powers or management of its business may not be a ground for imposing personal liability on the member(s) or manager(s) of the company.[62]

The test adopted by the court in *Kubican* appears to anticipate Macey and Mitts, at least with respect to when it is appropriate to protect involuntary creditors.[63]

A plaintiff's claim will fail if the veil-piercing allegations are not supported by any evidence showing that the defendant owner made improper payments to himself, commingled funds, or failed to maintain separate financial records and that these actions harmed the plaintiff.[64]

A. IMPOSING ALTER EGO LIABILITY ON NONOWNERS

In *McCallum Family L.L.C. v. Winger*,[65] Manitoba Investment Advisors, Inc. ("Manitoba"), a Wyoming corporation,[66] entered into a commercial triple-net lease with McCallum Family L.L.C. ("McCallum") of real property in Grand Junction, Colorado, from which Manitoba ran a mobile home sales operation. Manitoba did not pay property taxes as required by the lease for 2003, 2004, and part of 2005. It vacated the property seven months before the end of the lease term, defaulting on the

62. *Kubican*, 752 S.E.2d at 313.

63. Macey & Mitts, *supra* note 11 at 42, stating: "It is in these [tort] cases that undercapitalization seems to arise as the sole explanation for piercing the veil and holding shareholders individually accountable for the corporation's tort liability. However, a careful look at these situations shows that this generally only occurs when courts seek to discourage inadequate oversight or other forms of negligent management of the corporation. As such conduct can impose inefficient harms on third parties, courts' intervention can be understood under a rationale analogous to preventing the "mistaken" extension of credit in a broader sense, i.e., the negligent infliction of involuntary harm."

64. *See, e.g.*, *Bonner v. Brunson*, 585 S.E.2d 917, 920 (Ga. App. 2003).

65. McCallum Family L.L.C. v. Winger, 221 P.3d 69 (Colo. App. 2009).

66. The court's opinion applies Colorado law with no discussion of Manitoba being a Wyoming corporation.

remaining rent. McCallum obtained a judgment against Manitoba for $76,224.[67]

The Colorado Court of Appeals imposed alter ego liability on Marc Winger, who was not a shareholder, director, or officer of Manitoba. However, he was married to one fifty percent shareholder who was a director and officer of Manitoba and was the son of the other fifty percent shareholder, who was also a director and officer. The evidence showed that Winger dominated Manitoba and used corporate funds to pay his personal expenses as well as personal expenses of the two shareholders.[68] The court then stated its conclusion that Manitoba had been harmed by Winger's actions, noting that to impose alter ego liability, Winger's actions must have, and did, abuse the corporate form "to defeat the rightful claims of creditors."[69] There is no additional requirement that Winger's actions have been "*specifically directed at the plaintiff-creditor*."[70]

In *Sheffield Services Company v. Trowbridge,*[71] Charles A. Trowbridge was a co-manager (but not himself a member) of Colfax Industrial, LLC ("Colfax") and Villas Ventures, LLC ("Villas"). Each of Colfax and Villas owned residential lots in a subdivision in Broomfield, Colorado that it intended to develop. Colfax entered into a subdivision agreement requiring it and Villas to complete specific landscaping and infrastructure improvements to receive the necessary building permits. When the work was not completed, the City of Broomfield declared a default. Later, Trowbridge, on behalf of Colfax and Villas, entered into contracts with Sheffield Services Company, LLC ("Sheffield") to sell Sheffield the lots owned by Colfax and Villas. Colfax and Villas remained liable for completing the subdivision agreement requirements. Prior to closing the sales contracts, Sheffield was aware that the subdivision agreement requirements had not been satisfied. After the Villas sale to Sheffield closed but before the closing of the Colfax sale to Sheffield, Trowbridge received a letter from the City of Broomfield stating that it would withhold building permits if the requirements of the subdivision agreement were not satisfied. Trowbridge did not disclose this letter to Sheffield before Sheffield closed on the property with Colfax; Trowbridge also did not disclose to Sheffield the continuing failure to satisfy the

67. *McCallum Family L.L.C.*, 221 P.3d at 72.

68. *McCallum Family L.L.C.*, 221 P.3d at 77.

69. For an article critical of the reasoning applied by some courts in veil-piercing cases, see Herrick K. Lidstone, Jr., *Piercing the Veil of an LLC or a Corporation*, 39 THE COLO. LAW., no. 8, 71 (Aug. 2010), http://ssrn.com/abstract=2207735.

70. *McCallum Family L.L.C.*, 221 P.3d at 78 (emphasis in original).

71. Sheffield Services Company v. Trowbridge, 211 P.3d 714 (Colo. App. 2009), *overruled in part*, Weinstein v. Colburne Foodbotics, Inc., 302 P.3d 263, 269 (Colo. 2013). *Weinstein* is an important decision regarding improper distributions. *See infra* notes 662–674 and accompanying text.

requirements of the subdivision agreement.

The court first discussed and then held that the provisions of veil piercing of the Colorado LLC Act[72] did not preclude applying the common law veil piercing doctrine to a manager of a Colorado LLC. The court then discussed cases from other jurisdictions applying veil-piercing to corporate officers and directors of corporations and concluded that "no reason exists in law or equity for treating an LLC differently from a corporation when considering whether to disregard the legal entity."[73] In concluding that the veil-piercing claim against Trowbridge should be remanded to the trial court for further determination, the court noted:

> Here, the trial court found, with record support, that (1) the complicated, interrelated and commingled financial circumstances of Trowbridge and his various business entities were intended to frustrate the entities' creditors; (2) Trowbridge's overall conduct resulted in a clear financial benefit to him, which was not properly documented because of his elaborate scheme of concealment; and (3) Trowbridge engaged in various transactions and complicit conduct that disregarded the separate LLC entities, intending to keep the "ambulance chasers" from identifying and reaching the LLCs' members' assets at the time of liquidation and provide him and one LLC member "plausible deniability" to insulate preferential distributions to another member.[74]

The Minnesota Court of Appeals has also applied veil-piercing liability to non-shareholders and nonmembers. In *Equity Trust Company v. Cole*,[75] the court considered veil-piercing claims against several individuals arising out of a massive fraudulent real estate investment scheme. The individuals argued that they should not be held personally liable because they were not shareholders or members of the defendant entities. As the court explained, however:

72. COLO. REV. STAT. § 7-80-107(1) (2015). "In any case in which a party seeks to hold the members of a limited liability company personally responsible for the alleged improper actions of the limited liability company, the court shall apply the case law which interprets the conditions and circumstances under which the corporate veil of a corporation may be pierced under Colorado law." *See also* Lidstone, *supra* note 69.

73. *Sheffield Services Co.*, 211 P.3d at 721 (citing Kaycee Land & Livestock v. Flahive, 46 P.3d 323, 327, 329 (Wyo. 2002) and Roth v. Voodoo BBQ, LLC, 964 So.2d 1095, 1097 n. 3 (La. Ct. App. 2007)). The opinion in *Sheffield* does not explain why the plaintiff did not also assert a veil-piercing claim against Trowbridge's co-manager, Roy W. Mason.

74. *Sheffield Services Co.*, 211 P.3d at 722.

75. Equity Trust Company v. Cole, 766 N.W.2d 334 (Minn. Ct. App. 2009).

> [M]uch of the evidence suggests that the Thompsons did maintain an ownership interest in the entities. But whether a party holds an ownership interest in the entity is not dispositive. Veil piercing is an equitable remedy, and courts are to consider "reality and not form" in determining a party's involvement in a corporate enterprise. If veil piercing were solely dependent on a party's ownership interest in an entity, unscrupulous parties could avoid personal liability under the doctrine by simply acting in a capacity that does not involve ownership. Because veil piercing is grounded in equity and intended to prevent abuse of corporate protections, we hold that a district court may pierce the corporate veil to impose personal liability against any party who disregards the corporate form, regardless of whether the party holds an ownership interest in the entity.[76]

The South Dakota Supreme Court affirmed the trial court's holding that the veil of Toure, Ltd. ("Toure"), an Illinois corporation, should be pierced and four of its directors held personally liable for misrepresentations made to Mobridge Community Industries, Inc, ("MCI") in connection with the sale by MCI to Toure of personal property and equipment located in a plastics plant in Mobridge, South Dakota.[77] *Mobridge* held the four individual directors liable under a veil-piercing theory with no indication that they were or were not also shareholders.[78] Macey and Mitts note that, "like many veil-piercing cases, the *Mobridge* court emphasized the relative undercapitalization of Toure in light of the contractual activity to be undertaken."[79] But, Macey and Mills state:

> [T]his case demonstrates precisely what we have argued throughout this Article: rather than serving as an independent justification for piercing the veil, undercapitalization serves to buttress one or more of the three primary rationales for disregarding the corporate form that we have identified. In *Mobridge*, the court imposed liability on the four directors because they misrepresented Toure's capitalization in order to obtain credit from MCI. The court refers specifically to the directors' "false representations" regarding their "financial ability to carry out

76. *Equity Trust Company*, 766 N.W.2d at 339–40. (emphasis added).
77. Mobridge Cmty. Indus., Inc. v. Toure, Ltd., 273 N.W.2d 128 (S.D. 1978).
78. *Id.* at 132.
79. Macey & Mitts, *supra* note 11, at 125.

> the agreement." Undercapitalization in this setting, then, constituted the factual representation that was falsely conveyed to the contractual counterparty in exchange for an extension of credit. It did not serve as an independent justification for the veil-piercing decision.[80]

McCallum, *Sheffield*, *Equity Trust*, and *Mobridge* stand for the proposition that those in control of an entity, whatever their formal titles and status, may be held liable under a veil-piercing claim whether the claim arises out of "preventing fraud or something like it"[81] or "avoiding fraud or misrepresentation by shareholders trying to obtain credit."[82]

B. VEIL PIERCING IS AN EQUITABLE REMEDY[83]

The person seeking to pierce the veil of an entity may be denied if that person has unclean hands. For example, in *Tom Thumb Food Markets, Inc. v. TLH Properties, LLC*,[84] the court denied Tom Thumb's attempt to pierce the veil of its LLC landlord in part because Tom Thumb had contributed to the failure to obtain the lease it sought by ignoring requests from the LLC and its bank for financial information from Tom Thumb. A different but similar application of this doctrine arose in *Truckstop.Net, L.L.C. v. Sprint Communications Company, L.P.*[85] In that case, the court denied Sprint's motion to amend its counterclaim to pierce the veil of the defendant LLC and hold its members personally liable because Sprint knew of the LLC's financial condition and that its investors were refusing to bail it out long before it sought, without good cause for the delay, to amend its pleadings.

D'Elia v. Rice Development, Inc.[86] denied plaintiff's veil-piercing claim because the plaintiff had encouraged the defendant's behavior. As stated by the court:

> Here, the trial court, in declining to pierce the corporate veil, relied on evidence that Mr. d'Elia and the Trust encouraged, participated, and sanctioned the informal business activities

80. Macey & Mitts, *supra* note 11, at 125 (emphasis added).
81. *Id.* at 109 (internal quotations omitted).
82. *Id*. at 102, 113.
83. *See generally id.* As Bainbridge LLCs, *supra* note 16, at 79, and *supra* note 14 (collecting cases) note, the cases differ on whether veil piercing is an equitable remedy with no right to a jury or a legal doctrine where there would be a right to a jury.
84. Tom Thumb Food Markets, Inc. v. TLH Properties, LLC, No. C9-98-1277, 1999 WL 31168 (Minn. App. Jan. 26, 1999).
85. Truckstop.Net, L.L.C. v. Sprint Communications Company, L.P., Nos. CV-04-561-S-NRS, CV-05-138-S-NRS, 2007 WL 2480001 (D. Idaho Aug. 29, 2007).
86. D'Elia v. Rice Development, Inc., 147 P.3d 515 (Utah App. 2006).

> that the Trust now claims justify disregard for the corporate entity. In reaching its decision, the trial court also relied on evidence that Defendants did not siphon funds. The record reveals that substantial evidence exists to support the trial court's decision not to pierce the corporate veil.[87]
>
> First, the record demonstrates that Rice Inc. and Rice LLC appropriately followed certain internal corporate formalities. Second, with regard to Defendants' failure to follow certain other corporate formalities, the record reveals that Mr. d'Elia and the Trust were not only complicit, but at times promoted and engaged, themselves, in the informal, and arguably lax, business practices that the Trust argues render Mr. Rice liable. Finally, the record indicates that although Mr. Rice received distributions from Rice Inc. and Rice LLC, these distributions were not inappropriate since the parties made no agreement that Mr. Rice should forego all remuneration, such as a salary, and risk his own personal wealth in the wake of the Cherry Hills and Bridlevale projects.[88]

In other words, *D'Elia* tells us that a creditor's complicit actions with respect to an entity may preclude any relief for the creditor under a veil-piercing claim.[89]

C. TORT LIABILITY VERSUS CONTRACT LIABILITY

Courts may apply a veil piercing analysis differently for contract liability versus tort liability. Where a plaintiff enters into a contract knowing that it is dealing with an entity and fails to ensure that the entity is adequately capitalized to carry out its contractual obligations, the plaintiff may be precluded from asserting a veil-piercing claim.[90] In *White v. Winchester Land Development Corporation*,[91] two individuals, who were husband and wife, signed promissory notes payable to The Winchester Bank on behalf of The White House, Inc. The court discussed the factors that would support the bank's attempt to pierce the veil of The White

87. *D'Elia*, 147 P.3d at 523.

88. *Id*.

89. If, as Macey & Mitts, *supra* note 11 at 5 argue, one of three policy justifications for veil piercing is protecting creditors from owner misrepresentations, it is consistent with that policy to deny any relief to a creditor who is complicit in the defendant's actions.

90. *See* Marina, LLC v. Burton, No. CA 97-1013, 1998 Ark. App. LEXIS 441 (Ark. Ct. App. May 6, 1998).

91. White v. Winchester Land Development Corporation, 584 S.W.2d 56 (Ky. App. 1979).

House Inc. and found most were not supported by the record. The court stated that the factor of undercapitalization was "somewhat more problematic,"[92] but noted that Kentucky law did not require any minimum paid-in capital before a corporation commenced business and that, more significantly, the policy behind the undercapitalization factor is the protection of "innocent third parties who had no way of knowing that they were dealing with an impecunious entity."[93] The court then said "in the instant case, the bank cannot be heard to complain that The White House, Inc. was undercapitalized because the bank had knowledge of the financial status of the corporation and could have protected itself."[94]

Serio v. Baystate Properties, LLC[95] is another case standing for the proposition that an experienced business person who contracts with an LLC may face difficulties attempting to establish a viable veil-piercing claim against the owner of the LLC. In *Serio*, Baystate Properties, LLC, "an established building contractor who understood it was dealing with another LLC"[96] contracted with Serio Investments, LLC ("Serio Investments") to build houses on two lots. Vincent Serio was the sole member and manager of Serio Investments. Serio obtained a waiver from Baystate of any claims of personal liability. The court stated:

> Baystate, also a limited liability company, contracted with Serio Investments, a valid, subsisting limited liability company at the time of the transaction. While Serio Investments might have been inadequately capitalized, often times possessing just around $100 in cash in its account, there is no evidence that Baystate entered into the Agreement depending on Serio to fund its contracts from his personal account or that Baystate took reasonable steps to assure the availability of adequate funding. Based on Wenzel's testimony, Baystate was aware that the lots were in Serio's name prior to entering the Agreement. Even though an escrow account that was provided for in the Agreement was not established, there was no evidence that Baystate ever challenged or questioned the failure to establish a funded escrow account.[97]

92. *White,* 584 S.W.2d at 62.
93. *Id*.
94. *Id.* at 63. *See also* Macey & Mitts, *supra* note 11 at 133.
95. Serio v. Baystate Properties, LLC, 60 A.3d 475 (Md. App. 2013).
96. *Id.* at 489.
97. *Id.* at 488–89.

> Serio made it clear in the beginning that Serio Investments was Baystate's contractual partner for funding the project. The Agreement and each addendum continued to identify "Serio Investments" as Baystate's contractual partner and were signed by Serio as the "Managing Member." During their course of business, the parties also executed a document stating that Wenzel and Serio were not to be held liable for any obligations of their respective limited liability companies. Serio Investments made payments to Baystate consistent with its obligations under the contract for six months. All payments made to Baystate under the contract were either with checks issued from Serio Investments' corporate account, signed by Serio as the "Managing Member," or with cashier checks funded by Serio Investments. Moreover, the transfers of money by Serio to Serio Investments were supported by Confessed Judgment Promissory Notes indicating the payments were loans and not a simple commingling of funds.[98]
>
> In sum, Serio Investments fulfilled the contract with Baystate until, as Serio testified, the collapse of the housing market caused problems. Baystate was an established building contractor who understood and agreed that it was doing business with another limited liability company, as reflected in the Agreement, later addenda, and their continuing course of business. Under these circumstances, we conclude that the circuit court abused its discretion in finding Serio personally liable for the obligations of Serio Investments.[99]

Based on the facts that Baystate clearly knew it was dealing with an LLC, that Baystate took no steps to ensure that Serio Investments had adequate funding, and that the parties executed an agreement stating that the individual members and managers of Serio Investments and Baystate were not to be held liable for any obligations of their respective LLCs, the appellate court rejected Baystate's veil-piercing claim despite the trial court's holding that the veil should be pierced because Serio Investments misled Baystate regarding the sale of the homes and failed to establish an escrow agreement as called for by the contract.

98. *Serio*, 60 A.3d at 489.
99. *Id.*

In *Restaurant of Hattiesburg, LLC v. Hotel & Restaurant Supply, Inc.*,[100] plaintiff Hotel & Restaurant Supply, Inc. ("HRS") Restaurant of Hattiesburg, LLC ("RHLLC"), its two members, and a separate commonly owned LLC seeking to impose liability on the individual members and the related LLC for a debt of RHLLC.[101] The Mississippi Court of Appeals reversed the trial court's grant of summary judgement in favor of HRS. In reaching its conclusion, the court held that the three prong test adopted by the Mississippi Supreme Court for piercing the veil of a corporation[102] would also apply to LLCs.

Advanced Telephone Systems, Inc. v. Com-Net Professional Mobile Radio, LLC[103] denied plaintiff's attempt to pierce the veil of an LLC where the plaintiff knew it was dealing with an LLC that would not have significant assets unless it closed a pending deal with a third party. The court stated that the plaintiff "now asks the court to provide guarantees after-the-fact."[104]

Also see *Shook v. Walden*,[105] which explains the policy behind the amendments Texas made to the veil-piercing provision of its entity statutes:

> The basic notion was that contract claimants, unlike most third parties suing in tort, had voluntarily chosen to deal with the corporation and, "[a]bsent some deception or fraud," would have had the opportunity to apportion, through negotiated contract terms, the risk that the entity would be unable to meet its obligations.[106]

Gray v. Shaw[107] denied the plaintiffs' argument that the veil of several LLCs they had dealt with in a mortgage assistance effort should be pierced,

100. Restaurant of Hattiesburg, LLC v. Hotel & Restaurant Supply, Inc., 84 So.3d 32 (Miss. Ct. App. 2012).

101. *Id.* at 35.

102. *Id*. (citing Gray v. Edgewater Landing, Inc., 541 So.2d 1044, 1047 (Miss. 1989)) (holding that for a court to disregard the corporate entity and expose shareholders to liability, the complaining party must show: "(a) some frustration of contractual expectations regarding the party to whom he looked for performance; (b) the flagrant disregard of corporate formalities by the defendant corporation and its principals; [and](c) a demonstration of fraud or other equivalent misfeasance on the part of the corporate shareholder").

103. Advanced Telephone Systems, Inc. v. Com-Net Professional Mobile Radio, LLC, 846 A.2d 1264 (Pa. Super. Ct. 2004).

104. *Id.* at 1281.

105. Shook v. Walden, 368 S.W.3d 604 (Tex. App. 2012), also discussed *infra* notes 528-530 and accompanying text.

106. *Id.* at 620. See discussion of Lucas v. Texas Industries, Inc., 696 S.W.2d 372 (Tex. 1984); SSP Partners v. Gladstone Invs. (USA) Corp., 75 S.W.3d 444 (Tex. 2008); and the Texas statutory changes, *infra* notes 113-20, 378-93 and accompanying text.

107. Gray v. Shaw, 2007 Ariz. App. Unpub. LEXIS 789 (Ariz. Ct. App. 2007).

in part because the plaintiffs did not assert "that they were unaware that they were dealing with LLCs rather than individuals."[108] The plaintiffs also did not present any evidence that the LLCs had failed to follow appropriate legal formalities or that they had commingled their finances with those of their members.[109]

The results in *Serio*, *Advanced Telephone Systems*, and *Gray* appear consistent with the argument of Macey and Mitts that one of the three appropriate reasons to pierce the veil is to protect creditors by preventing misrepresentations regarding owner involvement.[110] That is, although the opinions in these three cases mention, e.g., undercapitalization, each case appears to turn on the fact that the plaintiff knew he was dealing with an entity and was not misled as to the entity's owner's involvement.

Macey and Mitts note that previous commentators reached contradictory and unclear results in attempting to determine whether veil piercing/alter ego liability was more likely to be imposed in tort cases than contract cases.[111] The research undertaken for this Article found few cases that note whether a tort analysis or a contract analysis is being applied. Often, of course, a veil-piercing/alter-ego case may partake of both.[112]

One case that does distinguish tort from contract is *Lucas v. Texas Industries, Inc.*[113] In that case, the plaintiff sought to hold a corporation liable for the tort of a subsidiary. The Texas Supreme Court noted that:

> Generally, a court will not disregard the corporate fiction and hold a corporation liable for the obligations of its subsidiary except where it appears the corporate entity of the subsidiary is being used as a sham to perpetrate a fraud, to avoid liability, to avoid the effect of a statute, or in other exceptional circumstances.[114]

However, the court went on to say that "the type of proof needed to satisfy the plaintiff's burden in an alter ego case varies depending on whether the underlying cause of action is for breach of contract or tort" and that, in a tort case, "it is not necessary to find an intent to defraud. Generally, in a tort case, the financial strength or weakness of the corporate

108. *Gray*, 2007 Ariz. App. Unpub. LEXIS at *31–32.
109. *Id*.
110. *Id.* at *30.
111. Macey & Mitts *supra* note 11, at 110.
112. *See* David v. Glemby Co., 717 F. Supp. 162 (S.D.N.Y. 1989), *infra* notes 185-187 for a case that arguably involves a mixed tort/breach of contract situation.
113. Lucas v. Texas Industries, Inc., 696 S.W.2d 372 (Tex. 1984).
114. *Id.* at 374.

tortfeasor is an important consideration."[115]

It is unclear whether the view *Lucas* expressed with respect to tort cases survived the amendments to Texas law limiting when alter ego/veil-piercing liability could be imposed.[116] At least one commentator has asserted the following with respect to *SSP Partners v. Gladstone Investments (USA) Corporation:*[117]

> *SSP* rejects the business enterprise liability theory, and adopts the approach taken by the Legislature in TBCA article 2.21 as the embodiment of public policy in Texas. Additionally, because it was a pure products liability case, *SSP* should be interpreted as applying the public policy of TBCA article 2.21 to all tort cases, not just those arising out of contracts. *SSP* is now the definitive statement of the Texas law of veil piercing for all cases, whether arising out of contracts, torts or otherwise.[118]

The problem with the assertion that "SSP is now the definitive statement of the Texas law of veil piercing for all cases" is that *SSP* is not a veil-piercing case. Indeed, the court in *SSP* noted that plaintiff did not "contend that liability should be imposed on Gladstone USA by disregarding its structure as a separate corporation — that is, by piercing the corporate veil or holding it to be the alter ego of Gladstone Hong Kong."[119] As no alter ego/veil-piercing claim was before the court for decision, the statements in *SSP* about when alter ego/veil-piercing liability may be imposed are *dicta*. Whether the rule of TBOC § 21.223(2) as made applicable to LLCs by TBOC § 101.002 that shareholders and members will not be liable for any *contractual* obligation of the entity unless the shareholder or member "caused the corporation [or LLC] to be used for the purpose of perpetrating and did perpetrate an actual fraud on the obligee

115. *Lucas*, 696 S.W.2d at 375 (noting the policy that "an inadequately capitalized corporation in a risky business in effect transfers the risk of loss to innocent members of the general public" (internal citation omitted)).

116. As discussed in *Shook v. Walden, infra* notes 528-530 and accompanying text, the Texas legislature amended the Texas statutes to limit application of alter-ego/veil-piercing claims. Article 2.21 of the Texas Business Corporation Act was amended, and, as carried forward in Texas Business Organizations Code § 21.223, provides that a shareholder may not be held liable for any *contractual* obligation of the corporation on the basis that the shareholder is or was the alter ego of the corporation or on the basis of actual or constructive fraud, a sham to perpetrate a fraud, or other similar theory, or for any obligation of the corporation on the basis that the corporation failed to observe any corporate formality. Texas Business Organizations Code § 101.002 makes § 21.223 applicable to LLCs.

117. SSP Partners v. Gladstone Investments (USA) Corporation, 275 S.W.3d 444 (Tex. 2008).

118. BYRON F. EGAN, CHOICE OF ENTITY DECISION TREE 81–82 (2015), http://images.jw.com/com/publications/2054.pdf.

119. *SSP Partners*, 275 S.W.3d at 451.

primarily for the direct personal benefit of the" shareholder or member will be applied in tort cases remains for further development.[120]

The Fifth Circuit Court of Appeals also recognized a different analysis in a tort case. *United States of America v. Jon-T Chemicals, Inc.*[121] arose out of fraudulent misrepresentations made by two individuals and Jon-T Farms, Inc. ("Farms") to obtain agricultural subsidies under the Upland Cotton Program.[122] The individuals and Farms had previously been convicted of criminal violations in connection with these misrepresentations.[123] The government then brought a civil action to recover the erroneously paid subsidies and obtained summary judgment based on the criminal convictions.[124] In this case, the government sought to hold the Farms' parent, Jon-T Chemicals, Inc. ("Chemicals") liable on the ground that Farms was its alter ego.[125]

The court noted that it had recently held that fraud was an essential element of an alter ego finding in a contract case,[126] "[h]owever, we do not require a finding of fraud in tort cases."[127] The court then stated:

> The reason for this distinction is clear. In a contract case, the creditor has willingly transacted business with the subsidiary. If the creditor wants to be able to hold the parent liable for the subsidiary's debts, it can contract for this. Unless the subsidiary misrepresents its financial condition to the creditor, the creditor should be bound by its decision to deal with the subsidiary; it should not be able to complain later that the subsidiary is unsound. In a tort case, by contrast, the creditor has not voluntarily chosen to deal with the subsidiary; instead, the creditor relationship is forced upon it. Thus, the question of whether the creditor relied on misrepresentations by the subsidiary is irrelevant. Where a parent establishes a subsidiary, undercapitalizes it, and dominates it to such an extent that the subsidiary is a mere conduit for the parent's business, then the parent should not be able to shift the risk of loss due to the subsidiary's

120. *See infra* notes 378-93 and accompanying text.
121. United States of America v. Jon-T Chemicals, Inc., 768 F.2d 686 (5th Cir. 1985).
122. *Id.* at 688. The Upland Cotton Price Support Program is codified at 7 U.S.C. § 1444(e).
123. *Jon-T Chemicals, Inc.*, 768 F.2d at 688.
124. *Id*.
125. *Id.* at 689.
126. *Id.* at 692 (citing *Edwards Co*. *v*. *Monogram Industries*, 730 F.2d 977, 980-81 (5th Cir. 1984) (en banc)).
127. *Jon-T Chemicals, Inc.*, 768 F.2d at 692.

> tortious acts to innocent third parties.[128]

The court affirmed the district court's holding that Chemicals "exercised total domination and control over" Farms and that, consequently Farms was the alter ego of Chemicals. The district court entered judgment against Chemicals in the amount of $4,787,604.20.[129] Chemicals argued that Farms should not be considered undercapitalized because it had "virtually unlimited access to credit in the form of loans from its parent, Chemicals."[130] The court responded:

> In our view, Chemicals' argument misses the point. The underlying question is whether Farms was an economically viable, independent entity or whether it operated merely as the adjunct or alter ego of Chemicals. The fact that Farms continually had net operating losses and survived due to massive and ongoing transfusions from Chemicals does not indicate that Farms ever stood on its own two feet. Quite the contrary; it reinforces the district court's conclusion that Farms did not have any separate financial existence.[131]

The court then stated that the district court's finding that there had been commingling of the funds of Chemicals and Farms and addressed Chemicals' argument that there was no comingling because records were kept of each advance made by Chemicals to Farms:

> [W]e agree with the district court that these records did not reflect the true economic realities and that the officers and directors treated the two corporations as one corporate enterprise. Chemicals admits that no collateral was posted for the "loans" it made to Farms and does not contest that Farms paid no interest on the loans. While we do not denigrate careful recordkeeping of corporate transactions, we do not regard mere records as a philosophers' stone capable of transmuting alter egos into distinct corporations. Records are primarily a memorialization of economic reality, not

128. *Jon-T Chemicals, Inc.*, 768 F.2d at 693 (citations omitted).
129. *Id.* at 689.
130. *Id.* at 694.
131. *Id*.

> constitutive of that reality.[132]

The court concluded by noting all of the evidence that Chemicals provided substantial loans to Farms (at one time, $7,000,000) and that Chemicals provided all the employees and equipment for Farms' operations. "Indeed, Chemicals, while disputing that it exercised day-to-day control over Farms or participated in Farms' crimes, admits that '[t]he evidence in this case is mainly to the effect that Chemicals controlled or dominated Farms.'"[133]

Unfortunately, the court also found it necessary to note that "Chemicals and Farms filed consolidated financial statements and tax returns."[134]

Macey and Mitts discuss Jon-T Chemicals and state:

> In explaining its decision to pierce the corporate veil, the Fifth Circuit emphasized that while "in contract cases, fraud is an essential element of an alter ego finding . . . we do not require a finding of fraud in tort cases, particularly where the subsidiary is undercapitalized." But as with *Minton*, the court's rhetorical emphasis on undercapitalization belies the true rationale for holding the parent responsible.
>
> The court's justification makes it clear: To mention just some of the evidence supporting the district court's alter ego holding, all of the directors and officers of Farms served as directors and officers of Chemicals; Farms was wholly owned by Chemicals; Chemicals paid many of the bills, invoices, and expenses of Farms; it covered Farms's overdrafts; *it made substantial loans to Farms (at one time amounting to $7 million) without corporate resolutions authorizing the loans and without demanding any collateral or interest*; Chemicals and Farms filed consolidated financial statements and tax returns; Farms used the offices and computer of Chemicals without paying any rent; the salary of Farms's one regular employee was paid by Chemicals; and *employees of Chemicals performed services for Farms without charging for their time.* Chemicals also advanced money and provided services on an informal basis to the joint ventures.

132. *Jon-T Chemicals, Inc.*, 768 F.2d at 694.
133. *Id.*
134. *Id.* *See infra* notes 404-28 and accompanying text.

> The emphasized text suggests that what was really motivating the court's holding was the concern that the casual manner in which the parent-subsidiary relationship was managed increased the likelihood that the subsidiary would impose inefficient harms on third parties. As with *Minton*, the judicial search for the "legitimacy" of the subsidiary's corporate existence finds its expression in specific actions of insufficient oversight that instrumentally justify piercing the corporate veil. The "alter ego" finding is not a metaphysical recognition of a unified parent subsidiary identity but rather a rhetorical device that courts employ to justify discouraging management of the corporation that is likely to be socially harmful.[135]

It is unclear why Macey and Mitts assert "that what was really motivating the court's holding was the concern that the casual manner in which the parent-subsidiary relationship was managed increased the likelihood that the subsidiary would impose inefficient harms on third parties."[136] The court was not dealing with an increased likelihood that harm would be imposed on a third party. The third party in Jon-T Chemicals, the federal government, had suffered concrete harm of $4,787,604.20.[137] Indeed, in response to Chemicals' argument that Farms was not undercapitalized, the court stated: "Our short answer to this is that if Farms had unlimited access to the coffers of Chemicals, this access should have been sufficient to pay involuntary creditors who were prejudiced by the limited funds in Farms's own coffers."[138]

Perhaps Jon-T Chemicals is better viewed as a case in which the court in fact expressed its true rationale, namely, that a parent corporation may escape the tort liability of a subsidiary where the parent by its actions demonstrates an almost total disregard of the separateness of its subsidiary. It also appears that Jon-T Chemicals could be appropriately classified as a case in which veil piercing was appropriate because it was necessary to carry out the purposes of a statute, i.e., the Upland Cotton Price Support Program.[139]

135. Macey & Mitts, *supra* note 11, at 130.
136. *Id*. at 129–130.
137. *Jon-T Chemicals, Inc.*, 768 F.2d at 689.
138. *Id.* at 694.
139. *Supra* note 122 and accompanying text; *see also* Macey & Mitts, *supra* note 11, at 129–30.

D. Single-Member LLCs

Many if not most of the cases discussed in this Article involve single-member LLCs. Although a single member is not necessarily evidence of the LLC being the *alter ego* of the single member, single member or closely held membership may raise a red flag in many situations, and many may think that single member LLCs are more subject to potential abuse. If the single member completely disregards the separateness of the LLC, a court will treat the LLC as a sham or alter ego of the member.[140]

In a case where the plaintiff pled only conclusory arguments for piercing the veil of a single member LLC, the court rejected the plaintiff's claim and noted that "Single-shareholder corporations and limited liability companies are not de facto illegal or inherently a sham."[141]

Metroplex Mailing Services, LLC v. RR Donnelly & Sons Company[142] provides a good analysis of piercing the veil of a single member LLC under Texas law and illustrates that the separate existence of a single-member LLC that is properly maintained and used will be respected. Jesse R. Marion ("Marion") formed Metroplex Mailing Services, LLC ("Metroplex") as a Texas LLC. In May 2008, Metroplex entered into a mail processing agreement with Bowne & Co. ("Bowne"), which was acquired in 2010 by RR Donnelly & Sons Co ("Donnelly").[143] The mail processing agreement was for a five-year term and required Bowne to pay Metroplex a minimum of $50,000 per month regardless of the amount of mail Bowne had.[144] The mail processing agreement also required Bowne to deposit a certain amount of money with Metroplex.[145] Metroplex needed additional equipment to process the amount of mail expected under the mail processing agreement with Bowne. Metroplex entered into a separate

140. *See, e.g.*, Connecticut Light & Power Co. v. Westview Carlton Grp., LLC, 950 A.2d 522, 527 (Conn. App. 2008). The court affirmed the trial court's determination that the LLC's veil should be pierced to hold the single member personally liable for the LLC's unpaid electric bills. The LLC had no registered agent, filed no annual reports with the Secretary of State, failed to maintain any business records for its property, failed to file any tax returns for the years involved, and was undercapitalized. Finally, when the LLC sold its property, the member rather than the creditor was the beneficiary of the proceeds. Although the court in *Connecticut Light & Power* cited a list of all possible veil-piercing factors, the case appears to be one that, in the parlance of Macey and Mitts, turns on the necessity to protect creditors against misrepresentations about owner involvement. Macey & Mitts, *supra* note 11, at 141.

141. Smith v. Shining Rock Golf Cmty., LLC., No. 20061510B, 2007 Mass. Super. LEXIS 222, at *7 (Mass. Super. June 20, 2007). Macey and Mitts do not discuss many LLC cases and discuss a single-shareholder corporation in only one instance. Macey & Mitts, *supra* note 11, at 115–16.

142. Metroplex Mailing Services, LLC v. RR Donnelly & Sons Company, 410 S.W.3d 889 (Tex. App. 2013).

143. *Id.* at 893–94.

144. *Id.* at 893.

145. The amount of the deposit was to be determined by Metroplex alone!

agreement with an affiliate of Bowne to purchase additional mail sorting equipment for $1,000,000.[146] Metroplex could not obtain financing to purchase the additional equipment, and Marion borrowed $750,000 personally, secured by the equipment, and added $250,000 of his own money.[147] Marion leased the equipment to Bowne for a three-year term.[148]

In the fall of 2008, Bowne lost one of its major customers, and the amount of mail being processed for Bowne by Metroplex declined from approximately 10,000,000 pieces per month to less than 3,000,000 per month.[149] By that time, Metroplex was no longer using one of the pieces of equipment purchased by Marion. Metroplex sold the unused equipment to a third party, which wired its payment to Metroplex's operating account. Metroplex then used the sale proceeds to make a payment to Marion's bank to reduce the principal amount of Marion's personal loan as required by the security agreement.[150]

In October 2008, Bowne determined that a substantial amount of the money it had on deposit with Metroplex had not been properly segregated to postage, and it requested a refund of $586,000 from the remaining $700,000 balance.[151] Bowne did not have a right to a refund under the terms of the mail processing agreement, but Metroplex voluntarily returned $200,000 of the deposit.[152] On January 13, 2009, Bowne notified Metroplex that it would not pay any further invoices unless it received the remaining $386,000 of its requested refund. Less than two weeks later, Metroplex notified Bowne that it was ceasing operations.[153] Bowne again requested its refund and was told that no funds were available.

On January 23, 2009, Bowne sued Metroplex seeking return of the money it had on deposit and alleging, inter alia, breach of contract and conversion. Bowne later added various tort claims and added Marion, individually, as a defendant. Metroplex asserted various counterclaims, including breach of contract and promissory estoppel.[154]

The jury found that Metroplex failed to comply with the agreement and Bowne did not fail to comply with the agreement. The trial court entered judgment ordering Donnelly recover damages of $40,391.28 in

146. *Metroplex Mailing Services, LLC*, 410 S.W.3d at 893.
147. *Id.* at 894.
148. *Id*.
149. *Id*.
150. *Id*.
151. *Id*.
152. *Id*.
153. *Id.*
154. *Id*.

actual damages and $538,358.32 in attorney fees from Metrolpex and Marion.[155]

On appeal, the court concluded that "Donnelly produced no evidence that Marin operated Metroplex in a manner that would allow the trial court to render judgment against him individually in this case."[156] The court then pointed out that the applicable Texas "statutory protections afforded to members and managers of an LLC give way only when a plaintiff can show that the LLC was used for the purpose of perpetrating, and did perpetrate, an actual fraud for the member or manager's direct personal benefit."[157] Further, "Evidence that a company was used as an alter ego does not, by itself, create an issue regarding whether it was used to commit an actual fraud on the plaintiff for the defendant's personal benefit."[158]

The court then responded in detail to Donnelly's arguments that three actions by Marion demonstrated actual fraud:

> Donnelley points to three actions by Marion that it argues demonstrate the type of dishonesty encompassed by the concept of actual fraud. First, Donnelley points to Marion's use of the money wired to Metroplex from the sale of the sorting machine to pay off a portion of his personal loan. Although Donnelley characterizes this transaction as a fraudulent diversion of corporate assets for personal benefit, the evidence adduced at trial shows there was nothing dishonest about the use of the sale proceeds. It is undisputed that Marion took out a personal loan of $750,000 to purchase sorting equipment to be used by Metroplex. It is also undisputed that the sorting equipment was used as security for the loan and the security agreement required all proceeds from any sale of the equipment to be used first to pay off the loan. Finally, it is undisputed that Marion sold one of the pieces of equipment after Metroplex no longer had a use for it. Marion then applied the proceeds to reduce the balance of the loan as required by the security agreement. Marion's creation and use of a single-member limited liability company, as statutorily authorized by the legislature, combined with an ordinary personal loan to purchase equipment for the company's use secured by that equipment, amounts to no evidence of a fraud even in combination with

155. *Metroplex Mailing Services, LLC*, 410 S.W.3d at 894.
156. *Id.* at 896.
157. *Id.*
158. *Id.* at 896–97 (citing Shaw v. Maddox, 73 S.W.3d 472, 481 (Tex. App. 2002)).

the other facts of this case. Donnelley relies on the fact that the bill of sale for the purchase of the sorting equipment shows Metroplex as the purchaser rather than Marion. Based on this, Donnelley argues that Marion sold equipment owned by Metroplex to satisfy his personal debts. Donnelley presented no evidence, however, that Marion ever concealed the fact that the equipment was purchased with money from a personal loan and that the equipment was used as security for the loan. Nor is there any evidence that Marion represented that the equipment would be a gift to Metroplex. The evidence in fact contains a lease agreement between Marion and Metroplex for Metroplex's use of the machinery. *The bill of sale showing Metroplex as the purchaser of the equipment, at most, might be some evidence that Marion treated the company as his alter ego. It does not, however, show that Marion committed a fraud on Bowne or Donnelley*.[159]

Second, Donnelley contends that Metroplex used some of Bowne's postage deposit as operating funds in violation of the agreement and without disclosing this fact to Bowne. *Even assuming the evidence shows this was the case, there is no evidence that this action resulted in any direct personal benefit to Marion*. Donnelley speculates that the use of Bowne's deposit as operating funds "obviated the need for Marion to contribute additional capital and/or take on additional personal debt to keep Metroplex afloat." But Donnelley cites no evidence to support this contention. Indeed, the evidence shows that Metroplex's company agreement with Marion did not require him to contribute any capital other than his original contribution. Nor was he required to take on any personal debt. Because there is no evidence to show that the alleged misuse of the postage deposit resulted in any direct benefit to Marion, it cannot be used as the basis for holding him personally liable for the company's debts.[160]

Finally, Donnelley argues Marion committed an act of fraud by shutting down Metroplex's operations in the face of Bowne's demand for the return of its deposit. The evidence does not show, however, that Marion closed the company to

159. *Metroplex Mailing Servs.*, 410 S.W.3d at 897 (emphasis added).
160. *Id.* at 879–98 (emphasis added).

> avoid returning a deposit that Donnelley concedes Metroplex had no obligation to return at the time of Bowne's demand. All the evidence shows that Metroplex ceased operations because of declining business. To the extent Donnelley suggests Marion fraudulently placed some of Metroplex's assets out of the reach of its postclosing creditors by pledging them as security for his personal loan, the evidence conclusively shows that Marion's personal loan was obtained to purchase those assets for Metroplex's use. As stated above, there is nothing in the record to suggest the assets were gifted to the company by Marion or that the transaction was concealed in any way. Furthermore, as with the alleged misuse of the deposit money, Donnelley presented no evidence that Marion obtained any direct personal benefit from the closing of the company as required to pierce the corporate veil.[161]

In a pyrrhic victory for Donnelly, the court affirmed the award of actual damages and attorneys' fees against Metroplex, which was defunct and had no funds. The court's statements quoted above indicate that this was another case where the court found no owner misrepresentations from which the plaintiff needed protection.[162]

E. Domination and Control/Lack of Separateness

In a detailed Second Circuit Court of Appeals decision discussing the piercing of a veil of a single-member Delaware LLC,[163] the plaintiffs sought to hold the member liable for breach of contract by the LLC on the basis that the member was the LLC's alter ego. The trial court granted summary judgment in favor of the member on the ground that the plaintiffs had not set forth sufficient evidence to pierce the veil of the LLC. In reaching its conclusion that the defendant was not entitled to summary judgment, the court examined the evidence that the LLC and its sole member operated as a single entity and found that the evidence, viewed most favorably to the plaintiffs, showed:

(1) *Lack of corporate formalities:* Although corporate veil-piercing principles are generally applicable to an LLC, somewhat less emphasis

161. *Metroplex Mailing Servs.*, 410 S.W.3d at 898.
162. Macey & Mitts, *supra* note 11, at 114.
163. NetJets Aviation, Inc. v. LHC Commc'n, LLC, 537 F.3d 168, 172 (2d Cir. 2008).

should be placed on whether the LLC observed internal formalities in an alter ego analysis of an LLC. However, if two entities with common ownership "failed to follow legal formalities *when contracting with each other*, it would be tantamount to declaring that they are indeed one in the same."[164]

(2) *Inadequate capitalization:* The LLC was started with a capitalization of no more than $20,100, then it proceeded to invest millions of dollars supplied by its member,[165]

(3) *Treating the LLC's funds as if it were the member's*: The member put money into the LLC as needed and took money out as the member needed it.[166]

(4) *Lack of financial segregation with other entities:* The LLC had only one officer other than its member, and the officer was paid by the member or one of his corporations. The LLC shared space with other companies owned by the member and shared employees with the member or other companies owned by the member.[167]

(5) *Lack of independent decision-making:* The member formed the LLC to be used as an investment vehicle for him to make investments, and the ultimate decisions were always made by the member.[168]

(6) *Personal use of LLC funds:* The court reviewed evidence relating to financial transactions involving the LLC, including —

a. The LLC made transfers to the member or third-parties on his behalf in connection with living expenses.[169]

b. The individual in charge of the LLC's financial records testified that the member made the decision to treat moneys deposited into the LLC as loans so that the member could make withdrawals as he needed money without having to pay taxes on the money withdrawn.[170]

c. The loans were not evidenced by written agreements, and there were no set repayment programs or terms.[171]

d. The member decided when to put money in or take money out of the LLC.[172]

The Second Circuit concluded that this evidence was ample to permit a reasonable fact-finder to find that the member completely dominated the

164. *NetJets Aviation, Inc., LLC*, 537 F.3d at 178.
165. *Id.* at 179.
166. *Id*.
167. *Id*.
168. *Id.* at 179–80.
169. *Id.* at 180.
170. *NetJets Aviation, Inc., LLC*, 537 F.3d at 182.
171. *Id.*
172. *Id.* at 180.

LLC and treated its bank account as one of his pockets.[173]

The court found evidence of injustice in an affidavit submitted by the member to counter the plaintiffs' contention that the LLC was undercapitalized. The affidavit stated that the member did not intend for the monies paid to the LLC to be treated as loans and that such payments were in fact capital contributions. In testimony, the individual in charge of the LLC's books stated that the member instructed him to treat the payments as loans so that the member could take money out of the LLC without tax consequences.[174]

The court pointed out that the member's withdrawals of money from the LLC would be properly characterized as distributions if the payments to the LLC were capital contributions and that distributions to the member may well have violated the prohibition on distributions under the Delaware LLC statute given that the LLC had ceased operating and was unable to pay its debt to the plaintiffs. The court stated that a fact-finder could infer that the member's payments to the LLC were deliberately mischaracterized as loans to mask the fact that the member was making withdrawals prohibited by law.[175] The court also stated that a reasonable fact-finder could find that the member operated the LLC in his own self-interest in a manner that unfairly disregarded the rights of the LLC's creditors given various payments and withdrawals on the member's behalf at a time when the LLC was unable to pay its debt to the plaintiffs and evidence that the member withdrew more money from the LLC than he put in.[176] The court concluded by finding that neither the LLC member nor the plaintiffs were entitled to summary judgment on the veil piercing claim.[177]

McCallum Family L.L.C. v. Winger,[178] *Sheffield Services Company v. Trowbridge*,[179] *Equity Trust Company v. Cole*,[180] and *Mobridge Community Industries, Inc. v. Toure*,[181] discussed previously,[182] stand for the proposition that if those actually in control of an entity dominate it to the detriment of third parties, whatever their formal titles and status, they may be held liable under a veil-piercing claim whether the claim arises out of "preventing fraud or something like it"[183] or "avoiding fraud or

173. *NetJets Aviation, Inc., LLC*, 537 F.3d at 182.
174. *Id.* For more discussion of this case, see *infra* notes 427-28.
175. *Id.* at 183.
176. *Id.* at 184. This may have been the court's real justification even though it discussed a laundry list of factors. *See* Macey & Mitts, *supra* note 11, at 107.
177. *Id.* at 184.
178. McCallum Family L.L.C. v. Winger, 221 P.3d 69 (Colo. App. 2009).
179. Sheffield Services Company v. Trowbridge, 211 P.3d 74 (Colo. App. 2009).
180. Equity Trust Company v. Cole, 766 N.W.2d 334 (Minn. App. 2009).
181. Mobridge Community Industries, Inc. v. Toure, 273 N.W.2d 128 (S.D. 1978).
182. *Supra* notes 65-82 and accompanying text.
183. Macey & Mitts, *supra* note 11, at 107.

misrepresentation by shareholders trying to obtain credit."[184]

In *David v. Glemby Co.*,[185] plaintiff contracted separately with defendants Glemby Co. ("Glemby") and its ninety eight% subsidiary Hair Programming, Inc. ("HPI") to license plaintiff's brand name and operate hair salons in the United States under plaintiff's brand name. When HPI failed to perform under the contract, plaintiff sued Glemby as well, claiming that HPI's veil should be pierced because the two corporations acted as one entity in the transaction. The district court denied the defendants' motion to dismiss the veil-piercing claim, holding that a jury could reasonably find that HPI's corporate form should be disregarded and liability imposed on Glemby. Although the court discussed the traditional elements of veil-piercing, e.g., failure to observe formalities, it did so in the context of implied and express representations by Glemby that it would perform HPI's duties under the contract:

> Letters apparently written on behalf of HPI appeared on Glemby letterhead and referred ambiguously to "our obligation." . . . David had no reason to believe HPI's function was to avoid liability for Glemby, especially in light of David's allegations that "Glemby promised Mr. David that it would take all steps necessary to see that Hair Programming performed the obligations stated in the Market Development Agreement, which Hair Programming signed, on instructions from Glemby."[186]

Macey and Mitts analyze this case as follows:

> It is apparent that the failure to observe corporate formalities distinguishing Glemby from HPI justifies disregarding HPI's corporate form because Glemby implicitly misled David into extending credit on the basis of Glemby's involvement as well as HPI. *Such misleading conduct does not rise to the level of common law fraud — indeed, there is no specific false statement — but justifies the imposition of liability because the extension of credit on the basis of a mistake regarding the involvement of the parent is inefficient*.[187]

184. Macey & Mitts, *supra* note 11, at 102, 113.
185. David v. Glemby Co., 717 F. Supp. 162 (S.D.N.Y. 1989).
186. *David*, 717 F. Supp. at 167–68.
187. Macey & Mitts, *supra* note 11, at 125 (emphasis added).

In *Connecticut Light and Power Company v. Westview Carlton Group, LLC*,[188] the court affirmed the trial court's determination that the LLC's veil should be pierced to hold the single member personally liable for the LLC's unpaid electric bills. The LLC had no registered agent, filed no annual reports with the Secretary of State, failed to maintain any business records for its property, failed to file any tax returns for the years involved,[189] and was undercapitalized. Finally, when the LLC sold its property, the member rather than the creditor was the beneficiary of the proceeds.[190] Although the court in Connecticut Light and Power cited a list of all possible veil-piercing factors,[191] the case appears to be one that, in the parlance of Macey and Mitts,[192] turns on the necessity to protect creditors against misrepresentations about owner involvement.[193]

Double G.G. Leasing, LLC v. Underwriters at Lloyds, London[194] pierced the veil of a single-member LLC to require the member to comply with the LLC's insurer's demand for information. Double G.G. Leasing, LLC ("Leasing) purchased property for $550,000 on which was situated a vacant, two-family residential structure. Leasing obtained an insurance policy from defendant that insured Leasing against, inter alia, physical loss or damage to the property by fire for the period from March 19, 2005, to September 19, 2005. On April 24, 2005, less than five weeks after the beginning of the policy period, the building on the property was destroyed by fires of incendiary origin that were ignited at two separate locations at the rear of the building with the use of flammable liquid accelerant.[195] With respect to the grounds for piercing the veil of Leasing, the trial court stated:

> The plaintiff admits that "Double G.G. is owned and controlled by Carl Glatzel, Jr." A document submitted by the plaintiff in opposition to the motion reflects that Glatzel is the only principal of the company. It is apparent that he

188. Connecticut Light and Power Company v. Westview Carlton Group, LLC, 950 A.2d 522 (Conn. App. 2008).

189. As a single-member LLC, Westview Carlton Group, LLC was not required to file federal income tax returns. There is no indication in the opinion that the LLC had elected to be treated as an association taxable as a corporation, which would have required it to file tax returns, notwithstanding the court's reference to the LLC's sole member as the LLC's "sole shareholder." *Connecticut Light and Power Company*, 950 A.2d at 523. Also see cases discussed *infra* notes 404-28 and accompanying text under *Tax Status as a Factor in Veil-Piercing*.

190. *Connecticut Light & Power Co.*, 950 A.2d at 527.

191. *Id.*

192. Macey & Mitts, *supra* note 11, at 123.

193. *Connecticut Light & Power Co.*, 950 A.2d at 525–26.

194. Double G.G. Leasing, LLC v. Underwriters at Lloyds, London, No. AANCV075003003, 2008 WL 2345205 (Conn. Super. May 16, 2008), *aff'd* 978 A.2d 83 (Conn. App. 2009).

195. *Id.* at *1.

> maintained no company books but, rather, ran the affairs of this relatively passive real estate investment out of his pocket. That, alone, might not be sufficient to pierce the corporate veil. However, that he conveyed the company to Glatzel, Sr. (unbeknownst at the time to Glatzel, Sr.) for such purely personal reasons, continued to run its affairs, and then re-conveyed the company back to himself when circumstances suited him reflects a unity of interest and ownership between Glatzel and the company and a complete lack of independence of the latter. In such circumstances adherence to the fiction of a separate company identity would serve only to defeat justice and equity by permitting Glatzel to escape obligations assumed by the LLC pursuant to an insurance policy of which he, Glatzel, was the ultimate and lone beneficiary. Quite clearly, there was such a unity of interest and ownership between Glatzel and the plaintiff that the plaintiff never was an independent entity. Adherence to the fiction of separate identity would serve only to defeat justice and equity by permitting Glatzel and the LLC to escape the "duties in the event of loss or damage" under the policy. Under the identity theory, the court pierces the plaintiff's company veil and holds that the "duties in the event of loss or damage" imposed under Part B of the insurance policy are imposed on Glatzel as well as the plaintiff insured.[196]

Double G.G. Leasing indicates that an owner's actions may necessitate protecting a creditor's right to information.

Double Constr. Co. v. Advanced Home Builders, LLC[197] involved egregious misuse of an LLC and a corporation and questionable conduct by the defendants' attorney. Double Construction Company, LLC ("Double C") sued Advanced Home Builders, LLC ("Advanced"), Creative Building Corporation, ("Creative"), Robert A. Chiulli, Sr. ("Robert"), and Laura Chiulli ("Laura"). Plaintiff sought money damages for the breach of a contract for work performed at defendants' request on a subdivision development in Rocky Hill, Connecticut, for which plaintiff had not been paid. Plaintiff Double C also sought to impose personal liability on the individual defendants on the ground that the individual defendants were the

196. *Double G.G. Leasing, LLC*, 2008 WL 2345205 at *8.

197. Double Constr. Co. v. Advanced Home Builders, LLC, No. CV65003609, 2008 WL 4050864 (Conn. Super. Aug. 6, 2008).

alter egos of Advanced and Creative.

Both Robert and Laura[198] testified that the plaintiff had not performed much of the work it claimed to have done. Plaintiff's owner, Chris Chiulli ("Chris") submitted daily time reports to show that the work had been done. Despite a "vigorous cross-examination," defendants could not invalidate these reports. In addition, the Town of Rocky Hill's engineers approved the work that plaintiff had done. Moreover, defendants did not submit any bills or other documents from other contractors to show that the work plaintiff did had to be redone or corrected.[199]

The court then described the actions of Robert and his attorney, James Ripper:

> What the Court finds particularly troubling are the actions of Attorney James Ripper and Robert. The paving contractor who paved the roadways which were prepared by the plaintiff was J.S.L. Asphalt, Inc. of Westfield, Massachusetts. Ken Begin of that company testified that he insisted when his proposal was accepted for the final paving of the roads, etc. that he had had difficulty in the past in being paid by Robert so he insisted on a letter from Attorney Ripper who was to hold monies in escrow to cover the bid proposal. This . . . reads, in pertinent part: "This office is holding the funds in excess of $80,000.00 which covers your bid proposal of $59,540.00 and estimated additional work. This escrow is to be disbursed as directed by the Town of Rocky Hill Engineer as work is completed on the Old Dividend Road subdivision." The letter is dated October 18, 2005. According to Mr. Begin, whom the Court believes, when he sought payment from Attorney Ripper, Attorney Ripper refused to pay him money out of the escrow account stating that Robert had instructed Attorney Ripper not to pay J.S.L. out of the escrow even though the Town of Rocky Hill Engineer had advised Attorney Ripper that the work to be done by J.S.L. had been satisfactorily completed. Not only is this an apparent conflict of interest on the part of Attorney Ripper who generally represents the defendants, but based upon this letter of October 18, 2005, Robert had no right to refuse payment.[200]

198. The court noted that Laura's testimony was, at times, hesitant and contradictory. She admitted that she had little experience developing a subdivision, and the court concluded that she was often repeating what she had been told by Robert. *Double Constr. Co.*, 2008 WL 4050864 at *2.

199. *Id.*

200. *Id.*

> Although the plaintiff did not receive a similar letter from Attorney Ripper, the plaintiff wrote a letter to Attorney Ripper dated January 16, 2005, . . . setting forth that Attorney Ripper had guaranteed immediate payment of the work to be done by the plaintiff upon approval by the Town Engineer of the work and invoice. The plaintiff, through Chris, states, in pertinent part, as follows: "After having this discussion with you, and agreeing to do the work based on our discussion, you can only imagine my surprise that you are now refusing to release the funds because Robert Chiulli is disputing invoices previously paid by other funds which have nothing to do with this work. I find myself in a precarious situation begging for payment months after completion of work and Town Engineer approval from the very Attorney who guaranteed me immediate payment." The Court has no doubt that Attorney Ripper made this commitment based upon Chris' testimony and that the only response Attorney Ripper gave him was "I don't see it the way you do," and based upon the fact that the same situation took place with J.S.L. as previously mentioned.[201]

With respect to Robert's and Laura's personal liability under plaintiff's veil-piercing claim, the court discussed the three-part test adopted by the Supreme Court of Connecticut for piercing the veil under the instrumentality rule and stated:[202]

> The Court finds that, under the totality of the evidence, all three elements have been proven by clear, unequivocal, precise and convincing evidence:
>
> (1) Robert and Laura Chiulli conspired to and did exercise complete domination of the defendant LLC with respect to finances, policy and business practice with respect to the defendant LLC's relationship and transactions with the plaintiff so that the defendant corporations as to such transactions had at the time no separate mind will or existence of its own.
>
> (2) Robert and Laura Chiulli conspired to and did use such control to commit a wrong (i.e. not pay the monies due to the plaintiff), to perpetrate a violation of a positive legal duty (breaching the contract with the plaintiff) which was in

201. *Double Constr. Co.*, 2008 WL 4050864 at *3.
202. *Id.* at *4.

> contravention of plaintiff's legal rights; and
>
> (3) The control and breach of contract and the aforesaid duties proximately caused, actually solely caused, the unjust loss or injury complained of; i.e. non-payment of a fair and reasonable value of the plaintiff's services and breach of the contract and agreements with the plaintiff.
>
> Additionally, Robert and Laura Chiulli were the alter egos of the defendant corporations and are, therefore, personally liable.[203]

Double Constr. Co. and *Tzovolos*, below, are cases that appear similar to a case that Macey and Mitts cite for "piercing the corporate veil in a setting similar to common law fraud."[204]

Tzovolos v. Wiseman[205] involved piercing the veil of several commonly owned LLCs and corporations to facilitate the plaintiff's ability to collect a judgment of $12,700 for the value of restaurant equipment that the defendants had wrongfully taken plus $39,640 in punitive damages and attorney fees. Plaintiffs sold kitchen equipment to Seawind, LLC ("Seawind") and Scott Wiseman ("Wiseman").[206] Plaintiffs perfected a purchase money security interest in the equipment. Plaintiffs also sued Robert Hartmann, Sr. ("Hartman, Sr."), Jason R. Hartman, Robert Hartmann, Jr. ("Hartmann, Jr."), Jason Roberts, Inc. ("JRInc."), Jason Robert's Concrete ("JRCLLC"), and Alpert Realty, LLC ("Alpert").[207] Wiseman leased business premises for the restaurant from Alpert.[208] Shortly after purchasing the restaurant equipment, Wiseman, as a[209] member of Seawind, entered into an operating agreement for Seawind with Hartman, Sr., Jason R. Hartmann, and Hartmann, Jr. as additional members.[210]

The court noted that courts had looked at ten factors in determining whether an entity is dominated or controlled for purposes of the instrumentality test and then analyzed the defendants' conduct under each factor:

203. *Double Constr. Co.*, 2008 WL 4050864 at *4.

204. Macey & Mitts, *supra* note 11, at 124 (discussing Mobridge Cmty. Indus., Inc. v. Toure, Ltd., 273 N.W.2d 128 (S.D. 1978)). *Mobridge Community Industries, Inc.* is discussed in this Article in *supra* notes 77-82 and accompanying text.

205. Tzovolos v. Wiseman, 16 A.3d 819 (Conn. Super. 2007), *aff'd* 12 A.3d 563 (Conn. 2011).

206. *Id*. at 825.

207. *Id.*

208. *Id.* at 830.

209. So described by the court. *Id*. There is no indication in the opinion that Seawind initially had any members other than Wiseman.

210. *Id.*

> The Hartmann sons elected not to testify. The evidence has demonstrated that Hartmann, Sr., owns and manages several LLCs, or corporations, several of which have been involved in the transactions that form the basis of the present case. He and his sons have utilized the corporate entities and LLCs in furtherance of their business goals. The facts of the present case satisfy several of the above elements, indicating that the corporate veil of each of the Hartmann LLCs should not be left intact to shield Hartmann and his sons from personal liability as a result of their conduct.[211]
>
> The evidence establishes a lack of corporate formalities, thus satisfying the first element. Pursuant to the operating agreement of Seawind, "[a]ny transactions between the [c]ompany and [m]embers or their affiliates not specified in this [a]greement shall require the approval of a majority vote of the [p]articipating [p]ercentage." Hartmann, Sr., consistently ignored this provision while transacting business between Seawind and his various LLCs as the evidence fails to establish any record of adherence to the majority vote provision.[212]

Note that the lack of formalities that the court is discussing in the immediately preceding quotation is not simply a failure to keep good minutes, but is the disregard of a requirement of the operating agreement that imposed a special approval requirement for transactions between the LLC and its members or their affiliates. As the requirements of the operating agreement were not followed, the transactions in question were not validly authorized. If a legal opinion had been required for some reason, at a minimum, the opinion giver likely would have required cleanup of these approvals. The actions taken without the approval required by the Seawind operating agreement included a $100,000 note from Seawind to JRCLLC[213] and changing the statutory agent for Seawind,[214]

> Regarding the fourth and fifth factors, Hartmann, Sr., has created and/or controlled several LLCs in the pursuit of business opportunities. Hartmann, Sr., as of August, 2003, was active in the operation of Seawind. Hartmann, Sr., was a comanager of Seawind, was designated the tax manager and

211. *Tzovolos*, 16 A.3d at 840.
212. *Id.*
213. *Id.* at 831.
214. *Id.*

was responsible for keeping the books. He also owned and controlled JR Inc. and JRC LLC. JRC LLC was formed in October of 2003, and although it is headed by Hartmann, Sr.'s wife, Hartmann, Sr., testified that the nominal involvement of his wife in the business venture was so that JRC LLC might qualify for "minority owned" business contracts. In addition to sharing the same core set of principal officers, the principal office of each of these LLCs was designated as the same address, in Milford, thus satisfying the fifth factor.[215]

The interplay of the numerous LLCs also demonstrates the satisfaction of the seventh and eighth factors. While the involvement of multiple LLCs controlled by Hartmann does not in and of itself establish grounds for the piercing of the corporate veil; the conduct in fact of the LLCs indicate a lack of separate identities. The evidence indicates that the individual LLCs were used interchangeably by Hartmann, Sr., as need arose and even Hartmann, Sr., failed to differentiate between the individual entities while conducting his business.[216]

The seventh factor, a lack of arm's-length dealing, is demonstrated by the billing for the Seawind renovation project, which was handled in a confusing and misleading manner. The exhibits offered at trial had numerous invoices that were identical except for the fact that one was issued by JR Inc. and another was issued by JRC LLC. There were no independent accounting controls between Seawind as the debtor, and JR Inc. or JRC LLC as the contractors. All of the entities were served by the same bookkeeper who also was a bookkeeper for Real Estate Plus, Inc. Furthermore, each of the entities was represented by a single law firm, Shepro, even when they had conflicting interests and when at least one, Seawind, was insolvent.[217]

The eighth factor is satisfied through evidence that the finances and obligations of JR Inc. and JRC LLC were constantly shifting between the two entities. Hartmann, Sr., used his position in Seawind, and a threat to withhold wages from Wiseman, as a means of securing a $100,000

215. *Tzovolos*, 16 A.3d at 831.
216. *Id.*
217. *Id.* at 840–41.

promissory note and a security interest from Seawind to another of his entities, JRC LLC. The consideration for the note was claimed to be the renovations performed at Selden Street. These same renovations, however, were later claimed to have been performed by another of his corporate entities, JR Inc., when JR Inc. asserted a mechanic's lien of $139,000 against Alpert, the landlord. Hartmann, Sr., has taken contradictory positions with regard to who did the work.[218]

Given the evidence, the court finds by clear and convincing evidence that Hartmann, Sr., and sons exercised dominion and control over JR Inc., JRC LLC, and Seawind. The facts of this case establish that Hartmanns' corporate entities are their mere alter ego and their own personal business conduit, thus satisfying the first element of the instrumentality test. The corporate entities owned and controlled by the Hartmanns lacked a separate mind, will or existence of their own.[219]

Turning next to the second element of the instrumentality test, the court finds that the control exerted by the Hartmanns was purposefully used to commit a "fraud or wrong, to perpetrate the violation of a statutory or other positive legal duty, or a dishonest or unjust act in contravention of [the] plaintiff's legal rights . . . ." The control exerted by Hartmann, Sr., over Seawind, JR Inc. and JRC LLC has been used to frustrate the efforts of the plaintiffs to obtain the kitchen equipment that secured their debt from Wiseman. For example, in April of 2004, the doors of Seawind's restaurant were closed for business, its kitchen equipment was being appraised for sale, plans were being made to remove custom furnishings in the restaurant, and Seawind was in default on its lease and its list of accounts payable exceeded its assets. At this time, and with full awareness of the above situation, Hartmann, Sr., signed a $1000 check from Seawind's checking account to one of his corporate entities. The evidence indicates that he exercised his control over Seawind to wrongfully give preference to other entities he controlled.[220]

Additionally, regarding the kitchen equipment, the court

218. *Tzovolos*, 16 A.3d at 840.
219. *Id.*
220. *Id*. (citations omitted).

has previously noted that Hartmann, Sr., and/or his attorney, Shepro, were aware of the perfected security interest held by the plaintiffs and the faulty foundation of JRC LLC's asserted interest in the kitchen equipment. At a time when he was aware of the filing of the instant action, Hartmann, Sr., ordered Shepro to do anything necessary to get back into Selden Street to remove "his" property. Hartmann, Sr., took steps to give a preference to the debts owed to his corporate entities as opposed to the secured interest of the plaintiffs or other creditors. These steps included his decision to remove kitchen equipment from the property knowing that it was subject to the plaintiffs' security interest, when given access by Alpert to remove only the items subject to a lien in his favor. The court finds that Hartmann, Sr. used his position of control to wrongfully contravene the rights of others to his own benefit. The conduct of Hartmann, Sr., therefore, is sufficient to satisfy the second element of the instrumentality rule.[221]

Finally, the third element, requiring that "the aforesaid control and breach of duty must proximately cause the injury or unjust loss complained of" is also satisfied in the present case. As a result of the actions of Hartmann, Sr., on behalf of his numerous corporate entities, the plaintiffs were injured in that the kitchen equipment that they had a security interest in was removed and the plaintiffs have been entangled in litigation involving numerous corporate entities controlled by Hartmann, Sr. He successfully exerted his control over the various corporate entities to the plaintiffs' detriment.[222]

With regard to the Hartmanns' corporate entities, the court finds by clear and convincing evidence that there is an absence of corporate formalities, overlapping ownership or managers, common office space, a lack of arm's-length transactions, and preferences exercised in favor of the dominate corporation or entities controlled exclusively by Hartmann, Sr., or his family members. Additionally, the facts indicate that the plaintiffs have shown that there was such a unity of interest and ownership that the independence of Seawind, JR Inc. and JRC LLC had in effect ceased. The adherence to the fiction of separate corporate identities

221. *Tzovolos*, 16 A.3d at 841–42.
222. *Id.* at 842.

> would serve only to defeat justice and equity. The court concludes that it is appropriate, and justice requires, that in this case the corporate entities Seawind, JR Inc. and JRC LLC be pierced and that the responsibility for their conduct be placed upon Hartmann, Sr., Hartmann, Jr., and Jason R. Hartmann.[223]

The court in *Tzovolos* also cited as a factor showing that there was a lack of separateness among the defendant LLCs was that "each of the entities was represented by a single law firm, [Sherpo & Blake, LLC], even when they had conflicting interests and when at least one, Seawind, was insolvent."[224] In addition to approving alter ego liability for Hartmann, Sr., Jason R. Hartmann, and Hartmann, Jr., the court awarded common-law punitive damages against them on the ground that they had "acted dishonestly and with intentional disregard to the rights of the plaintiffs."[225] Despite the laundry list of factors discussed by the court, *Tzovolos* appears to be a case of "preventing fraud or something like it."[226]

A Federal District Court in Georgia gave an interesting take on separateness. In *Instituform Technologies, LLC v. Cosmic TopHat, LLC*,[227] the court responded to plaintiff's argument that the member failed to treat the LLC as separate from the member by noting that the plaintiff's evidence may have shown that the member failed to keep the LLC separate from another entity owned by the member but did not show that he failed to keep the LLC separate from himself. In this case, plaintiff owned several patents relating to a process for repairing sewage pipelines. One of the defendants was Cosmic-Sondermaschinenbram, GmbH ("Cosmic Austria"), an Austrian corporation owned by an individual defendant, Johann Kübel, who was also the president of Cosmic Austria. Kübel also owned and controlled another defendant, Cosmic TopHat, LLC ("Cosmic TopHat"), a California LLC. Plaintiff alleged that a competing product formerly manufactured by Cosmic Austria infringed plaintiff's patents. The court first noted that although all of the claims in the case were patent law claims, the veil-piercing issue was governed by Georgia law.[228] It then

223. *Tzovolos*, 16 A.3d at 842.

224. *Id.* at 841.

225. *Id.* at 846.

226. Macey & Mitts, *supra* note 11, at 109.

227. Instituform Tech., LLC v. Cosmic TopHat, LLC, 959 F. Supp. 2d 1335 (N.D. Ga. 2013). Also discussed *infra*, notes 304-10 and accompanying text (undercapitalization must be coupled with intent to avoid debts), notes 499-501 and accompanying text (causation), and notes 620-22 and accompanying text (reverse veil piercing).

228. *Insituform Tech., LL*C, 959 F. Supp. 2d at 1344.

observed that plaintiff "wants to pierce the veil in both directions. That is, it wants to hold Kübel liable for Cosmic Top Hat's infringement (traditional piercing), and it wants to hold Cosmic Top Hat liable for Kübel's infringement (reverse piercing)."[229] But, the court noted, the Georgia Supreme Court had rejected outsider reverse piercing.[230]

As to the plaintiff's arguments for piercing the veil of Cosmic Top Hat to impose personal liability on Kübel, the court noted that Georgia law provided that "[t]he failure of a limited liability company to observe formalities relating to the exercise of its powers or the management of its business and affairs is not a ground for imposing personal liability on a member, manager, agent, or employee of the limited liability company for liabilities of the limited liability company."[231] The court then stated:

> Next, Insituform argues that alter-ego liability is appropriate because Kübel failed to treat Cosmic TopHat as a separate entity from himself. In support of this argument, Insituform relies on evidence that (1) customers paid Cosmic-Austria directly for products distributed by Cosmic TopHat; (2) Cosmic TopHat paid the duty tax for Cosmic-Austria's sales into the United States; and (3) Kübel controlled the cash flow between the entities and ensured that Cosmic TopHat had only enough cash to pay its expenses. But while these facts may show that Kübel failed to keep the Cosmic entities separate from each other, they do not show that he failed to keep Cosmic TopHat separate from himself.[232]

The court in *Cosmic TopHat* appears to be saying that there was no evidence that what lack of separateness the plaintiff showed had contributed to the harm suffered by plaintiff.

In *McWilliams Ballard, Inc. v. Level 2 Development*,[233] plaintiff McWilliams Ballard, Inc. loaned $100,000 to Level 2 Development, a District of Columbia limited liability company, to assist in the purchase and development of real property in the District of Columbia.[234] Another LLC

229. *Insituform Tech., LL*C, 959 F. Supp. 2d at 1344.
230. *Id.* (citing Acree v. McMahan, 585 S.E.2d 873, 874 (Ga. 2003)).
231. *Id.* at 1344.
232. *Id.* (citing Bonner v. Brunson, 585 S.E.2d 917, 918 (Ga. App. 2003) ("[E]vidence of overpayment to [the defendant's] corporation would not be evidence that [the defendant], individually, confused his personal affairs with the LLC.") and Global Diagnostic Dev., LLC v. Diagnostic Imaging of Atlanta, 643 S.E.2d 338, 341 (Ga. App. 2007) ("[S]ole ownership of a corporation by one person is not a factor, nor is the fact that the sole owner uses and controls it to promote his ends.")).
233. McWilliams Ballard, Inc. v. Level 2 Dev., 697 F. Supp. 2d 101 (D.D.C. 2010).
234. *Id.* at 104.

involved was L2CP, a Delaware limited liability company doing business in the District of Columbia with the same address as Level 2 Development. Jeffery Blum and David Franco were "managers, members, directors, or officers of Level 2 and L2CP."[235] L2CP purchased the property, presumably with the money plaintiff lent to Level 2 Development.[236] No payments were ever made on the loan. Plaintiff sued, alleging that the two LLC defendants and the two individual defendants were alter egos of each other. The court denied defendants' motion to dismiss, stating:[237]

> [P]laintiff has sufficiently alleged facts allowing a plausible inference that there is unity of ownership and interest between Level 2, L2CP, and the individual defendants. In particular, plaintiff alleges that "[t]he acquisition of the Property and development of the [View 14] Project were the personal investments and business ventures" of the individual defendants and that the individual defendants formed L2CP to "create a layer of a limited liability company" between them and defendant Level 2 and between defendant Level 2 and the View 14 Project without establishing any separate business structure, following business formalities, or maintaining separate business records. Plaintiff also alleges that neither Level 2 nor L2CP was a separate business with its own separate decision-making process and personnel allowing them to deviate from the wishes of the individual defendants. At this stage, these claims are sufficient to plead the unity of ownership and interest element of this cause of action.
>
> Second, the complaint sufficiently demonstrates that considerations of equity and justice justify maintaining the claim against the moving defendants at this stage. For instance, plaintiff alleges that the defendants represented that the loan was "absolutely necessary" to effectuate the purchase, development, and improvement of the View 14 Property. Thus, as plaintiff argues, the project could not have moved forward without the loan and should Level 2 be found liable for the money allegedly owed plaintiff, considerations of justice and equity may require piercing the corporate veil in order to ensure that the loan is repaid.

235. *McWilliams Ballard, Inc.*, 697 F. Supp. 2d at 104.
236. *Id.*
237. *Id.* at 106.

Federal Trade Commission v. Bronson Partners, LLC[238] involved a false advertising enforcement action brought against Bronson Partners, LLC, a Texas LLC and Martin Howard. The Commissioner later sought to add Sandra Howard, Martin's wife, and H & H Marketing, LLC, a Texas LLC ("H & H") owned in equal shares by Martin and Sandra Howard. In explaining its determination that H & H was the alter ego of Howard Martin, the court stated:

> The record reflects that H & H was formed on the advice of the Howards' accountant in order to pay the Howards' personal expenses. This is consistent with Sandra Howard's testimony at the hearing that H & H was formed to pay the personal expenses of the Howards. H & H paid the Howards' mortgage, medical expenses, household expenses and Sandra Howard testified that she could take extra money out of H & H as needed. In his deposition, Martin Howard, provided further support for the finding that the Howards' monies were indistinguishable from H & H's monies. He testified that H & H received $787,940 from Bronson during the 2003 and 2004 tax years. Those monies were evenly split between Martin and Sandra Howard and were used for mortgage payments, real estate taxes, income taxes, household expenses, medical expenses, retirement savings, and to pay off a mortgage. The Howards used the H & H bank accounts to pay those personal expenses. The total dealings of H & H and the Martin Howard are inextricably intertwined. The Howards were the only employees of H & H and H & H's location was wherever the Howards happened to be. Other than the filing of formation papers, Martin Howard did little to operate H & H as a company. The evidence at the hearing showed that H & H ignored the corporate form and did not hold membership meetings. Additionally, Sandra Howard acknowledged that it did not matter if the money came from Bronson or H & H, the money belonged to the Howards, not H & H. Overwhelming evidence shows that Martin Howard maintained full control over H & H. Accordingly, I find that H & H is an alter ego of Martin Howard and grant the Commission's motion to name H & H a full defendant in light of the evidence at trial

238. Federal Trade Commission v. Bronson Partners, LLC, 674 F. Supp. 2d 373 (D. Conn. 2009).

> because I find that H & H is an alter ego of Martin Howard, I do not need to decide if H & H is engaged in a common enterprise with Bronson.[239]

The final outcome of this case was that Bronson Partners, LLC, H & H, and Martin Howard were held jointly and severally liable to pay $1,942,325 in restitution.[240]

Harris v. Kupersmith[241] held the individual owner of an LLC and a corporation personally liable to the plaintiff for plaintiff's unpaid salary from the LLC on the basis that the entities were the alter ego of the owner and for damages to the plaintiff for defamation on the basis that the defamation was tortious conduct in which the owner directly participated. With respect to the alter ego claim, the court stated:

> [T]he plaintiff's . . . allegations state that Kupersmith used the assets of the companies for his own personal use and exercised complete control over the companies with respect to all aspects of the business. Thus, when reading these allegations in the light most favorable to the nonmovant, the allegations are sufficient to show that the lack of formalities, use of employees for personal business and use of the LLC's assets for personal matters, evidence such a unity of interest and ownership that the independence of the LLCs, if it indeed ever existed, ceased to exist. Thus, the court finds that the plaintiff has alleged sufficient facts to pierce the corporate veil and hold Kupersmith liable for the acts and omission of the defendant companies.[242]

239. *Federal Trade Commission*, 674 F. Supp. 2d at 391.

240. *Id.* at 394. Macey and Mitts would classify *Bronson Partners* as a case in which the result was appropriate to support a statutory scheme. Macey & Mitts, *supra* note 11. Moreover, *Bronson Partners* appears to be an example of recordkeeping so poor that "where the failure to keep records is so profound that one cannot utilize such records to determine which assets legitimately belong to the corporation and which legitimately belong to its shareholders, then piercing is appropriate to prevent the unfair and strategic abuse of creditors by unilaterally categorizing assets as belonging to the shareholder (and thus unavailable to creditors) when there is no legitimate basis for doing so." Macey & Mitts, *supra* note 11 at 109.

241. Harris v. Kupersmith, No. FSTCV086000995S, 2009 WL 3286108 (Conn. Super. Aug. 31, 2009).

242. *Id.* at *8. *Harris v. Kupersmith* appears to be another case that Macey and Mitts would classify either as one in which a creditor needed protection from the acts of the entity's owners or one that was correctly decided as necessary to carry out the goals of a regulatory scheme. Macey & Mitts, *supra* note 11, at 102. Whether or not there is an applicable statute, society certainly has an interest is seeing that legitimate salary and wage claims are paid. For another instance where a court approved piercing the veil in a case involving unpaid wages, see Allison v. Danilovic, 2004 WL 2797988 (Cal. App. 2 Dist. Dec. 7, 2004), *infra* note 364.

Bastan v. RJM & Associates, LLC[243] suggests that total disregard of formalities may indicate a lack of separateness between an LLC and its owner. The plaintiff alleged that "the [individual defendant] is the controlling member of the LLC, that he treated LLC funds as his own by paying virtually all of his personal expenses from the account of the LLC, thus draining the LLC's assets such that they are insufficient to meet its obligations, that by his conduct [he] 'caused the independence of said LLC to cease,' and that adherence to the fiction of separate identity would defeat the interests of justice."[244] The court first gave short shrift to the LLC's owner's argument that because the Connecticut statutory scheme allowed single-member LLCs that were member-managed, and the member necessarily had to act for the LLC, there could be no veil piercing of a member-managed LLC.[245] The court then discussed the circumstances under which it is appropriate to pierce the veil of a corporation and stated that "a person who ignores the intended separation between the individual and the company ought to be no better off than the sole shareholder who ignores corporate obligations."[246]

F. COMMINGLING OF FUNDS

GreenHunter Energy, Inc. v. Western Ecosystems Technology, Inc.[247] affords a constructive look at commingling, improper payments, and under capitalization as well as domination. GreenHunter Energy, Inc. ("GreenHunter") was the sole member of GreenHunter Wind Energy, LLC, a Wyoming limited liability company (the "LLC"). The LLC and Western Ecosystems Technology, Inc. ("Western") entered into a contract pursuant to which Western agreed to provide consulting services to the LLC related to the potential development of a wind turbine farm in Platte County, Wyoming. The evidence at trial showed that the LLC did not have employees of its own, that employees of GreenHunter performed all bookkeeping and financial management for the LLC, the LLC consistently carried an operating capital balance that was insufficient to cover its debts, and that GreenHunter decided when and how much money to advance to the LLC to allow it to pay its accounts payable. "Therefore, [GreenHunter], as the sole source of operating funds for the LLC, decided which of its

243. Bastan v. RJM & Associates, LLC, No. CV99 0593189 S, 2001 WL 1006661 (Conn. Super. June 4, 2001). This case also appears to be one that Macey and Mitts would describe as correctly decided to protect creditors. Macey & Mitts, *supra* note 11, at 123.

244. *Bastan*, 2001 WL 1006661, at *1.

245. *Id.*

246. *Id.* at *2.

247. GreenHunter Energy, Inc. v. W. Ecosystems Tech., Inc., 337 P.3d 454 (Wyo. 2014).

creditors would be paid. Although [GreenHunter] advanced funds to permit the LLC to pay some creditors, it did not transfer any funds to allow the LLC to pay Western."[248]

The court in *GreenHunter* affirmed the district court's finding in favor of Western and its holding that the LLC's veil should be pierced. In discussing inadequate capitalization as applicable to limited liability companies, the *GreenHunter* court states that "it is important to note, however, that undercapitalization alone will not suffice to pierce the veil . . . . If the LLC is undercapitalized, or its members have never attempted to make arrangements to secure sufficient capital, these facts may be evidence that the company was used to screen members from legitimate debt."[249]

The *Greenhunter* court's observations on undercapitalization are consistent with Macey and Mitts view that the second of the real justifications for veil piercing is to protect creditors against owner misrepresentations.[250] Indeed, one of the defendant's arguments was that the plaintiff should have protected itself by seeking a guarantee or a retainer; the court responded to this argument as follows:

> It makes good business sense for a contract creditor to try to obtain a guarantee from the member or retainer from the limited liability company itself. But we are mindful of the reality of the marketplace that many businesses are not in a position — competitively or economically — to insist on guarantees. For that reason, we decline Appellant's invitation to find piercing inappropriate in this case because Western did not protect itself from Appellant's misuse of the LLC by attempting to obtain a guarantee or other form of security. To do so would invite abuse of entities, as is the case here.[251]

With respect to intermingling, the court stated that:

> Funds and assets should be separated and not commingled. Failure to maintain an arm's-length relationship between the member and company, as by not keeping separate bank accounts and bookkeeping records, may be weighed along with other factors. If the member treats limited liability company property as if it were that person's or company's

248. *GreenHunter Energy, Inc.*, 337 P.3d at 458.
249. *Id.* at 463.
250. Macey & Mitts, *supra* note 11, at 102.
251. *GreenHunter Energy, Inc.*, 337 P.3d at 469.

> personal property, a court should consider also this fact. Manipulation of assets and liabilities between the member and company so as to concentrate the assets in the former and the liabilities in the latter can be suggestive of improper use of the LLC as well.[252]

In *GreenHunter*, the court determined that undercapitalization and commingling were both present because the LLC often had a zero balance in its bank account, and the sole member of the LLC transferred money to it from time to time to pay bills selected by the member.[253] In the end, the *GreenHunter* court approved the trial court's finding that "Appellant misused the LLC in order to improperly manipulate the situation to avoid paying for services which benefitted it, that it failed to maintain adequate separation, and that to allow it to do so would be unjust and inequitable."[254] Accordingly, Macey and Mitts[255] would say that *GreenHunter* reached the right result because Western needed to be protected from the actions of the owner of the LLC.

A bankruptcy court in New York also stated that the veil of an LLC should only rarely be pierced because of undercapitalization:

> As an initial matter, undercapitalization is rarely sufficient to pierce the corporate veil, because otherwise "the veil of every insolvent subsidiary or failed start-up corporation could be pierced." The inquiry "is most relevant for the inference it provides into whether the corporation was established to defraud its creditors or other improper purpose such as avoiding the risks known to be attendant to a type of business." When determining whether a subsidiary was adequately capitalized, courts focus on the initial capitalization: "whether a corporate entity was or was not set up for financial failure."[256]

In *Polaris Industrial Corporation v. Kaplan*,[257] the Nevada Supreme

252. *GreenHunter Energy, Inc.*, 337 P.3d at 464 (citations omitted).
253. *Id.* at 465–67.
254. *Id.* at 470.
255. Macey & Mitts, *supra* note 11, at 110. This Article discusses GreenHunter further, including an amendment to Wyoming's veil piercing statute prompted, in part, by GreenHunder, at *infra*, notes 404-08 and accompanying text.
256. *In re* BH S&B Holdings LLC, 420 B.R. 112, 136 (Bankr. S.D.N.Y. 2009) (citing *In re* RSL COM PRIMECALL, Inc., No. 01-11457, 2003 WL 22989669, at *16 (Bankr. S.D.N.Y. Dec. 11, 2003); Trevino v. Merscorp, Inc., 583 F. Supp. 2d 521, 530 (D. Del. 2008); George Hyman Constr. Co. v. Gateman, 16 F. Supp. 2d, 129, 152–53 (D. Mass. 1998).
257. Polaris Indus. Corp. v. Kaplan, 747 P.2d 884, 887 (Nev. 1987).

Court stated that the failure by a corporation to issue stock or to keep proper minutes would not support a veil-piercing claim when there was no evidence that the plaintiff had been harmed by these failures.[258] Following its discussion of formalities, however, the court went on to note:

> We are, however, troubled by the district court's conclusion in light of its findings that Davis and Kaplan cashed numerous unnumbered counter checks for their personal benefit and that these withdrawals further thinned the capitalization of CRI which, according to another finding, had little real assets and a negative net worth.[259]
>
> On July 20, 1979, the same day that Polaris served Kaplan and Davis with its complaint, Kaplan withdrew $12,500.00 by unnumbered counter check. A notation on the check charged the withdrawal to Account 140, revealed at a trial to be "Employee Advances." From August 1979 to October 1979, Kaplan and Davis made numerous payments to themselves, Jerome Kaplan and McKenzie Davis. CRI's bookkeeper was not apprised of the withdrawals by unnumbered checks. Kaplan admitted Davis took funds from the corporation to support his gambling habit. He, himself, claimed to have made temporary withdrawals to protect corporate funds from Davis. However, the district court found the funds were taken for the personal use of both officers. This finding is supported by notations on the checks charging them to "employee advances." R. Craig Bird, an auditor retained by Polaris, opined that CRI would have had the funds to pay its debt if the withdrawals had not further thinned the capitalization of the corporation. He also stated that CRI had few real assets because the accounts receivables carried on its books were uncollectable. The district court was entitled to accept his opinion. Our review of the record shows the district court's findings concerning the unnumbered counter checks and their effect on the corporation are supported by substantial evidence. They will, therefore, not be disturbed on appeal.[260]
>
> *In light of the findings, it becomes clear that CRI's officers treated corporate funds as their own by making ad*

258. *Polaris Indus. Corp.*, 747 P.2d at 887. *See also infra* notes 542-46 and accompanying text.
259. *Polaris Indus. Corp.*, 747 P.2d at 887.
260. *Id.* at 887–88.

> *hoc withdrawals at the bank in the form of advances to themselves at a time when the corporation's debt to Polaris was not being paid, and that Polaris was damaged because these actions left the corporation without funds to repay the debt*. The essence of the alter ego doctrine is to do justice. We are compelled to recognize that the district court clearly reached a wrong conclusion in determining that Michael Kaplan had not been shown to be the alter ego of NMS and CRI.[261]
>
> Accordingly, we affirm the judgment of the district court as to Jerome Kaplan, and reverse the judgment as to Michael Kaplan.[262]

Polaris, thus, as to its holding with regard to Kaplan's use of counter checks to pay personal expenses and his failure to inform the bookkeeper of his withdrawals, demonstrates another instance in which a court felt it necessary to protect a third party creditor from "fraud or something like it."[263]

The Wyoming Supreme Court upheld veil piercing in a case where it found inadequate capitalization and disregard of formalities."[264] In this case, C & B Plumbing and Heating, Inc. ("C & B") owed Amfac Mechanical Supply Company ("Amfac") $11,000. Amfac sued Carl and Beverly Federer, the sole shareholders of C & B, to collect the debt of C & B from them. Although the *Amfac* court found that there was inadequate capitalization and disregard of formalities, the crucial facts supporting the court's determination that veil piercing was appropriate in this case were that Carl Federer sometimes billed for plumbing work in his personal name and sometimes billed in the name of C & B. Further, payments for plumbing work sometimes were deposited directly into the Federers' personal bank account.[265] In addition, the Federers placed themselves in a preferred position by taking $1,000 per month out of C & B to repay themselves for a loan they had made to the corporation but did not pay anything to Amfac.[266]

Amfac was followed in *Miles v. CEC Homes, Inc.*[267] In that case, the court affirmed the district court's piercing of the veil of Meadowbrook

261. *Polaris Indus. Corp.*, 747 P.2d at 888 (emphasis added).
262. *Id.*
263. Macey & Mitts, *supra* note 11, at 101.
264. Amfac Mech. Supply Co. v. Federer, 645 P.2d 73 (Wyo. 1982).
265. *Id.* at 78.
266. *Id.* at 80–81.
267. Miles v. CEC Homes, Inc., 753 P.2d 1021, 1024 (Wyo. 1988).

Development, Inc. ("Meadowbrook") and holding its majority shareholder, Maurice Miles, liable for an unpaid obligation of Meadowbrook. Factors that the court emphasized were that Miles moved funds into and out of the Meadowbrook accounts at his whim without any documentation, that Meadowbrook constructed buildings for Miles without being reimbursed for its expenses, and that there was unauthorized diversion of assets of Meadowbrook for personal purposes.[268] These actions by Miles left Meadowbrook without funds to pay its obligations.

In *Vanderford Company, Inc. v. Knudson*,[269] the Idaho Supreme Court returned the case to the trial court with instructions to consider the plaintiff's claim that an LLC was the alter ego of the managing member where the evidence showed that the managing member paid himself, as manager, to manage his personal properties, and he "and his accountant testified that the LLC's checking account was so confusing that the accountant could not be sure whose money was in the account at what times."[270]

Amfac, *Miles*, and *Vanderford Company* all involved significant commingling of funds and use of entity funds for personal purposes. Accordingly, these three cases appear to be classifiable as instances in which veil piercing was appropriate to protect creditors against misrepresentations by owners.[271]

In 2012, the Colorado Court of Appeals rendered an improvident veil-piercing decision in *Martin v. Freeman.*[272] Dean C.B. Freeman was the sole member and manager of Tradewinds Group, LLC, a single-member Delaware LLC.[273] Tradewinds contracted with Robert C. Martin to construct an airplane hangar and, in 2006, sued Martin for breaching the construction agreement. In 2007, while the litigation was still pending, Tradewinds sold its only asset — an airplane — for $300,000. The proceeds were distributed to Freeman as the single member (in a manner that the trial court had found proper under § 7-80-606 of the Colorado LLC

268. *Miles*, 753 P.2d at 1024.

269. Vanderford Co., Inc. v. Knudson, 165 P.3d 261 (Idaho 2007).

270. *Vanderford Co.*, 165 P.3d at 271.

271. Macey & Mitts, *supra* note 11, at 123. Macey and Mitts that "where the failure to keep records is so profound that one cannot utilize such records to determine which assets legitimately belong to the corporation and which legitimately belong to its shareholders, then piercing is appropriate to prevent the unfair and strategic abuse of creditors by unilaterally categorizing assets as belonging to the shareholder (and thus unavailable to creditors) when there is no legitimate basis for doing so." Macey & Mitts, *supra* note 11, at 109.

272. Martin v. Freeman, 272 P.3d 1182 (Colo. App. 2012).

273. *Id.* at 1185. The Court of Appeals did not address the fact that Tradewinds Group, LLC was a Delaware LLC in applying C.R.S. § 7-80-606 or in applying Colorado veil piercing case law.

Act[274]), and Freeman paid for the ongoing litigation against Martin. Judgment in the litigation was initially entered in favor of Tradewinds (2008), but then reversed (2009) and on remand judgment in the amount of $36,645.40 in costs was entered for Martin. At the time of the judgment, Tradewinds had no remaining assets. Martin then brought suit against Freeman seeking to pierce the LLC veil of Tradewinds, and in 2010 the trial court found Freeman to be personally liable.

The Colorado Court of Appeals affirmed the trial court's finding that Freeman should be held liable for the debts of Tradewinds on the grounds that: (i) Tradewinds was the *alter ego* of Freeman; (ii) the limited liability form was used to perpetrate a fraud or defeat a rightful claim; and (iii) an equitable result would be achieved by disregarding the limited liability form of Tradewinds.[275]

The Court of Appeals did not apply a fraudulent transfer analysis under the Colorado Uniform Fraudulent Transfers Act in *Martin v. Freeman* as the court had done in an earlier case,[276] but assumed that the transfer by the LLC to Freeman's individual account was fraudulent.

The Court of Appeal's real justification for *alter ego* determination would appear to be the commingling of assets described in footnote 275.

274. *Id.* at 1189; *see generally* COLO. REV. STAT. § 7-80-606 (2015). Note that the trial court initially, and the Colorado Court of Appeals subsequently, ignored the fact that Tradewinds was a Delaware limited liability company, not a Colorado LLC. Both courts applied Colorado law to conclude that the distribution was improper. *Id.* at 1189.

275. *Martin*, 272 P.3d at 1185. In reaching the conclusion that Tradewinds was the *alter ego* of Freeman, the trial court made six findings. Four of the trial court's findings should be inapplicable or of little weight in piercing the veil of an LLC — poor record keeping, the same person was the sole member and manager, thin capitalization, and undocumented infusions of cash were used to pay Tradewinds' operating expenses. The Colorado LLC Act (applied by the trial court and the Court of Appeals) specifically provides in Colorado Revised Statutes section 7-80-107(2) that the failure of an LLC to observe the formalities or requirements relating to the management of its business and affairs is not in itself a ground for imposing personal liability for the debts of the LLC on its members. Veil piercing for inadequate capitalization should be less likely for LLCs than corporations, in part because of the anticipated informalities. 2 ROBERT R. KEATINGE, LARRY E. RIBSTEIN, RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES § 12.3 (2d ed. 2010); *see also* 1 WILLIAM M. FLETCHER, FLETCHER'S CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 41.35 (suggesting that a sole shareholder should not be suspect "merely because he or she conducts business in an informal manner").

276. *See, e.g.*, CB Richard Ellis, Inc. v. CLGP, LLC, 251 P.3d 523 (Colo. App. 2010). There, the LLC was in litigation with CBRE over a real estate commission. The LLC distributed the proceeds of a property sale to the members, but the members delivered two promissory notes to the LLC to reflect the likely costs of the litigation and an estimate of a potentially unfavorable outcome. The litigation was significantly more expensive than expected and the LLC had no further funds. In an effort to recover damages following a favorable judgment, CBRE sued the two members under a fraudulent transfer theory which, like the Colorado law on LLC distributions, contemplated insolvency as a precursor to liability. Because the two LLC members had contributed promissory notes equal to a reasonable estimate of litigation expenses and damages at the time they took the distribution from the LLC, the members were found not to be liable to CBRE even though, when the litigation was concluded, there were insufficient assets remaining in the LLC to pay the resulting damages.

Commingling assets is a bad business practice and, more often than not, will result in a judicial determination that the entity is an *alter ego* of the defendant.[277]

Alter ego is only the first step. The second step is whether the LLC form was used to perpetrate a fraud or defeat a rightful claim. The majority noted that the transfer of the assets occurred during the litigation, but years before Martin's claim was liquidated. The majority stated that "[a]ny party engaged in litigation is exposed to potential liability" regardless of the nature of the litigation. (It could be just as easily stated that any person driving a car is exposed to potential liability.) Based on this statement, the majority supported the trial court's determination that the transfer of assets was "sufficient to support piercing the corporate [*sic*] veil," and that (as a matter of "first impression") "wrongful intent or bad faith need not be shown to pierce the LLC veil."[278]

It is difficult to see how *Martin v. Freeman* would fit into one of the categories of appropriate veil-piercing articulated by Macey and Mitts.[279] There is no indication that the plaintiff was misled by any action of the defendant. There is no statutory or regulatory scheme involved, and it is not a bankruptcy case. *Martin v. Freeman*, therefore, must be included in what thankfully are a handful of results-driven cases that seem to hold that undercapitalization may be found if the entity lacks assets to satisfy any liability arising at any time.[280]

G. INADEQUATE CAPITALIZATION

Macey and Mitts state that they had found "no piercing cases in which a court pierced the corporate veil *solely* because a corporation is undercapitalized."[281] In their analysis of corporate veil-piercing cases, Macey and Mitts[282] argue that inadequate capitalization *per se* should not

277. *See, e.g.*, *GreenHunter Energy, Inc*., 337 P.3d at 454; *Amfac Mechanical Supply Co. v. Federer*, 645 P.2d 73 (Wyo. 1982); *Miles v. CEC Homes, Inc*., 753 P.2d 1021, 1024 (Wyo. 1988); *Sheffield Services Co*., 211 P.3d at 714; *McCallum Family LLC v. Winger*, 221 P.3d 69 (Colo. App. 2009); *Polaris Indus. Corp. v. Kaplan*, 747 P.2d 884 (Nev. 1987).

278. *Martin*, 272 P.3d at 1186. The dissent noted that the trial court had found that, at the time of distribution, "Freeman actually and reasonably believed" that Tradewinds "had more than sufficient value to cover any reasonably possible obligation on the horizon for the corporate [*sic*] entity," and that the "distribution was lawful under section 7-80-606." *Id.* at 1189. The application of the *CB Richard Ellis* analysis under CUFTA requires a finding of fraudulent intent and is more appropriate in situations such as *Martin v. Freeman*. If the distribution was made when the liabilities were covered, where is the fraud or wrongful conduct just because a new liability later surfaces?

279. *See supra* notes 17-23 and accompanying text.

280. *See* the discussion *infra* notes 312–29 of *Axtmann v. Chillemi*, 746 N.W.2d 838 (N. D. 2007) and other similar cases.

281. Macey & Mitts, *supra* note 11, at 103 (emphasis added).

282. *Id.* at 126.

be a veil-piercing factor. They discuss how undercapitalization as a factor is inconsistent with several other policies and state:

> [C]urrent accounts of the rationales for disregarding the corporate form, particularly accounts that consider undercapitalization as a grounds for veil piercing fail to reconcile the basic tension between the well-settled doctrine that corporations can be established for the very purpose of avoiding personal liability, and the doctrine that the veil can be pierced to avoid injustice. Under our account, corporations can be established for the sole purpose of avoiding personal or corporate liability on the part of investors, but not when doing so is inconsistent with the goals of another regulatory or statutory scheme; when there is evidence of fraud or misrepresentation by companies or individuals trying to obtain credit; or when respecting the corporate form facilitates or enables favoritism among claimants to the cash flows of a firm.[283]

In connection with their analysis of undercapitalization as a factor, Macey and Mitts discuss *Browning-Ferris Industries of Illinois, Inc. v. Ter Maat*.[284] In *Browning-Ferris*, the plaintiffs sued two corporations in a contribution action for cleanup costs resulting from the defendants improperly abandoning a landfill and also sued Richard Ter Maat, the president and principal shareholder of the two corporations. The Seventh Circuit remanded the case because the district court had failed to consider the individual's potential liability under the environmental laws. The Seventh Circuit noted that, as the plaintiffs were involuntary creditors, there was no issue of reliance on misrepresentations by the defendant.[285] The court also rejected the plaintiff's argument that the defendant corporations' veil should be pierced because of undercapitalization, stating: "[t]he cases in which undercapitalization has figured in the decision to pierce the corporate veil are ones in which the corporation had so little money that it could not and did not actually operate its nominal business on its own."[286]

Macey and Mitts discuss *Minton v. Cavaney*[287] and describe it as "a

283. Macey & Mitts, *supra* note 11, at 153.

284. Browning-Ferris Indus. of Ill., Inc. v. Ter Maat, 195 F.3d 953 (7th Cir. 1999); *see* Macey & Mitts, *supra* note 11, at 117–18.

285. *Ter Maat*, 195 F.3d at 960.

286. *Id.* at 961.

287. Minton v. Cavaney, 364 P.2d 473 (Cal. 1961).

leading case often mistakenly cited for the proposition that undercapitalization alone is sufficient to pierce the veil."[288] The plaintiffs in that case had obtained a judgment against the Seminole Hot Springs Corporation ("Seminole") for their daughter's wrongful death by drowning in a public swimming pool operated by the corporation. The plaintiffs then sought to hold William M. Cavaney ("Cavaney"), the sole director and the secretary and treasurer of the corporation, personally liable for the judgment. Macey and Mitts state that "in imposing liability on Cavaney personally, the California Supreme Court emphasized Seminole's insufficient capitalization" and quoted from the court's opinion:

> The equitable owners of a corporation . . . are personally liable when they . . . provide inadequate capitalization and actively participate in the conduct of corporate affairs. In the instant case the evidence is undisputed that there was no attempt to provide adequate capitalization. Seminole never had any substantial assets. It leased the pool that it operated, and the lease was forfeited for failure to pay the rent. Its capital was "trifling compared with the business to be done and the risks of loss."[289]

Macey and Mitts then analyze the court's holding as follows:

> Despite the *Minton* court's rhetorical emphasis on undercapitalization, this was not the only deficiency in Seminole's conduct as a corporation. Specifically, the court emphasized that "section 800 of the Corporations Code provides that '* * * the business and affairs of every corporation shall be controlled by, a board of not less than three directors.' . . . A person may not in this manner divorce the responsibilities of a director from the statutory duties and powers of that office."[290]
>
> Seminole's failure to comply with an express statutory mandate provides a much more compelling basis to disregard the corporate form because it suggests *inadequate oversight* of the corporation. Inadequate oversight (i.e., by a board of directors that is smaller than the statutory minimum) can increase the probability that the corporation

288. Macey & Mitts, *supra* note 11, at 127–28.
289. *Minton*, 364 P.2d at 475 (internal citations omitted).
290. Macey & Mitts, *supra* note 11, at 128.

> will act in a socially harmful manner. Were Seminole to have been subject to a larger board of directors and conducted its affairs in accordance with the statutory requirements, perhaps it would have taken greater care in preventing drowning in the swimming pool, i.e., by posting a lifeguard. The *Minton* court's emphasis on failure to observe formalities should be understood as reflecting a refusal to uphold limited liability when the corporation is operated in a manner that is significantly likely to impose harm on others and thereby render them involuntary tort creditors of the firm.[291]

Whether the view that a single director is more likely to cause a corporation to engage in socially undesirable activity is correct appears open to question. Certainly, if the organizer of a corporation added two cronies to the board just to have the statutory minimum, it is unlikely that the two cronies would make much difference. On the other hand, a single director, if conscientious, may certainly keep the corporation on the proper path. Instead of placing hope in statutory requirements for a minimum number of directors, law makers would be better served by reviewing what industries are required to have liability insurance and in what amounts. Meanwhile, bad actors, whether solo or in an ensemble, may be policed by the courts.

For a different take on the legal effect of a corporation acting without the minimum number of directors, see *White v. Thatcher Financial Group*.[292] In White, the court held that action taken by a corporation's board of directors at a time when there were only two directors instead of the then statutory mandated minimum of three was binding on the corporation because all actions were approved by the two serving directors, who constituted a quorum of the statutory minimum of three.[293]

Milk v. Total Pay and HR Solutions, Inc.[294] offers useful guidance on inadequate capitalization. In that case, Total Pay and HR Solutions, Inc. ("Total Pay") sought to hold Joseph Milk personally liable for amounts due under a under a payroll services contract with Burrito Joe's Holdings, LLC ("Burrito Joe's). Milk was the sole member and the manager of Burrito Joe's. The court stated that for undercapitalization to justify piercing the veil, "*it must be coupled with evidence of an intent at the time of*

291. Macey & Mitts, *supra* note 11, at 128.
292. White v. Thatcher Fin. Group, Inc., 940 P.2d 1034 (Colo. App. 1996).
293. *Id.* at 1037–38.
294. Milk v. Total Pay and HR Solutions, Inc., 634 S.E.2d 208 (Ga. App. 2006).

capitalization to improperly avoid future debts of the [LLC]."[295] The court further stated:

> There is a lack of evidence of such intent in the present case. While Total Pay contends that a $20,000 check written out to cash conclusively shows that Milk withdrew "working capital for personal use so that the business would not have sufficient funds to pay creditors," there is no evidence in the record whatsoever that the withdrawn money was used for such a purpose. In fact, the check is dated April 30, 2003, before the debt to Total Pay was even incurred, the memo portion of the check denotes "equipment," and the amount withdrawn matches the amount McGhee testified was spent on equipment for the restaurant.[296]
>
> In a further effort to show that funds were purposefully and wrongfully diverted from Burrito Joe's to avoid paying the payroll services debt, Total Pay relies upon a one-page correspondence from McGhee to Milk in which McGhee suggested that the restaurant's limited funds be used to pay the current payroll of the restaurant's employees rather than to pay off past debt owed to Total Pay. However, as previously noted, veil-piercing based on undercapitalization requires an improper "intent at the time of the capitalization to improperly avoid future debts." [5] Moreover, there is no evidence showing that these payments to employees were anything other than legitimate business expenses, or that the payments were even made. Accordingly, Total Pay has failed to show that it was entitled to pierce the veil of the separately maintained Burrito Joe's in order to impose personal liability upon Milk.[297]

The court's footnote 5 in the above quote states: "For the same reason, Total Pay cannot rely upon McGhee's deposition testimony in which he discussed how Milk declined to make additional financial contributions to the restaurant *after* it was clear that the restaurant was not making a profit

295. *Milk*, 634 S.E.2d at 212 (emphasis added) (citing *Boswell v. Primary Care Professionals*, 265 Ga. App. 522, 525–26 (2004)).

296. *Id.*

297. *Milk*, 634 S.E.2d at 212–13 (citing *Fuda v. Kroen*, 204 Ga. App. 836, 838 (1992)) (veil could not be pierced when plaintiff failed to establish that Correct withdrawal of corporate funds "were not legitimate business expenses or authorized by the corporation as part of . . . [legitimate] compensation packages").

and had incurred substantial debt."

In *Flores v. DDJ, Inc.*,[298] the court rejected an alter ego claim, noting, in part, that the existence of a dissatisfied creditor does not itself create an inequitable result, and an inequitable result does not follow in cases where the corporation was once adequately capitalized and then encountered bad financial times. The court also noted that the plaintiff had the burden of proof to show that checks were written for a nonbusiness purpose[299] and that:

> In this case, many of the factors often discussed in alter ego cases are not raised by Plaintiffs. For example, it appears that the Individuals never held themselves out as being liable for the corporations' debts, the Individuals did not fail to segregate their own records from that of the corporations, the individuals did not obtain required licenses or certifications in their own name rather than the corporate name, the Individuals segregated their funds from those of the corporation, the Individuals did not treat the corporations' physical assets as their own, and the Individuals and corporations did not use the same address. There is no evidence that anyone dealing with Defendant Corporations believed or would have reasonably believed that they were dealing with the Individuals in their personal capacity rather than Defendants.[300]

In *Canter v. Ebersole*,[301] the court denied plaintiff's veil piercing claim, noting that the plaintiff argued that the individual had caused the LLC to be undercapitalized and that he should be responsible for paying all of the LLC's debts because he had paid some of them. The court responded:[302]

> Mr. Ebersole testified that the initial capital of WPT was $ 1,000.00. However, he and Mr. Mabee and companies they controlled made loans to WPT as needed. Most important, the members had estimated the costs of the

298. Flores v. DDJ, Inc., No. 1:99 CV 5878, 2007 WL 4269259, at *17 (E.D. Cal. Nov. 30, 2007).
299. *Id.* at *9.
300. *Flores*, 2007 WL 4269259 at *6.
301. Canter v. Ebersole, No. E2005-02388-COA-R3-CV, 2006 WL 1627288, at *3 (Tenn. App. May 13, 2006).
302. *Id.*

> project and agreed to borrow sufficient funds from First Tennessee Bank to build the townhomes. Unfortunately for Mr. Ebersole, there was an increase in costs and expenses and two townhomes did not sell as expected. The anticipated profit did not occur.
>
> Mr. Canter points to Mr. Ebersole's personal payment of some of WPT's debts. Therefore, Mr. Canter argues that Mr. Ebersole should be liable for all debts of WPT. Mr. Ebersole testified, without contradiction, that he only paid those obligations of WPT for which he also was personally liable. For example, he executed a personal guarantee to First Tennessee Bank. He had paid some of his personal monies to First Tennessee Bank when WPT did not have the funds to make payment. His alternatives were to loan funds to WPT, so WPT could make the payment, or let the bank sue him. His direct payment to the bank was reasonable and permissible. This case is an example why creditors want a personal guarantee and/or adequate security for a loan.

Milk, *Flores*, and *Canter v. Ebersole* are cases in which the court could be viewed as saying that the creditors in these cases did not need protection from actions by the entities' owners because the owners acted reasonably.[303] In *Instituform Technologies, LLC v. Cosmic TopHat, LLC*,[304] the court stated that to justify piercing the veil of an LLC based on undercapitalization the plaintiff must show undercapitalization coupled with an intent at the time of capitalization to improperly avoid future debts.[305]

In *United States v. WRW Corp.*,[306] the United States brought suit against three individuals seeking to hold them personally liable for substantial fines levied against WRW Corporation for violations of the Federal Mine Safety and Health Act.[307] The court upheld piercing the veil of WRW Corporation on the grounds of undercapitalization and lack of formalities.[308] The court stated:

303. *Cf.* Macey & Mitts, *supra* note 11, at 133-35.

304. *Insituform Tech., LLC*, 959 F. Supp. 2d at 1345. *See also supra* notes 227-32 and accompanying text (interesting take on separateness) and *infra* notes 499–501 and accompanying text (discussing causation) and notes 620-22 and accompanying text (reverse veil piercing).

305. *Insituform Tech., LLC*, 959 F. Supp. 2d at 1345.

306. United States v. WRW Corp., 986 F.2d 138 (6th Cir. 1993).

307. *Id.* at 140.

308. *Id.* at 143. Macey and Mitts would classify *United States v. WRW Corp*. as a case in which the stated rationales of the court may not express the true rationale of the case, i.e., to protect the purposes of the Federal Mine Safety and Health Act. *See* Macey & Mitts, *supra* note 11, at 115–23.

> The [district] court first found that WRW was undercapitalized because it was incorporated with only $3,000 of capital, which the record indicates was insufficient to pay normal expenses associated with the operation of a coal mine. Although the defendants complain that there was no expert testimony on whether WRW was undercapitalized, it is clear from the record that expert testimony was not required to support the district court's conclusion in this case, based upon uncontroverted findings by the district court that WRW lacked working capital to pay any employees or expenses, to pay licensing or permit fees, or to obtain adequate mining equipment. Although undercapitalization will not support piercing the corporate veil in every case, . . . the district court did not err in weighing its significance in this case.[309]

In its discussion of failure to observe formalities, the court noted that the "individual defendants do not contest the district court's additional findings that they commingled funds with WRW, and guaranteed WRW's liabilities in their individual capacities."[310] The court then stated:

> In addition to holding that the equities of this case support piercing the corporate veil, the district court held that the corporate veil should be pierced under the "alter ego" theory, because WRW and the defendants did not have separate personalities. In light of the lack of observance of corporate formalities or distinction between the individual defendants and the corporation, we agree with the district court's conclusion that "[t]here was a complete merger of ownership and control of WRW with the individual Defendants."[311]

A decision of the North Dakota Supreme Court arguably stands for the proposition that adequate capitalization must exist at all times.[312] In 1985, Geri Chillemi ("Chillemi") and another individual formed Main Realty, Inc. ("Main Realty") to purchase the trade name Main and Company Realtors and "everything that was in it" for $20,000.[313] Chillemi was the

309. *WRW Corp*, 986 F.2d at 143.
310. *Id*.
311. *Id*.
312. Axtmann v. Chillemi, 740 N.W.2d 838, 844 (N.D. 2007).
313. *Id.* at 840.

sole shareholder, president, and treasurer of Main Realty. Jon Natwick was the vice president and secretary of Main Realty. Chillemi and Natwick lived with each other and were partners in Mainland Ventures Unlimited, a partnership owning commercial property that leased office space to Main Realty.

Main Realty's business model was to engage real estate agents as independent contractors. An agent could opt for either a seventy percent earned commissions contract or a one hundred percent earned commissions contract. In the case of a one hundred percent earned commissions contract, the agent would be responsible for:

> Desk fee, all MLS dues, books, and listing fees, all advertising expenses, all their own promotional advertising, all individual office supplies, all business cards, stationary, envelopes, Purchase Agreements, Listing Contracts, Handy Pads, For Sale Signs, Open House Signs, Sign Installation fees, long distance phone calls, camera and film, and any other expenses incurred over and above the Company Expenses listed in paragraph 9.[314]

The Company Expenses were:

> The monthly office fee will pay for the office rent, office desk and chairs, secretary and related expenses such as FICA, Unemployment Insurance and Workmen's Compensation, telephones and local telephone service, office MLS fees, office Real Estate Commission fees. Copy machine supplies and service, Supra Locks, business liability insurance and office keys.[315]

Thomas P. Axtmann and Ariel E. Axtmann (the "Axtmanns") sued a Main Realty agent and Main Realty in connection with the Axtmanns' purchase of a house. In May 2004, a jury found that Main Realty and the individual agent were liable to the Axtmanns for $75,000 in economic damages, the individual agent was guilty of fraud and liable to the Axtmanns for $45,000 in exemplary damages, and Main Realty was guilty of fraud and liable to the Axtmanns for $19,000 in exemplary damages.[316]

314. *Axtmann*, 740 N.W.2d at 841.
315. *Id.*
316. *Id.* at 842.

Apparently while the trial was going on, Chillemi and Natwick held a special meeting of the board of directors on Main Realty on April 22, 2004. The minutes of that meeting reflected that Main Realty had lost a number of agents, that it could not get any new agents to transfer to it, and the rent from the remaining five agents was insufficient to cover Main Realty's costs of doing business. The minutes also record approval of a motion to dissolve Main Realty and state that Natwick would form his own company and transfer his real estate license to that company.[317]

Natwick formed Mainland, Inc. ("Mainland") in May 2004, and, on June 1, 2004, Chillemi, as president of Main Realty, executed assignments of all listing contracts of agents affiliated with Main Realty to Mainland. Main Realty agreed to relinquish to Mainland all claims for any commissions for the sale of real estate covered by the assigned listings. Mainland did not pay any consideration to Main Realty for these assignments and Chillemi began working for Mainland as an agent and independent contractor.[318]

After Main Realty dissolved, the Axtmanns levied on Main Realty's property and received $7.52 from a sheriff's sale of office equipment. The Axtmanns then sued Chillemi, Natwick, Mainland, Main Realty, and Mainland Ventures asserting that the transfer of the listing agreements from Main Realty to Mainland was a fraudulent transfer and seeking an order piercing the veil of Main Realty and imposing personal liability on Chillemi and Natwick for the Axtmanns' judgment against Main Realty.[319]

The court upheld the trial court's imposition of personal liability on Chilllemi and Natwick, primarily on the grounds that, in the court's view, Main Realty was substantially undercapitalized. The court stated:

> Proof of fraud is not a necessary prerequisite for disregarding the corporate entity, but an element of injustice, inequity, or fundamental unfairness must be present before a court may properly pierce the corporate veil and that element of unfairness may be established by the showing of a number of the requisite factors for piercing the corporate veil. The essence of the requirement for fairness is that an individual cannot hide from the normal consequences of carefree entrepreneuring by doing so through a corporate shell.[320]
>
> This Court has also recognized that the attitude toward piercing the corporate veil is more flexible in tort than in

317. *Axtmann*, 740 N.W.2d at 842.
318. *Id*.
319. *Id.* at 842–43.
320. *Id.* at 843.

> contract, because the creditor has an element of choice inherent in a voluntary contractual relationship whereas the ordinary tort case forces the debtor-creditor relationship upon the creditor by the occurrence of an unexpected tort. In tort cases, particular significance is placed on whether a corporation is undercapitalized, which involves an added public policy consideration of whether individuals may transfer a risk of loss to the public in the name of a corporation that is marginally financed. [T]his Court [has] explained the obligation for adequate capitalization: "[t]he obligation to provide adequate [risk] capital begins with incorporation and is a continuing obligation thereafter * * * during the corporation's operations." '[321]

The court cited with approval the following findings of the trial court:

> The [trial] court found Main Realty was undercapitalized, it was insolvent and could not pay its debts at the time of the Axtmanns' judgment and for several years before that judgment, and it was a "pass through" corporation with no substantial assets. The court said it would be unfair and unjust not to pierce Main Realty's corporate veil, and the court held Chillemi and Natwick personally liable for the Axtmanns' judgment.
>
> The district court found Chillemi "purchased the business twenty years ago for $20,000.00. However, there [was] no evidence that more capital was put into the business after that $20,000.00." The court also found it was foreseeable that Main Realty might be liable for claims by customers, Main Realty failed to make any provisions for assets to cover foreseeable liabilities, and Main Realty was insolvent at the time of the Axtmanns' judgment and for years because it was unable to pay its normal debts and relied upon Chillemi's personal credit to operate. The court said although Main Realty "provided a necessary service to Chillemi, Natwick and the other agents by providing the tools they needed to sell real estate and close on real estate transactions, most notably the brokerage services and the use of a trust account," Main Realty was merely a "pass

321. *Axtmann*, 740 N.W.2d at 843–44 (citing *Jablonsky v. Klemm*, 377 N.W.2d 560, 566 (N. D. 1985)).

> through" corporation.
>
> [T]he minutes of Main Realty's annual meetings establish that Main Realty was not itself making a profit and had some outstanding credit card debt. The minutes also reflect that Chillemi and Natwick used their commissions to pay Main Realty's credit card debt. Although Main Realty may have operated as a viable entity for several years, there was evidence it struggled to satisfy corporate debts, which must be considered with the evidence about its level of capitalization and the use of the corporation as a "pass through" business for its agents.
>
> The Axtmanns' underlying judgment against Main Realty was based, in part, on a jury finding that Main Realty was guilty of fraud. Our analysis in this case is informed by that underlying judgment. In tort cases, a lack of capitalization is particularly significant and involves an added policy consideration of whether individuals may transfer a risk of loss to the public in the name of a corporation that is marginally financed. As we [have] recognized, the essence of the requirement for fairness is that an individual cannot hide from the normal consequences of corporate entrepreneuring by doing so through a corporate shell.[322]

The references to Main Realty being a "pass-through" corporation or business are apparently references to the fact that Main Realty had elected to be taxed as an S corporation.[323]

In approving piercing the veil of Main Realty, Inc., the North Dakota Supreme Court in *Axtmann* stated that "the ordinary tort case forces the debtor-creditor relationship upon the creditor by the occurrence of an *unexpected* tort"[324] and "it was foreseeable that Main Realty *might be liable* for claims by customers."[325] Note the similarity of the logic used by the court in *Axtmann* to that employed by the Colorado Court of Appeals in *Martin v. Freeman*, where the court stated that "[a]ny party engaged in litigation is exposed to *potential* liability."[326] As the dissent in *Axtmann* stated, the better view is that inadequate capitalization should be determined when an entity is formed and the majority's view of the law "would hold shareholders of any failing corporation liable for the

322. *Axtmann*, 740 N.W.2d at 846–47.
323. *Id.* at 852.
324. *Id.* at 843 (emphasis added).
325. *Id.* at 845 (emphasis added).
326. Martin v. Freeman, 272 P.3d 1182, 1186 (Colo. App. 2012) (emphasis added).

company's debts."[327] Also see *Rice v. Oriental Fireworks Company*,[328] where the court stated that "a corporation is inadequately capitalized when its assets are insufficient to cover its potential liabilities, *which are reasonably foreseeable from the nature of the corporation's business*."[329]

For a contrasting and arguably more appropriate from a policy standpoint result, see *Riggins v. Dixie Shoring Company, Inc.*[330] In that case, the Louisiana Supreme Court reversed the holdings of the appeals court and trial court piercing the veil of the corporation to hold its shareholder personally liable for damages to the plaintiffs' home when the corporation attempted to jack and level the home. Despite some evidence of lack of formalities and improper payments, the Louisiana Supreme Court focused on the many formalities maintained by the corporation over a more than twenty-year period of business operations. Although not discussed by the court, there was no indication that any of the factors that the trial court and appeals court thought supported piercing the veil of the corporation had any connection, causal or otherwise, to the harm suffered by the plaintiffs. In addition, the trial court found that there was no personal negligence on the part of the shareholder of the corporation in connection with the work on the plaintiffs' home.

Also see *Oriental Commercial and Shipping Co., Ltd. v. Rosseel, N.V.*[331] Oriental involved a $34,000,000 transaction between a Belgian oil trading corporation ("Rosseel") and Oriental U.K. Ltd., a United kingdom corporation established and held by Abdul Hamed Bokhari, who also owned Oriental S.A., a Saudi Arabian corporation.[332] Rosseel sought to hold Bokhari personally liable for Oriental U.K's breach of contract. Rosseel argued that Bokhari should be liable because Oriental U.K. was extremely undercapitalized and had represented that Bokhari and Oriental S.A. would stand behind Oriental U.K.'s contractual obligations. The court, although acknowledging that undercapitalization was an element to be considered, stated that "undercapitalization alone is not a sufficient ground for disregarding the corporate form" and "the mere fact that an entity may or may not have the capital to respond to a potential large award against it does not justify piercing the corporate veil."[333] However, the court went on to say that undercapitalization is "particularly important

327. *Axtmann*, 740 N.W.2d at 852.
328. Rice v. Oriental Fireworks Co., 707 P.2d 1250 (Or. App. 1985).
329. *Id.* at 1256 (emphasis added).
330. Riggins v. Dixie Shoring Co., Inc., 590 So. 2d 1164, 1169 (La. 1991).
331. Oriental Commercial & Shipping Co., Ltd. v. Rosseel, N.V., 702 F. Supp. 1005 (S.D.N.Y. 1988).
332. *Id.* at 1009.
333. *Id.* at 1020; *see also* Macey & Mitts, *supra* note 11, at 126 (stating that "just as in *Mobridge*, the undercapitalization in *Oriental* constituted the subject of the misrepresentation to creditors").

where, as here, there has been a misrepresentation as to the assets of the company."[334] The court held Bokhari personally liable, finding that he had used his entities to commit fraud.[335]

H. Entity Formed/Used for an Improper Purpose

Anderson, LLC v. Stewart[336] held the owners of an LLC personally liable for the debts of Check Mart of Hot Springs, LLC ("Check Mart"). Check Mark operated a payday loan business, and Check Mark and its owners failed to comply with state statutes on check cashers by failing to properly maintain business records.[337] The owners could not explain whether Check Mark had an accountant or anyone keeping its books, and the entire amount of the loss reflected on Check Mart's profit and loss statement for the period from January through November 2001 was reported by one of the owners on his 2001 personal federal income tax return.[338] Moreover, one of the members withdrew the LLC's letters of credit and cancelled its bond[339] (actions that the plaintiff contended to ensure that the LLC would not be able to satisfy any judgment), and the owners operated the same business under another name after the LLC closed.

In *Kalashian v. Krebs*,[340] Mona G. Krebs and Ronald C. Krebs owned a computer sales company, Mark Data Products, Inc., doing business as Connecting Point Computer Centers ("Mark Data"). The Krebs agreed to sell all of their Mark Data stock to Connecting Point Computers, LLC (the "LLC"). Michael N. Kalashian and Vita Kalashian were the sole members of the LLC.[341] The agreement for the sale of the Mark Data stock provided that the Krebs would retain ownership of an account of Mark Data containing over $1,000,000.[342] The purchase price for the sale of the Mark Data stock was $700,000. $140,000 was paid to the Krebs at closing, and

334. *Oriental Commercial & Shipping Co., Ltd.*, 702 F. Supp. at 1020.

335. *Id.* at 1023.

336. Anderson, LLC v. Stewart, 234 S.W.3d 295, 301 (Ark. 2006).

337. Ark. Code Ann. § 23-52-112(a) requires check cashers to "keep and use in its business any books, accounts, and records that the State Board of Collection Agencies may require to carry into effect the provisions of this chapter and the administrative regulations issued hereunder"; § 23-52-112(b) requires check cashers to "preserve all relevant records for a period of at least two (2) years after making the last entry on any transaction."

338. *Anderson, LLC*, 234 S.W.3d at 301.

339. *Id.* at 296. If Check Mart continued to operate its business after its letters of credit and bond were cancelled, it would be in violation of Ark. Code Ann. § 23-52-107(1).

340. Kalashian v. Krebs, No. G03297, 2004 Cal. App. Unpub. LEXIS 10789 at *3 (Cal. App. Nov. 29, 2004).

341. *Id.* at *4.

342. *Id*.

the LLC executed a promissory note for the $560,000 balance.[343] The promissory note was secured by a pledge agreement reciting that the Kalashians were the pledgors, but only Michael Kalashian executed the pledge agreement, and he did so in his individual capacity.[344]

A few months after the sale of the First Data stock, Kalashian and the LLC sued the Krebs, asserting breach of contract, fraud, and other causes of action in connection with the Mark Data sale. The Krebs filed a cross-complaint alleging breach of contract and other causes of action and asserted that the Kalashians had raided the Mark Data account that the Krebs were to retain.[345]

The Court approved the jury's findings, which included the following:

> (1) the Krebses did not breach any contract with Kalashian and the LLC; (2) the Krebses did not commit fraud and made no negligent misrepresentations in connection with the stock purchase; (3) the LLC breached the terms of its promissory note, and the resulting damages were $ 549,814.68 plus 8 percent interest; (4) the LLC breached the Sales Agreement with the Krebses, and the resulting damages were $ 1,575,000 plus interest; (5) the Kalashians and the LLC had and received money from the Krebses that ought to be repaid, and interfered with the Krebses' superior right of ownership of the funds; (6) the Kalashians and the LLC did not commit fraud in inducing the Krebses to leave their funds in a Wells Fargo bank account; (7) the Kalashians and the LLC did not fraudulently conceal or suppress a material fact; and (8) the total amount of all damages the Krebses suffered on account of the breach of contract, money had and received, conversion, fraud, and concealment or suppression by the Kalashians and the LLC was $ 2,124,815 plus interest as described above, and attorney fees.[346]

The court characterized the Kalashians' actions with respect to the Mark Data account as "theft."[347]

The court held that there was sufficient evidence to hold the LLC member personally liable as the alter ego of the LLC based on

343. *Kalashian*, LEXIS 10789 at *4.
344. *Id.* The court noted that this was "interesting, as it would appear that it was the LLC that had purchased the stock." *Id.* at *39.
345. *Id.*
346. *Id.* at *7–*8.
347. *Id*. at *23.

undercapitalization of the LLC, use of the LLC's account to pay personal expenses, payment of the LLC's debts with personal funds, failure to observe LLC formalities (by failing to keep financial statements, signing documents on behalf of the LLC before it came into existence,[348] and personally exercising lease agreements for the LLC subsidiary's space), and the member's use of his position with the LLC to accomplish the wrongful purpose of seizing an account that belonged to the plaintiffs.[349]

In *Devan Lowe, Inc. v. Stephens*,[350] a commission based salesman for an auto dealership formed an LLC and requested that the dealership begin paying commissions to the LLC. The testimony in the case did not show any reason for forming the LLC other than to attempt to avoid a garnishment action filed against the dealership with respect to the salesman's commissions.

In *Stone v. Frederick Hobby Associates II*,[351] the plaintiffs sued Frederick L. Hobby, III, Sally M. Leindecker, Frederick Hobby Associates, LLC ("Hobby 1"), and Frederick Hobby Associates II, LLC ("Hobby II"). The plaintiffs purchased a home from Hobby II for $3,300,000. Hobby II failed to complete items on a punch list it had agreed to and the residence had a variety of substantial defects in design, materials, and workmanship. Hobby II also failed to fix any of these defects. The court noted the requirements of the instrumentality rule and the identity rule, stating the second requirement of the instrumentality rule as being that the domination requirement of the first prong of the instrumentality test "must have been used by the defendant to commit fraud or wrong, to perpetrate the violation of a statutory or other positive legal duty, or a dishonest or unjust act in contravention of plaintiff's legal rights."[352] The court then stated that it found the following:

> Frederick L. Hobby, III is one of two members of Hobby II and Sally M. Leiendecker is the other. Each member has a fifty percent ownership interest in Hobby II, as well as full authority to manage and control the company's business. Hobby II's office is located in Frederick L. Hobby, III's private home, owned by him in his individual capacity, and Hobby II pays no rent and has no lease with him. Furthermore, Hobby II currently has no assets and it never

348. *Kalashian*, LEXIS 10789 at *30. *See also infra* notes 633-39 and accompanying text.
349. *Id.* at *23.
350. Devan Lowe, Inc. v. Stephens, 842 So.2d 703, 706 (Ala. Civ. App. 2002).
351. Stone v. Frederick Hobby Associates II, No. CV000181620S, 2001 Conn. Super. LEXIS 1853 at *1, (Conn. Super. July 10, 2001).
352. *Id.* at *29–*30.

> had any assets other than the premises now owned by the plaintiffs. Attorney Gold, the attorney who formed Hobby II as a limited liability company, created Hobby II to enable the development of the subject premises and to shield and protect Frederick L. Hobby, III and Sally M. Leiendecker, the principals of Hobby II, from personal liability. Moreover, during a meeting between the parties in May of 2000, Attorney Gold, while acting on behalf of Hobby II, told the plaintiffs to "go ahead and sue us [Hobby II]. There is no money in [Hobby II]. Why do you think we set it up as an LLC in the first place?" This last statement evidences an intent on the part of the individual defendants, Frederick L. Hobby III and Sally M. Leiendecker, to use the limited liability company as a shield in order to avoid responsibility for contractual obligations owed to the plaintiffs.[353]

Bainbridge criticizes the opinion and result in *Stone*.[354] Bainbridge expressly criticizes the court's emphasis on the statements by Attorney Gold: "But so what? . . . [S]etting up a limited liability entity to shield oneself from personal liability is not a fraud or wrong."[355] True enough,[356] but what is wrong is when the owners of an entity misrepresent their involvement in the entity and its affairs.[357]

The Kentucky Court of Appeals in *Veterans Service Club v. Sweeny*,[358] disregarded the existence of a nonprofit corporation ostensibly organized to extend charitable help to ex-service men and to promote certain civic causes but that in operation promoted gambling. The court stated: "The facts developed . . . justified the finding by the Chancellor that the incorporation was but a cloak or mask devised by the incorporators to cover their illegal acts of gambling and to shield them from the consequences of those acts."[359]

In re Turner (Kendall v. Turner)[360] involved a debtor who with his wife, after attending an asset protection seminar, engaged in a series of transactions involving the transfer of their home. The transactions included transferring the home to a Bahamian trust, execution of a transmutation agreement purporting to change the character of the home to the wife's

353. *Stone*, 2001 Conn. Super. LEXIS 1853 at *33.
354. Bainbridge LLCs, *supra* note 16, at 89.
355. *Id.*
356. *See supra* text accompanying notes 29-30.
357. Macey & Mitts, *supra* note 11, at 131.
358. Veterans Service Club v. Sweeny, 252 S.W.2d 25 (Ky. 1952).
359. *Id.* at 27.
360. *In re* Turner, 335 B.R. 140 (Bankr. N.D. Cal. 2005).

separate property, creation of a Nevada LLC and a Nevada corporation, transfer of the home to the Nevada LLC, encumbrance of the home in favor of the Nevada corporation, and transfer of the home to the wife. The court devoted most of its opinion to discussing why the transfer of the home was a fraudulent transfer but also held that the Nevada LLC and Nevada corporation were alter egos of the debtor. In connection with its alter ego holding, the court stated:

> "Asset protection" is not illegal and is honored by the law if done for a legitimate purpose. For example, an individual may do business through a corporation or limited liability company and will not be held personally liable for the debts of the entity. The assets of the corporation or limited liability company will not be considered the assets of the individual interest holder. *However, an entity or series of entities may not be created with no business purpose and personal assets transferred to them with no relationship to any business purpose, simply as a means of shielding them from creditors*. Under such circumstances, the law views the entity as the alter ego of the individual debtor and will disregard it to prevent injustice.[361]

In *FILO America v. Olhoss Trading Company*, *LLC*,[362] based on legal commentary and cases from other states, the court concluded that the veil of an Alabama LLC could be pierced under Alabama law. Although the court stated that while some corporate veil-piercing factors might not apply in the same way to LLCs, "a fraudulent purpose in the conception or operation of an LLC should certainly be a valid reason for 'piercing' the LLC's 'veil' and '[h]ere, FILO America has stated a claim adequate to pierce Olhoss's LLC 'veil' by alleging that Fowler and Spann had a fraudulent purpose in the conception of their business."[363] Unfortunately, the court did not provide any details of what went into the plaintiff's claim.

Allison v. Danilovic[364] affirmed the trial court's decision holding an individual who was the CEO, director, and 662/3 owner of a Delaware LLC personally liable for plaintiff's unpaid wages whether Delaware or California law applied. The court cited as factors supporting piercing the LLC's view as the individual's never having held board meetings, never

361. *In re Turner*, 335 B.R. at 147 (emphasis added).
362. FILO Am. v. Olhoss Trading Co., LLC, 321 F. Supp. 2d 1266 (M.D. Ala. 2004).
363. *Id.* at 1270.
364. Allison v. Danilovic, No. B163363, 2004 Cal. App. LEXIS 10988, at *1–*12 (Cal. App. 2d. Dec. 7, 2004).

having executed a company agreement, never issued stock(!), had the authority to make business decisions for the LLC, and made the decision not to pay the plaintiff her wages when the LLC had $500,000 in its bank account but used the funds to pay investors instead. The court did not discuss what weight it gave to the factors it listed, and, except for using the LLC's funds to pay investors instead of the plaintiff, none of the factors appear to be ones that would have damaged the plaintiff. The court also did not discuss what considerations were used by the individual to pay the LLC's funds to investors. It would seem, however, that a valid wage claim[365] would be an expense of the LLC that should have been taken into account in determining whether to make a payment to investors and how large the payment to investors should be.

Somerville S Trust v. USV Partners, LLC[366] involved a member's demand for information from a Delaware LLC. The court's examination of this issue led the court to observe that:

> Somerville next claims that Earls mismanaged USV by not observing legal formalities while operating the business. In effect, Somerville argues, Earls used USV as his alter ego. The defendants make no effort to rebut that claim, and I find independently that Somerville's evidence supporting that claim is credible, Earls testified that USV had no officers, directors, or employees, that USV had no office, and that USV's address was Earls's home address. Moreover, USV's documents were kept at USXX's office, at Earls's personal accountant's office, and at his home.
>
> In a previous arbitration proceeding brought against Earls for his management of an unrelated single-purpose entity, the arbitrators found that there, as here, Earls was the "sole shareholder, director, officer, and decision-maker of the PC, which has no office or employees. Either Earls or his accountant maintains PC's books and records and its mailing address is that of Earls's office or residence. In that case, the arbitration panel also found (as Somerville claims here) that Earls had improperly used the entity's assets to secure debts, which the panel characterized as a "pervasive disregard of corporate formalities, all of which is probative in supporting the conclusion that the LLC, PC, and the Trust

365. *See* Macey & Mitts, *supra* note 11, at 121–133 (discussing the argument that protected the purpose of a regulatory scheme is one of the three true justifications for veil-piercing).

366. Somerville S Trust v. USV Partners, LLC, No. Civ. A. 19444-NC, 2002 Del. Ch. LEXIS 103, at *1–*34 (Del. Ch. Aug. 2, 2002).

> were in fact merely alter egos of Earls."
>
> In summary, the preponderance of the evidence supports Somerville's stated purpose of investigating possible mismanagement.[367]

In *United Automobile, Aerospace & Agricultural Implement Workers of America Local 157 v. OEM/Erie Westland, LLC,*[368] the court applied an alter ego analysis in denying the defendants' motion for summary judgment on the issue whether a twenty-four-percent member of an LLC was liable as a single-employer with the LLC under the Worker Adjustment and Retraining Notification Act (the "WARN Act"). Factors that the court found important in its WARN Act analysis included that the twenty-four-percent member controlled whether the employing LLC dissolved because the LLC's operating agreement provided that the LLC would be dissolved by member vote only if the vote were unanimous.[369] Another factor the court found significant in the WARN Act context was the twenty-four-percent member's refusal to make additional capital contributions to the LLC.[370]

The cases discussed above are similar in their rationale to the cases Macy and Mitts discuss to support their argument that one of the appropriate reasons to pierce the veil is to achieve the purpose of a regulatory or statutory scheme.[371]

I. FAILURE TO FOLLOW FORMALITIES

Note that limited liability company statutes often provide that the failure to follow formalities is not a factor that by itself justifies piecing the veil of a limited liability company. Section 304(b) of the Revised Uniform Limited Liability Company Act ("RULLCA")[372] states: "The failure of a limited liability company to observe any particular formalities relating to the exercise of its powers or management of its activities is not a ground for imposing liability on the members or managers for the debts,

367. *Somerville S Trust*, 2002 Del. Ch. LEXIS 103 at *23.

368. United Auto., Aero. & Agric. Implement Workers of Am. Local 157 v. OEM/Erie Westland, LLC, 203 F. Supp. 2d 825, 832 (E.D. Mich. 2002).

369. *Id.* at 833.

370. *Id.* at 834. The court found the member's refusal to make additional capital contributions relevant to whether the member had played a role in the LLC's decision to close its manufacturing plant. *Id.* at 830.

371. Macey & Mitts, *supra* note 11, at 115–123 (discussing cases arising under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 and the Employee Retirement Income Security Act).

372. REV. UNIF. LLC ACT § 304(b) (2011).

obligations, or other liabilities of the company."[373]

2 Ribstein and Keatinge on Limited Liability Companies §12.3 concludes that veil piercing for inadequate capitalization should be less likely for LLCs than corporations, in part because of the anticipated informalities. 1 *Fletcher Cyclopedia of the Law of Corporations* § 41.35 (also cited by the Court of Appeals) suggests that a sole shareholder should not be suspect "merely because he or she conducts business in an informal manner."

Macey and Mitts[374] liken piercing the veil because of failure "to observe corporate formalities such as holding directors' meetings or keeping minutes" to "imposing liability on a person because he did not wear a tie or keep a napkin in her lap while eating."[375] Note, however, that a total, or almost total,[376] disregard of formalities may support a finding of lack of separateness, particularly in the case of a single-member LLC.[377]

Texas appears to have gone further than any other state in statutorily protecting shareholders of corporations and members of LLC against veil-piercing/alter ego claims, particularly with respect to failure to follow formalities. Texas Business Organizations Code § 21.223 provides, in relevant part, as follows:

> Sec. 21.223. LIMITATION OF LIABILITY FOR OBLIGATIONS. (a) A holder of shares, an owner of any beneficial interest in shares, or a subscriber for shares whose subscription has been accepted, or any affiliate of such a

373. California, which has adopted RULLCA, revised this provision to read as follows:

"A member of a limited liability company shall be subject to liability under the common law governing alter ego liability, and shall also be personally liable under a judgment of a court for any debt, obligation, or liability of the limited liability company, whether that liability arises in contract, tort, or otherwise, under the same or similar circumstances and to the same extent as a shareholder of a corporation may be personally liable for any debt, obligation, or liability or the corporation; except that the failure to hold meetings of members or managers or the failure to observe formalities pertaining to the calling or conduct or meetings shall not be considered a factor tending to establish that a member or the members have alter ego or personal liability for any debt, obligation, or liability of the limited liability company where the articles of organization or operating agreement do not expressly require the holding of meetings of members or managers." CAL. CORP. CODE, tit. 2.6, § 17703.04(a) (2014).

374. *See generally* Macey & Mitts, *supra* note 11.

375. *Id.* at 109. This author has known, and is sure that Macey and Mitts have known, people who would try to impose some sort of social liability for the faux paus that they mention.

376. A validly formed LLC will always at the least have a formation document on file with the appropriate filing office. If a person acts on behalf of an LLC that has not been validly formed, that person will be subject to liability for acting as the agent of a nonexistent principal. *See infra* notes 633-39 and accompanying text.

377. Macey & Mitts, *supra* note 11, at 109 ("[W]here the failure to keep records is so profound that one cannot utilize such records to determine which assets legitimately belong to the corporation and which legitimately belong to its shareholders, then piercing is appropriate to prevent the unfair and strategic abuse of creditors by unilaterally categorizing assets as belonging to the shareholder (and thus unavailable to creditors) when there is no legitimate basis for doing so.").

> holder, owner, or subscriber or of the corporation, may not be held liable to the corporation or its obligees with respect to:
> (1) . . .;
> (2) any *contractual* obligation of the corporation or any matter relating to or arising from the obligation on the basis that the holder, beneficial owner, subscriber, or affiliate is or was the alter ego of the corporation or on the basis of actual or constructive fraud, a sham to perpetrate a fraud, or other similar theory; or
> (3) any obligation of the corporation on the basis of the failure of the corporation to observe any corporate formality, including the failure to:
> (A) comply with this code or the certificate of formation or bylaws of the corporation; or
> (B) observe any requirement prescribed by this code or the certificate of formation or bylaws of the corporation for acts to be taken by the corporation or its directors or shareholders.
> (b) Subsection (a)(2) does not prevent or limit the liability of a holder, beneficial owner, subscriber, or affiliate if the obligee demonstrates that the holder, beneficial owner, subscriber, or affiliate 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 holder, beneficial owner, subscriber, or affiliate.[378]

TBOC § 21.223 clearly distinguishes "any contractual obligation"[379] and "any obligation."[380] It would appear difficult to craft a clearer statutory statement that "the failure of the corporation to observe any corporate formality" shall not be the basis of imposing liability on a shareholder for obligations of the corporation.[381] As Macey and Mitts assert, and as cases

378. TEX. BUS. ORGS. CODE § 21.223 (2015) (emphasis added). Section 21.223 is made applicable to members of LLCs by section 101.002 of the Texas Business Organizations Code.

379. TEX. BUS. ORGS. CODE § 21.223(a)(2).

380. *Id.* at § 21.223(a)(3). Further, the exception to the protection from liability in subsection 21.223(b) applies to subsection 21.223(a)(2).

381. Arguably, however, the provisions of, for example, RULLCA and the California Corporate Code lead to the same substantive result as section 21.223. *See* REV. UNIF. LLC ACT § 304(b) (2011); CAL. CORP. CODE, tit. 2.6, § 17703.04(a) (2014). Perhaps the Texas Business Organizations Code section 21.223(a) provision appears stronger because it states that a shareholder "may not be held liable" for any failure to observe formalities rather than stating that failure to observe formalities "is not a ground for" imposing liability or "shall not be considered a factor tending to establish" that a member has alter ego liability.

such as *Polaris Industrial Corporation v. Kaplan*[382] illustrate, failure to observe formalities rarely seems to cause any harm. As this Article discusses earlier,[383] one commentator has asserted the following with respect to *SSP Partners v. Gladstone Investments (USA) Corporation:*[384]

> *SSP* rejects the business enterprise liability theory, and adopts the approach taken by the Legislature in TBCA article 2.21 as the embodiment of public policy in Texas. Additionally, because it was a pure products liability case, *SSP* should be interpreted as applying the public policy of TBCA article 2.21 to all tort cases, not just those arising out of contracts. *SSP* is now the definitive statement of the Texas law of veil piercing for all cases, whether arising out of contracts, torts or otherwise.[385]

The problem with the assertion that "*SSP* is now the definitive statement of the Texas law of veil piercing for all cases" is that *SSP* is not a veil-piercing case. The issues in *SSP* as framed by the court were:

> In Texas, the seller of a defective product is subject to strict liability for damages the product causes even though the defect was not his fault, but he is generally entitled to indemnity from the manufacturer by statute and by common law. Is he entitled to indemnity from an upstream supplier other than the manufacturer? Not, we hold, by statute, and not under the common law without showing that the upstream supplier was at fault. We also hold that corporations cannot be held liable for each other's obligations merely because they are part of a single business enterprise.[386]

The issues as framed by the court do not mention veil-piercing or alter ego. Indeed, the court in *SSP* noted that plaintiff did not "contend that liability should be imposed on Gladstone USA by disregarding its structure as a separate corporation-that is, by piercing the corporate veil or holding it

382. Polaris Indus. Corp. v. Kaplan, 747 P.2d 884, 887 (Nev. 1987); *see also* discussion in *supra* notes 257-63 and *infra* notes 542-46.
383. *See supra* notes 113-20 and accompanying text.
384. SSP Partners v. Gladstone Inv. (USA) Corp., 275 S.W.3d 444 (Tex. 2008).
385. EGAN, *supra* note 118, 81–82 and accompanying text.
386. *SSP Partners*, 275 S.W.3d at 446–47.

to be the alter ego of Gladstone Hong Kong."[387] As no alter-ego/veil piercing claim was before the court for decision, the statements in *SSP* about when alter-ego/veil piercing liability may be imposed are *dicta*. Whether the rule of TBOC § 21.223(2) as made applicable to LLCs by TBOC § 101.002 that shareholders and members will not be liable for any *contractual* obligation of the entity unless the shareholder or member "caused the corporation [or LLC] 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" shareholder or member will be applied in tort cases remains for further development. There is nothing in SSP to suggest that it intended to limit *Lucas v. Texas Industries, Inc.*,[388] or its statements that the proof required to satisfy the plaintiff's burden differs in a tort case from a contracts case. In *Lucas*, the court observed that in a tort case "it is not necessary to find an intent to defraud. Generally, in a tort case, the financial strength or weakness of the corporate tortfeasor is an important consideration."[389] The Texas legislature appears to have recognized this distinction by making TBOC § 21.223(a)(2) applicable by its terms only to "any contractual obligation." It is appropriate that TBOC § 21.223(a)(3) provides that failure to observe formalities is not a ground for imposing liability on a shareholder for "any obligation." Just as the failure to observe formalities seldom if ever bears a causal relation to the harm suffered by a contract creditor, it is difficult to envision how failure to follow formalities would contribute to the harm suffered by a tort creditor from difficulty in collecting a judgment. As the court in *Lucas* noted, in a tort case an important consideration is the financial strength or weakness of the corporate tortfesor.[390] Public policy suggests that the rule of TBOC § 21.223(a)(2) should not be applied in tort cases. Where an entity has committed a tort, it should be irrelevant whether the facts show that the owner has caused the entity "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. Rather, when an entity tortfeasor lacks adequate resources to respond in damages, the issue then should be whether the entity had adequate capitalization (including insurance) for the liabilities reasonably foreseeable in its business[391] or whether it is

387. *SSP Partners*, 275 S.W.3d at 451.

388. Lucas v. Tex. Indus., Inc., 696 S.W.2d 372 (Tex. 1984); *see supra* notes 113-20 and accompanying text.

389. *Lucas*, 696 S.W.2d at 375 (noting the policy that "an inadequately capitalized corporation in a risky business in effect transfers the risk of loss to innocent members of the general public" (internal citation omitted)).

390. *Id.*

391. *See generally* Rice v. Oriental Fireworks Company, 707 P.2d 1250 (Or. App. 1985).

appropriate to impose liability in all events, as *Martin v. Freeman*[392] and *Axtmann v. Chillemi*[393] would appear to stand for.

In *Butler v. Adoption Media, LLC*,[394] after a general partnership refused to post the profile of a gay couple on the partnership's website facilitating adoption, the couple sued the partnership, its two individual partners, two Arizona LLCs subsequently formed by the individuals, and two corporations formed by the individuals to serve as members of the LLC. The court denied the plaintiffs' alter ego claims, characterizing the evidence of the individuals' occasional disregard of corporate formalities and distinctions as "not particularly compelling." The court stated that the interests of management and ownership generally collide in a closely held corporation and that lack of formality is not unusual in a closely held corporation.[395] The court stated that it was more important that the plaintiffs had failed to present any evidence of bad faith or that the LLCs were created to avoid the operation of a statute.

In *Peinado v. Barnett*,[396] the court affirmed the conclusion of an administrative law judge that the alter-ego doctrine applied to a single member LLC that acted as a contractor without the required license. When formed under California law, the LLC was required to have at least two members but had only one — the court stated that the LLC accordingly was not legally constituted when formed. In addition, the court characterized the LLC's failure to file the required statement of information with the Secretary of State as a disregard of legal formalities and a failure to maintain adequate records.

With *Peinado*, one should also consider *Minton v. Cavaney*.[397] *Minton v. Caveney* is a case where the court's stated ground for its holding was the undercapitalization of the defendant corporation. Macey and Mitts, however, argue that "a much more compelling basis"[398] for disregarding the corporate form in this case was the corporation's having only one director rather than the statutorily mandated minimum of three.[399]

In *Regency Centers, L.P. v. Civic Partners Vista Village I, LLC*,[400] the court affirmed the trial court's holding that the sole member of an LLC was liable for the LLC's obligations as the LLC's alter ego. The court pointed

392. Martin v. Freeman, 272 P.3d 1182 (Colo. App. 2012).

393. *Axtmann*, 746 N.W.2d at 838.

394. Butler v. Adoption Media, LLC, 486 F. Supp. 2d 1022, 1070 (N.D. Cal. 2007).

395. See *supra* note 42 for a discussion of why this kind of reference to a "corporation" in a case involving LLCs is troubling.

396. Peinado v. Barnett, No. A093923, 2001 WL 1380441 (Cal. App. Nov. 6, 2001).

397. Minton v. Cavaney, 364 P.2d 473 (Cal. 1961).

398. Macey & Mitts, *supra* note 11 at 43.

399. *Id*. See discussion *supra* notes 287 to 291 and accompanying text.

400. Regency Centers, L.P. v. Civic Partners Vista Village I, LLC, No. G038095, 2008 Cal. App. Unpub. LEXIS 4760, 2008 WL 2358860. (Cal. App. June 11, 2008).

to the trail court's findings that the LLC had no capitalization, that funds between it and a corporation owned by the member were used interchangeably, that the entities were controlled by the member without formalities, that the LLC had no employees, no books, and no positive income, that the LLC's money was dissipated after it was reimbursed for costs and development fees, that the LLC was used for the convenience of its member, and that it would be inequitable to allow the LLC to shield the member from liability.

The court in *Cement-Lock v. Gas Technology Institute*[401] stated that failure to observe formalities might not be as significant in the LLC context as in the corporate context,[402] but concluded that there was sufficient other veil-piercing evidence for plaintiffs' claim to survive summary judgment based on allegations that LLC was intended to and did serve a fraudulent purpose.[403]

IV. TAX STATUS AS A FACTOR IN VEIL-PIERCING

GreenHunter[404] is one of a few cases in which the court discussed the tax status of the single member LLC as part of its veil-piercing analysis. The court in *GreenHunter* noted that "The LLC's tax returns were consolidated with the tax returns of Appellant."[405] The court further stated:

> Appellant claimed a deduction in the amount of $884,092.00 attributable to the Platte County wind energy project and a loss on its corporate tax return in the amount of $61,047.00 attributable to the same project on its 2009 tax return. Appellant manipulated the assets and liabilities in a manner such that Appellant improperly reaped all of the rewards and benefits of the LLC's activities, while simultaneously saddling the LLC with all of its losses and liabilities, including the unpaid bills for services rendered by Western. Appellant has enjoyed significant tax breaks attributable to the LLC's losses, without bearing any responsibility for the LLC's debt and obligations that contributed to such losses. Such a disparity in the risks and rewards resulting from this

401. Cement-Lock v. Gas Tech. Inst., 523 F. Supp.2d 827 (N. D. Ill. 2007).
402. *Id.* at 846.
403. *Id*.
404. *GreenHunter Energy, Inc.*, 337 P.3d at 454; *see also supra* notes 247-55 and accompanying text.
405. *GreenHunter Energy, Inc.,* 337 P.3d at 467.

manipulation would lead to injustice.[406]

The *GreenHunter* court attempted to moderate its remarks by stating:

> Appellant properly points out that as a single-member limited liability company, the LLC can properly be taxed as a disregarded entity. Federal tax law allows the LLC's losses to be attributed to Appellant and a consolidated tax return filed. As one commentator explains: With the advent of check-the-box, the tax treatment of single-member LLCs injects a new concept of "disregarded entity." A trend, however, is not to treat the LLC as disregarded for all purposes.[407] A single-member LLC is a "disregarded entity." The term "disregarded entity" is defined by IRC § 7701 and the regulations thereunder as any single-member entity that is not a corporation. The owner of a single-member entity can be a natural person or any other entity including a corporation. Natural persons who own single-member LLCs [disregarded entities] do not file any federal income tax forms for the entity. The disregarded entity owner reports the profits and losses of the company on the individual's personal Schedule C on the 1040 form. Single-member LLCs whose owners are corporations are treated as divisions of the corporate owner and the profits and losses are reflected on the corporate owner's returns . . . .
>
> For that reason, while consideration of Appellant's consolidated tax return and the losses of the LLC reported therein may have been relevant to the district court's piercing analysis, the amount of weight given to this evidence must be balanced by the fact that this practice is permitted under our nation's tax laws. Stated differently, courts should not create a scenario in which a single-member limited liability company would be confronted with a catch 22: either follow federal tax law and risk losing limited liability, or forego advantages available under federal tax law to assure limited liability. The district court's ruling

406. *GreenHunter Energy, Inc.*, 337 P.3d at 467.

407. *Id.* at 468. It is unclear what the court meant by this statement. The disregard of single-member LLCs has always only been for tax purposes. Single-member LLCs have always been state law entities to the same extent as single-shareholder corporations. Single-member LLCs are now regarded for self-employment tax purposes and certain excise tax purposes. Treas. Reg. §§ 301.7701-2(c)(2)(iv) (1996) (employment taxes) & 303.7701-2(c)(2)(v) (1996) (certain excise taxes).

> does not create that dilemma. Instead, it considered Appellant's tax filings as only one of many relevant pieces of evidence demonstrating that Appellant directed benefits from the LLC to itself, while at the same time it concentrated wind farm project debts it decided would not to be paid in the LLC. The district court did not err in doing so.[408]

Another such case is *White Family Harmony Investment, Ltd. v. Transwestern West Valley, LLC*,[409] where one of the factors cited by the court in granting the plaintiff's motion for summary judgment on its alter ego claim against Business Properties LLC ("Business Properties") was that Business Properties had for all years filed "a single tax return for itself" and its two wholly owned LLC subsidiaries and that one of the subsidiaries, Transwestern West Valley LLC did not have its own tax identification number.[410] "Accordingly, any bank accounts that were opened and all 1099-MISCs that were provided by Transwestern Valley

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408. *GreenHunter Energy, Inc.*, 337 P.3d at 468. Wyoming recently amended its LLC statute to impose new requirements that must be met before the veil of a Wyoming limited liability company may be pierced. Wyo. Stat. Ann. § 17-29-304(2016) now provides in new subsections (c) and (d);
(c) for purposes of imposing liability on any member or manager of a limited liability company for the debts, obligations or other liabilities of the company, a court shall consider only the following factors no one (1) of which, except fraud, is sufficient to impose liability:

> (i) Fraud;
> (ii) Inadequate capitalization;
> (iii) Failure to observe company formalities as required by law; and
> (iv) Intermingling of assets, business operations and finances of the company and the members to such an extent that there is no distinction between them.

(d) In any analysis conducted under subsection (c) of this section, a court shall not consider factors intrinsic to the character and operation of a limited liability company, whether a single or multiple member limited liability company. Factors intrinsic to the character and operation of a limited liability company include but are not limited to:

> (i) The ability to elect treatment as a disregarded or pass-through entity for tax purposes;
> (ii) Flexible operation or organization including the failure to observe any particular formality relating to the exercise of the company's powers or management of its activities;
> (iii) The exercise of ownership, influence and governance by a member or manager;
> (iv) The protection of members' and managers' personal assets from the obligations and acts of the limited liability company.

The 2016 amendment also deleted § 17-209-304(b), which had provided that neither a failure to observe formalities as to the operation and management of a limited liability company nor an election to be treated as a disregarded entity for federal income taxes was sufficient to justify setting aside limited liability.

The legislative fact sheet accompanying the amendment indicates that the changes were in response to GreenHunter Energy, Inc. v. Western Ecosystems Technology, Inc., 337 P.3d 454 (Wyo. 2014). Although the court in GreenHunter did make some unfortunate references to the tax status and attributes of the single-member LLC at issue in that case, the court appeared to place much more weight on the sole member's total control of the LLC's finances, including deciding to contribute funds to pay some of the LLC's debts and not others. See *supra*, notes 247-55 and accompanying text.

409. White Family Harmony Inv., Ltd. v. Transwestern W. Valley, LLC, No. 2:05CVDAK, 2007 WL 2821798 (D. Utah Sept. 27, 2007).

410. *Id*. at *26.

used Business Properties' tax identification number."[411] In *Connecticut Light and Power Company v. Westview Carlton Group, LLC*,[412] the court affirmed the trial court's determination that the LLC's veil should be pierced to hold the single member personally liable for the LLC's unpaid electric bills. The LLC had no registered agent, filed no annual reports with the Secretary of State, failed to maintain any business records for its property, failed to file any tax returns for the years involved,[413] and was undercapitalized. Finally, when the LLC sold its property, the member rather than the creditor was the beneficiary of the proceeds.[414] Notwithstanding that the court in *Connecticut Light and Power* cited a list of all possible veil-piercing factors,[415] the case appears to be one that, in the parlance of Macey and Mitts,[416] turns on the necessity to protect creditors against misrepresentations about owner involvement.[417] Although the tax status does not appear to have been given much weight in any of these case, it is unfortunate to see opinions that mischaracterize the tax attributes of an entity, and it would be unfortunate if the normal tax attributes of a single member LLC became seen as factors supporting piercing the veil.[418] In the corporate context, in *Axtmann v. Chillemi*,[419] the district court appears to have placed some weight that the S corporation was a "pass-through" in determining that its veil should be pierced. The better view of taking tax status into account was expressed in *Pinebrook Properties, Ltd. v. Brookhaven Lake Property Owners Association*.[420] In that case, the

411. *Id*. Business Properties' wholly-owned LLC subsidiaries would have been disregarded entities for tax purposes, assuming no election to be an association taxable as a corporation. Accordingly, they were not required to have their own tax identification numbers if they had no employees, and, any income and deductions generated by them were properly reportable on Business Properties' Form 1065.

412. Conn. Light & Power Co. v. Westview Carlton Group, LLC, 950 A.2d 522 (Conn. App. 2008).

413. *Id.* As a single-member LLC, Westview Carlton Group, LLC was not required to file federal income tax returns. There is no indication in the opinion that the LLC had elected to be treated as an association taxable as a corporation, which would have required it to file tax returns, notwithstanding the court's reference to the LLC's sole member as the LLC's "sole shareholder." *Id.* at 524. *See supra* note 42 for a discussion of why using corporate terms in an LLC case is problematic.

414. *Conn. Light & Power Co*., 950 A.2d at 527.

415. *Id*.

416. Macey & Mitts, *supra* note 11, at 123.

417. *Conn. Light & Power Co*., 950 A.2d at 525–526.

418. Some states have addressed this issue statutorily. *See, e.g.*, Ala. Code § 10A-5A-1.04(a) (A limited liability company is a separate legal entity. A limited liability company's status for tax purposes shall not affect its status as a separate legal entity formed under this chapter."); Va. Code § 13.1-1002 ("A limited liability company's status for federal tax purposes shall not affect its status as a distinct entity organized and existing under this chapter."). A similar provision is included in § 104(a) of the Prototype Act.

419. *Axtmann*, 740 N.W.2d at 844; *see also supra* notes 312-29 and accompanying text.

420. Pinebrook Prop., Ltd. v. Brookhaven Lake Prop. Owners Ass'n, 77 S.W.3d 487 (Tex. App. 2002).

plaintiffs sought to pierce the veil of Pinebrook Properties Management, L.L.C. to impose personal liability on A.C. Musgrave, Jr. In rejecting the plaintiffs' veil-piercing claim, the court stated:

> The evidence of alter ego between Musgrave and Pinebrook Management presented by the Owners is that Pinebrook Management had no checking account, had not filed a tax return, and that Musgrave sent a letter to the lot owners, signing his own name and not designating that he signed it in any other capacity. However, the Owners failed to cite any authority holding that failure to have a checking account, or failure to file tax returns, establishes alter ego. There is no evidence provided that Musgrave commingled funds or that his assets and those of Pinebrook Management were not kept separate. *The evidence clearly shows Pinebrook Management has never had the need, or been required, to file a tax return*. This is no evidence that Pinebrook is the alter ego of Musgrave.[421]

The opinion in *New Horizons Supply Coop. v. Haack*[422] would be more troubling if the Wisconsin Court of Appeals had not reversed the trial court, which had imposed partner liability on the members of an LLC because the LLC was taxed as a partnership: "the court's going to find that the corporate veil is pierced by the fact that the people were acting like a partnership, being taxed like a partnership, and haven't even dissolved the — I'm treating this as a partnership and assessing liability to the remaining partner. That's the evidence that's before me, and unless I would have some other evidence that was not presented, I have to treat this matter as a partnership and assume that the limited liability agreement did not alter the normal partnership liability situation."[423] The appellate court's holding that the trail court had improperly imposed partner liability on the remaining member of the LLC was cold comfort to the member because the appellate court affirmed the trial court's judgment on the ground that the member had not followed proper statutory proceedings to dissolve the LLC and was liable to the plaintiff to the extent of the value of the property the member had received from the LLC in dissolution.[424]

421. *Pinebrook Prop., Ltd*., 77 S.W.3d at 500 (emphasis added). *See infra* notes 649-653 and accompanying text.

422. New Horizons Supply Coop. v. Haack, No. 98-1865, 1999 Wisc. App. LEXIS 108 (Wisc. App. 1999).

423. *Id.* at *6–*7.

424. *Id.* at *9-*13.

United States v. Jon-T Chemicals, Inc.[425] in its opinion holding that Jon-T Chemicals was liable for a tort committed by its subsidiary discussed a great number of facts it considered as showing that Jon-T Chemicals dominated and controlled its subsidiary and included the observation that "Chemicals and Farms filed consolidated financial statements and tax returns."[426]

Note that tax issues may arise other than in connection with the entity's status. For example, in *NetJets Aviation, Inc. v. LHC Communications, LLC*,[427] one factor the court cited as showing injustice in the individual defendant's actions was that he had instructed the person in charge of the LLC's books to treat certain payments by the member to the LLC as loans so that the member could take money out of the LLC without tax consequences.[428]

V. IMPORTANCE OF DRAFTING CONTRACTS TO STATE WHAT IS INTENDED

Although the cases discussed under this heading are not, strictly speaking, veil-piercing cases, they are related in that sometimes poor contract drafting may leave a party unsatisfied and seeking a veil-piercing or alter-ego remedy. As these cases demonstrate, with one unusual exception,[429] courts generally will not protect a party against poor or incomplete drafting.

In *Primary Investments, LLC v. Wee Tender Care III, Inc.*,[430] the members/managers of an LLC that had sold its day care facility formed a new LLC and opened a new day care facility within three years after the sale. The purchaser sued the selling LLC, its members/managers, and the new LLC for breach of a noncompetition clause in the agreement for sale of the day care facility. The court held that the members/managers and the new LLC were not bound by the noncompetition agreement because they were not parties to the agreement. In a footnote, the court mentioned that the plaintiffs did not argue, and there was no evidence, that the existence of the selling LLC should be ignored. The attorney for the purchaser could have protected his client by requiring that the members/managers sign the sales agreement in their individual capacities agreeing to be bound by the

425. United States v. Jon-T Chem., Inc., 768 F.2d 686 (5th Cir. 1985); *see also supra* notes 121-139 and accompanying text.

426. *Jon-T Chem., Inc.*, 768 F.2d at 695.

427. NetJets Aviation, Inc. v. LHC Commc'ns, LLC, 537 F.3d 168 (2d Cir. 2008), s*upra* notes 163-177 and accompanying text.

428. *NetJets Aviation, Inc.*, 537 F.3d at 182.

429. *See infra* notes 436-437 and accompanying text.

430. Primary Inv., LLC v. Wee Tender Care III, Inc., 746 S.E.2d 823 (Ga. App. 2006).

noncompetition agreement and drafting the noncompetition agreement to be binding on affiliates (appropriately defined) of the selling LLC and its members/managers.

Similar issues arise when the members of an LLC desire to restrict its activities to a specified line of business or a specified geographic area. To ensure that the restriction will accomplish its purpose, the language should also prohibit the LLC from engaging in a prohibited business or area through affiliates. Otherwise the managers of the LLC might be able to get around the restriction by forming a subsidiary LLC.[431] Of course, in many instances, the managers' attempt to get around the restriction might exceed their authority[432] or violate a duty.[433] Careful drafting, however, would provide certainty.

Another case illustrating the consequences of failing to understand the meaning of applicable contract terms before a dispute arises is *Farina v. Perrotti*.[434] Plaintiff, the minority member of Hometown Waste, LLC ("Hometown Waste") sought to compel the owner of HTW Funding, LLC ("HTW"), the majority member of Hometown Waste, to participate in an arbitration pursuant to a provision of the operating agreement of Hometown Waste. The court rejected the plaintiff's attempt, noting that the owner of HTW was not a signatory to the operating agreement of Hometown Waste, and the record contained no evidence that would justify ignoring the existence of HTW. The plaintiff had originally formed

431. As long ago as 1925, commentators noted that "a subsidiary transacting business in a state, though a mere adjunct or instrumentality of a foreign corporation which owns and controls it, is a separate entity so that the foreign corporation is not doing business there itself." Henry W. Ballantine, *Separate Entity of Parent and Subsidiary Corporations*, 14 CALIF. L. REV. 12, 13 (1925), discussing the holding of *Cannon Manufacturing Company v. Cudahy Packing Company*, 267 U. S. 333 (1925). More recently, in *Estate of Thompson v. Toyota Motor Corporation Worldwide*, 545 F.3d 357 (6th Cir. 2008), the court held that, even though a plaintiff has only to make a prima facie showing that personal jurisdiction exists, the plaintiff in that case could not obtain jurisdiction over Toyota Motor Corporation Worldwide ("TMCW") merely because TMCW, a Japanese corporation, had numerous United States subsidiaries and a national presence. The court observed that plaintiff had presented no evidence that TMCW's United States subsidiary Toyota Motor Sales, U.S.A., Inc., was the alter ego of TMCW. According to the court "the alter-ego theory of personal jurisdiction, in the parent-subsidiary context, provides that 'a non-resident parent corporation is amenable to suit in the forum state if the parent company exerts so much control over the subsidiary that the two do not exist as separate entities but are one and the same for purposes of jurisdiction.'" Citing *Danton v. Innovative Gaming Corp*. 246 F. Supp.2d 64, 72, (D. Me. 2003). 545 F.3d at 362.

432. Some LLC statutes limit a manager's authority to actions taken in the ordinary course of the LLC's business. Other LLC statutes do not contain an explicit limit. Under either type of statute, however, the manager is an agent of the LLC and, as such, has a duty to act in accordance with the express and implied terms of any contract between the agent and the principal and to take action only within the scope of the manager's actual authority. RESTATEMENT (THIRD) OF AGENCY §§ 8.07, 8.09(1). This agency law provision, of course, also applies to members and other persons if they are acting as agents of the LLC.

433. *Id*.

434. Farina v. Perrotti, CV084032655, 2009 WL 941846 (Conn. Sup. Ct. Mar. 12, 2009).

Hometown Waste as the sole member, and when HTW was admitted as a member, the following arbitration provision was inserted in the operating agreement:

> In the event that any dispute shall arise between the Members as to the interpretation of this Operating Agreement or any dispute that may arise between the Members under this Operating Agreement or any dispute in regard to the management of the Company, such dispute may be submitted to a board of arbitrators. [and] . . ."[c]ompany" shall refer to HometownWaste, LLC [and] "[m]ember" shall mean each of the parties who executes a counterpart of this Operating Agreement as a Member and each of the other parties who may hereafter become a Member in accordance with the terms of this Operating Agreement.[435]

A Connecticut homebuilder won in two different courts on two different theories in attempting to enforce an arbitration clause he had signed with defendants, who resisted the arbitration demand on the ground that between signing the contract to build the defendants' home and making the demand for arbitration, the homebuilder, who had been operating as a sole proprietor, formed a single-member Connecticut LLC to conduct his business. The LLC was not a party to the construction contract the defendants had signed. The Connecticut Superior Court enforced the arbitration demand on the ground that the individual and his LLC were "practically identical" in relation to the defendant homeowners and there had been no suggestion that the formation of the LLC had any effect on the contractor's performance of his obligations to the defendants.[436] The Supreme Court of Connecticut affirmed the Superior Court[437] by characterizing the formation of the LLC as a conversion of the contractor's sole proprietorship and holding that the consequences would be the same as Connecticut statutory law provided for the conversion of a general partnership to an LLC.

It will not be often that a plaintiff seeking to enforce a contract that is missing a crucial term (such as one providing that the contractor could transfer the contract to a wholly-owned entity so long as he remained liable for performance) will be saved once, much less twice, by the courts.

435. *Id.* at *3.

436. C & J Builders and Remodelers, LLC v. Geisenheimer, No. CV 970405555S, 1998 WL 203400 (Conn. Super. April 17, 1998).

437. C & J Builders and Remodelers, LLC v. Geisenheimer, 733 A.2d 193 (Conn. 1999).

For a case where the plaintiff who failed on a veil-piercing claim could have protected himself by better contract drafting, see *K. C. Properties of N.W. Arkansas v. Lowell Investment Partners, LLC*.[438]

VI. VEIL-PIERCING FOR JURISDICTIONAL PURPOSES

Courts may apply a lesser standard to veil piercing and alter ego if the issue is personal jurisdiction. *Boston Scientific Corporation v. Wall Cardiovascular Technologies, LLC*[439] rejected an argument that a Texas LLC was subject to personal jurisdiction in Delaware as alter ego of Delaware LLC because the record did not show a sufficient level of control, absence of corporate formalities, or fraud, injustice, or inequity in use of the corporate form. The court recognized the separate legal existence of the LLC and its members under Texas law and rejected the argument that personal jurisdiction over an LLC is proper in any forum in which the LLC's members are subject to jurisdiction. *Wolf v. Summers-Wood, LP*[440] held that the fiduciary shield doctrine barred jurisdiction over non-resident officers of an LLC where the officers' contacts were in a representative capacity and were not systematic or continuous and the officers did not operate in a manner indistinguishable from their personal affairs or in a manner calculated to mislead. *ING (U.S.) Securities, Futures, & Options, Inc. v. Bingham Investment Fund, L.L.C.*[441] determined that personal jurisdiction over LLC members was lacking because of the fiduciary shield doctrine. *Yukon Partners, Inc. v. The Lodge Keeper Group, Inc.*[442] held, in the context of a challenge to personal jurisdiction, unspecified affiliation was insufficient to pierce the veil of numerous hotel LLCs in the absence of a showing that the entities were shams or were used to defeat public convenience, justify wrong, protect fraud, defend crime, or that there was any other reason that would in equity or good conscience justify disregard of the entities.[443] The Federal District Court for Nevada held, in a consolidated multi-district case arising out of the 2000-2001 energy crisis, that indirect partially owned subsidiary LLC's contacts could not be imputed to the parent North Carolina LLC for personal jurisdiction purposes where the parent LLC did not control the daily operations of its

438. K.C. Prop. of N.W. Ark. v. Lowell Inv. Partners, LLC, 280 S.W.3d 1 (Ark. 2008)*; see infra* notes 536-41 and accompanying text.

439. Boston Sci. Corp. v. Wall Cardiovascular Tech., LLC, 647 F. Supp. 2d 358, 367 (D. Del. 2009).

440. Wolf v. Summers-Wood, LP, 214 S.W.3d 783, 789 (Tex. App. 2007).

441. ING (U.S.) Sec., Futures, & Options, Inc. v. Bingham Inv. Fund, LLC, 934 F. Supp. 987, 989 (N.D. Ill. 1996).

442. Yukon Partners, Inc. v. The Lodge Keeper Group, Inc., 572 S.E.2d 647 (Ga. App. 2002).

443. *Id.* at 652.

subsidiary and plaintiff failed to establish that fraud or injustice would result from failure to pierce veil even assuming lack of separateness was established.[444]

Other cases have found personal jurisdiction based on alter ego claims. *Oliver v. Boston University*[445] held that an LLC was the alter ego of Boston University for purposes of personal jurisdiction, assuming truth of allegations that LLC was formed by Boston University solely to serve its interest and was completely dominated by the University. *Gonzalez v. Lehtinen*[446] concluded that there was sufficient evidence for the trial court to make an implied finding that a Texas LLC was the alter ego of Cardenas, a prominent Mexican citizen, and that Cardenas was therefore subject to the Texas long-arm statute as someone who "did business" in Texas. In a jurisdictional veil-piecing case, the court stated that it does not assess certain issues such as fraud and undercapitalization. Instead, the focus was on whether Cardenas controlled the internal business operations of the LLC to a degree "greater than that normally associated with common ownership and directorship." In *Rice v. Oriental Fireworks Company*,[447] the Oregon court exercised personal jurisdiction over a Maryland resident who had only visited Oregon once on the ground that the defendant corporation, over which the court clearly had jurisdiction, was his alter ego. *XL Vision v. Holloway*[448] exercised personal jurisdiction over an LLC's president and foreign parent where the plaintiff's complaint alleged that the president and the foreign parent of the LLC formed, operated, and manipulated the LLC to defraud creditors, that they commingled funds, that they failed to maintain other corporate formalities, that the parent directly paid the liabilities of the LLC, and that the LLC was run by the president and parent for their benefit. *White Family Harmony Investment, Ltd. v. Transwestern West Valley, LLC*[449] held that the evidence before the court was sufficient to treat LLCs under common ownership as alter egos and to impute forum contacts of one to the other for purposes of exercising personal jurisdiction.

444. *See, e.g.*, Heartland Reg'l Med. Ctr. v. Oneok Inc., No 2:03-CV-01431-PMP-PAL, 2: 07-CV-009887-PMP-PAL, 2009 U.S. Dist. LEXIS 13850 (D. Neb. 2009); Breckenridge Brewery of Colorado, LLC v. Oneok, Inc., No 2:03-CV-01431-PMP-PAL, 2:06-CV-01351-PMP-PAL, 2009 U.S. Dist. LEXIS 13815 (D. Neb. 2009); Learjet, Inc. v. Oneok, Inc., No 05-2531-CM, 2006 U.S. Dist. LEXIS 24589 (D. Kan. 2006); J.P. Morgan Trust Co. v. The Williams Co., Nos. 2:03-CV-01431-PMP-PAL, 2:06-CV-00233-PMP-PAL,2:05-CV-01331-PMP-PAL, 2009 U.S. Dist. LEXIS 39686 (D. Neb. 2008).

445. Oliver v. Boston Univ., No. 16570, 2000 WL 1038197 (Del. Ch. 2000).

446. Gonzalez v. Lehtinen, No. 13-06-441-CV, 2008 WL 668600, at *4 (Tex. App. 2008).

447. Rice v. Oriental Fireworks Co., 707 P.2d 1250, 1255 (Or. App. 1985).

448. XL Vision v. Holloway, 856 So. 2d 1063, 1066–67 (Fla. App. 2003).

449. *White Family Harmony Inv., Ltd.*, 2005 WL 2893784, at *7; *see also supra* notes 404-28 and accompanying text.

Kirby Morgan Dive Systems v. Hydrospace Ltd.[450] held the evidence in the record sufficient to support personal jurisdiction over the sole owner and managing director of a Scottish LLC. The court held that the LLC was the alter ego of its owner on the basis of evidence that the LLC was under the total control of its owner, the LLC was undercapitalized in relation to the obligations it had under a contract with the plaintiff, and injustice would result if the owner was not held personally liable for the arbitration award because plaintiff would not be able to recover fully and the Scottish owner could circumvent the arbitrator's injunctive relief through operation of his other businesses.

In *Morris v. Powell*[451] Dr. Robert Morris and his wife, Joyce Morris, were employees of Morris Genetics, LLC, a Missouri LLC. Dr. and Mrs. Morris travelled to Texas for four days in September 2001 to perform embryo transplant surgeries in plaintiff's Boer goats. Dr. Morris represented that his transplant program could achieve a seventy percent success rate. Instead, with the plaintiff's goats, Dr. Morris achieved only a ten percent success rate. The court did not find jurisdiction on the basis of alter ego,[452] but held that Dr. Morris was subject to personal jurisdiction in Texas on the ground that, assuming plaintiff's allegations to be true, he had personally committed a tort in Texas and:

> In determining whether there is a substantial connection between the nonresident defendant and the State of Texas, we must consider "foreseeability." Where a defendant sends false information into a state, knowing it will be relied upon by a resident of the forum state, there is a foreseeable consequence of direct economic injury to the resident at its domicile. Therefore, if the alleged tortfeasor knows that the brunt of the injury will be felt by a particular resident in the forum, it must reasonably anticipate being hailed into court there to answer for its actions.[453]

With respect to Dr. Morris specifically, the court stated:

> [W]hen Dr. Morris provided plaintiffs with an estimate of approximately 252.8 pregnancies while allegedly

450. Kirby Morgan Dive Sys. v. Hydrospace Ltd., No. CV 09-4934, 2010 WL 234791, at *4 (C. D. Cal. 2010), *rev'd on other grounds and vacated by*, Kirby Morgan Dive Sys. v. Hydrospace Ltd., 478 Fed. Appx. 382 (9th Cir. 2012).

451. Morris v. Powell, 150 S.W.3d 212, 219 (Tex. App. 2004).

452. *Morris*, 150 S.W.3d at 220.

453. *Id.* at 221 (internal citations omitted).

> withholding information about his declining success rate, he knew the plaintiffs were in Texas and it was foreseeable that plaintiffs would rely on the estimated success rate he represented to them. Accordingly, the injurious effect in Texas of the torts Dr. Morris allegedly committed could have been foreseen. Furthermore, there is a strong nexus between the alleged torts committed by Dr. Morris and the contacts with Texas, *i.e.*, it is these specific contacts that give rise to the claims brought by plaintiffs against Dr. Morris. For these reasons, we conclude that Dr. Morris' alleged actions/inactions support a finding that the trial court had specific jurisdiction over him.[454]

In *Michiana Easy Livin' Country, Inc. v. Holten*,[455] the Texas Supreme Court disapproved the foreseeability analysis applied in *Morris*.[456] The court in *Michiana* provides a comprehensive review of Texas long-arm jurisdiction. The court reversed the trial court's holding that it jurisdiction over the defendant. It appears, however, that the court could have disposed of the case on the basis that a forum selection clause in the contract between plaintiff and defendant for the purchase by plaintiff of a $64,000 Coachmen recreational vehicle provided that all actions under the contract would be brought in Indiana. With respect to the forum selection clause, the court stated:

> Holten argues it was within the trial court's discretion to refuse to enforce this clause. But enforcement of a forum-selection clause is mandatory absent a showing that "enforcement would be unreasonable and unjust, or that the clause was invalid due to fraud or overreaching." Holten does not assert that the clause itself was fraudulently induced, and presented no evidence showing why enforcement would be unreasonable or unjust. Accordingly, he should be held to it.[457]

VII. CHOICE OF LAW FOR VEIL PIERCING

The Restatement (Second) of Conflicts states: "The local law of the state of incorporation will be applied to determine the existence and extent

454. *Id.* at 222–23 (internal citations omitted).
455. Michiana Easy Livin' Country, Inc. v. Holten, 168 S.W.3d 777 (Tex. 2005).
456. *Id.* at 788–89.
457. *Michiana Easy Livin' Country, Inc.*, 168 S.W.3d at 793.

of a shareholder's liability to the corporation for assessments or contributions and to its creditors for corporate debts."[458]

A majority of cases either follow the Restatement rule or hold that a veil-piercing claim should be governed by the law of the state of formation of the entity whose veil may be pierced on the basis of other authority substantially the same as the Restatement rule. For example, *Soviet Pan Am Travel Effort v. Travel Committee, Inc.*[459] holds that "Because a corporation is a creature of state law whose primary purpose is to insulate shareholders from legal liability, the state of incorporation has the greater interest in determining when and if that insulation is to be stripped away."[460] *In re American International Refinery*[461] noted that "the Fifth Circuit has predicted that Louisiana courts would look to the law of the state of incorporation. This choice-of-law rule is consistent with the Restatement as well as the choice-of-law rules of other jurisdictions."[462] *Kalb, Voorhis & Co. v. American Financial Corporation*[463] stated that the law of state of incorporation controls alter ego claims notwithstanding a choice of law provision in related debentures that the court labelled "irrelevant."[464] *Blue Whale Corporation v. Grand China Shipping Development Co., Ltd.*[465] stated that *Kalb, Voorhis* "teaches us that choice-of-law clauses in underlying contracts are 'irrelevant' to assessing alter-ego claims."[466] *Howell Contractors, Inc. v. Berling*[467] followed the Restatement and *Kalb, Voorhis* to hold that Kentucky would apply Ohio law in a veil-piercing action against the sole owner of an Ohio LLC.[468] The court affirmed the trial court's piercing of the veil of the LLC, and also noted that the same result would obtain under Kentucky law.[469] *Dassault Falcon Jet Corp. v. Oberflex, Inc.*[470] states:

> A choice of law provision in a contract is not binding on what law to apply for piercing the corporate veil. The reason for this is that the issue of piercing the corporate veil is collateral to and not part of the parties' negotiations or

458. RESTATEMENT (SECOND) OF CONFLICTS OF LAWS § 307 (1971).
459. Soviet Pan Am Travel Effort v. Travel Comm., 756 F. Supp. 126 (S. D. N. Y. 1991).
460. *Id.* at 131.
461. *In re* American Int'l Refinery, 402 B.R. 728 (Bankr. W. D. La. 2008).
462. *Id.* at 743 (internal citations omitted).
463. Kalb, Voorhis & Co. v. Am. Fin. Corp., 8 F.3d 130 (2d Cir. 1993).
464. *Kalb, Voorhis & Co.*, 8 F.3d at 132.
465. Blue Whale Corp. v. Grand China Shipping Dev. Co., Ltd, 722 F.3d 488 (2d Cir. 2013).
466. *Id.* at 496.
467. Howell Contractors, Inc. v. Berling, 383 S.W.3d 465 (Ky. App. 2012).
468. *Howell Contractors, Inc.*, 383 S.W.3d at 467.
469. *Id.* at 469.
470. Dassault Falcon Jet Corp. v. Oberflex, Inc., 909 F. Supp. 345, 348–49 (M.D. N.C. 1995).

> expectations with respect to the contract. It involves imposing liability on third-party shareholders as opposed to governing the parties' obligations under the contract.
>
> The restatement position, which applies the law of the state of incorporation, is supported by sound policy reasons. After all the state's primary purpose for permitting corporations to be formed is to allow for limited liability. It would seem then that 'the state of incorporation has the greater interest in determining when and if that insulation is to be stripped away.'[471]

A bankruptcy court in Texas held that a veil-piercing claim against a Delaware corporation would be governed by Delaware law on the basis of the following then effective provision of Texas statutory law:

> [O]nly the laws of the jurisdiction of incorporation of a foreign corporation shall govern (1) the internal affairs of the foreign corporation, including but not limited to the rights, powers, and duties of its board of directors and shareholders and matters relating to its shares, and (2) the liability, if any, of shareholders of the foreign corporation for the debts, liabilities, and obligations of the foreign corporation for which they are not otherwise liable by statute or agreement.[472]

California courts have applied the state of formation rule in veil piercing actions involving a Delaware LLC and an Arizona LLC.[473] These cases were decided on the basis of Cal. Corp. Code § 17708.01, which is California's general rule applying the internal affairs doctrine to foreign LLCs. An earlier California case, *Allison v. Danilovic*,[474] although concluding in a case involving piercing the veil of a Delaware LLC that Delaware law and California law reached the same result, that had there been a conflict, the court would have applied California law because of California's superior interest in enforcing a wage claim and alter ego claim

471. *Dassault Falcon Jet Corp.*, 909 F. Supp. At 348–49 (citing Kalb, Voorhis & Co. v. Am. Fin. Corp., 8 F.3d 130, 132 (2d Cir. 1993)).

472. *In re* Kilroy, 357 B.R. 411, 425 (Bankr. S.D. Tex. 2006) (citing Texas Business Corporations Act article 8.02 (2003)). Substantially the same rules are now set forth in Texas Business Organizations Code sections 1.102, 1.104, 1.105.

473. *E.g.*, Bronstein v. Crowell, Weedon & Co., No. B191738, 2007 WL 969559, at *9 (Cal. App. Apr. 3, 2007); River Rock Dev. v. Palk, No. C057850, 2010 WL 46783, at *1 n. 1, (Cal. App. 2010).

474. Allison v. Danilovic, No. B163363, 2004 Cal. App. LEXIS 10988 (Cal. Ct. App. 2004).

where all parties, as well as the directors, officers, and employees of the LLC all lived in California.

It is unclear what law Colorado would follow in a veil piercing/alter-ego case. In *Martin v. Freeman*,[475] although the caption in the case identified the LLC in question as a Delaware LLC, the trial court and the Colorado Court of Appeals applied Colorado law without any discussion of choice of law issues. An earlier Court of Appeals opinion applied Colorado law to an alter-ego case involving a Montana corporation.[476] In *Ficor, Inc. v. McHugh*,[477] the Colorado Supreme Court applied Colorado law to determine the liability to creditors of the directors of a dissolved District of Columbia corporation. The court stated that Colorado law should apply because all of Ficor, Inc.'s activities were conducted in Colorado and all of its assets were located there.[478] However, the court took pains to demonstrate that the result would have been the same under the law of the District of Columbia.[479] Colorado now statutorily applies the internal affairs doctrine to foreign entities.[480] The court in *Martin v. Freeman* [481] and *McCallum Family L.L.C. v. Winger*[482] did not discuss this statute, possibly because not argued by the parties. Whether this statute will make a difference if properly presented and argued remains to be determined.

Illinois applies the state of formation rule.[483] A federal court in Illinois applied Colorado law to determine veil-piercing claims against the members of a Colorado LLC and concluded that the plaintiff had presented no significant evidence of factors that would support veil piercing.[484] Iowa applies the state of formation rule on the basis of the internal affairs doctrine.[485]

Kansas applies the state of formation rule.[486] A federal court in the District of Columbia and a bankruptcy court in Louisiana both applied

475. *See* Martin v. Freeman, 272 P.3d 1182–85 (Colo. App. 2012).

476. McCallum Family LLC. v. Winger, 221 P.3d 69, 73–74 (Colo. App. 2009).

477. Ficor, Inc. v. McHugh, 639 P.2d 385 (Colo. 1982).

478. Id. at 391.

479. *Id.*

480. COLO. REV. STAT. § 7-90-805(4) (2015) ("As to any foreign entity transacting business or conducting activities in this state, the law of the jurisdiction under the law of which the foreign entity is formed shall govern the organization and internal affairs of the foreign entity and the liability of its owners and managers.").

481. *See Martin*, 272 P.3d at 475.

482. *See McCallum Family LLC,* 221 P.3d at 74–75.

483. Westmeyer v. Flynn, 889 N.E.2d 671, 676 (Ill. App. Ct. 2008).

484. *In re* Liberty Coal Co., LLC, No. 09-CV-0371, 2010 WL 1415998, at *8 (S.D. Ill. Mar. 31, 2010); *see infra* notes 566–84 and accompanying text.

485. Tyson Fresh Meats, Inc. v. Lauer Limited, LLC, 918 F. Supp. 2d 835, 850 (N.D. Iowa 2013).

486. *See* ColtTech, LLC v. JLL Partners, Inc., 538 F. Supp. 2d 1355, 1358–59 (D. Kan. 2008).

Nevada law where that was the state of formation of the entities involved.[487] A federal court in Mississippi applied the law of the state of formation on the ground that the Mississippi LLC Act provided that the liability of a member is governed by the state of organization.[488] Federal courts in Oklahoma and Wisconsin have applied the law of the state of formation.[489] A federal court in California applied Washington veil-piercing law to alter ego claims against several Washington LLCs and a Washington corporation.[490] The court based its holdings on California LLC law and a balancing of interests.

A federal court in Nebraska applied Nebraska law to veil piecing claims against two Delaware entities on the ground that Nebraska's interest in applying its law to its citizens outweighed the interest of the state of formation.[491] Similarly, a federal court in Kentucky applied Kentucky law to a breach of contract and veil-piercing action against the members of a Tennessee LLC.[492] The court stated that Kentucky had the most significant relationship to the transaction despite the fact that the LLC was organized under Tennessee law, and the court relied on a Kentucky Supreme Court case[493] for the proposition that Kentucky law will apply to a contract issue if there are sufficient contacts in Kentucky and not overwhelming interests to the contrary. The Federal Court in this case treated the matter as a breach of contract action and did not address any choice of law issues in its relatively brief discussion of plaintiff's piercing claim (which the court denied.) If application of the law of the state of formation of the entity may be outcome determinative, an attorney who is defending an alter-ego/veil piercing claim will want to ensure to present to the forum court all of the preceding authorities that argue for the state of formation and that discount choice of law provisions.

A contrary argument could be been made that Section 307 of the Restatement (Second) of Conflicts is incorrect because the potential liability of the individual defendants in a veil-piercing case should be viewed as an external affair of the entities. This argument, however, would be based on a mistaken reading of the internal affairs doctrine, which is commonly stated as follows: "The internal affairs of a corporation will be

487. SEC v. Levine, 671 F. Supp. 14, 33 (D. D.C. 2009); *In re* Am. Int'l. Refinery, 402 B.R. 728, 743 (Bankr. W.D. La. 2008).

488. Andrews v. Kerr McGee Corporation, No. 1:00CV158-D-A, 2001 WL 1704144, at *2 (N.D. Miss. 2001).

489. Tomlinson v. Combined Underwriters Life Ins. Co., 684 F. Supp. 2d 1296, 1298, 1300 (N.D. Okla. 2010); Rual Trade Ltd. v. Viva Trade LLC, 549 F. Supp. 2d 1067, 1077 (E.D. Wis. 2008).

490. Wehlage v. EmpRes Healthcare Inc., 821 F. Supp. 2d 1122, 1128 (N.D. Cal. 2011).

491. Schwan v. CNH Am., LLC, No. 4:04CV3384, 2006 WL 1215395, at *17 (D. Neb. 2006).

492. First Constr., LLC v. Gravelroad Entm't, LLC, No. 6:07-155-DCR, 2008 WL 2038878, at *3 (E.D. Ky. 2008).

493. Breeding v. Mass. Indem. & Life Ins. Co., 633 S.W.2d 717, 719 (Ky. 1982).

governed by the corporate statutes and case law of the states in which the corporation is incorporated."[494]

This potential analysis is flawed because owners of corporations and limited liability companies ordinarily are not liable for obligations of the entity. If a corporation or limited liability company is sued because one of its employees causes an accident while acting in the scope of employment, it is appropriate that the liability of the entity will be determined by the law of the state in which the accident took place. If a plaintiff sues a shareholder or member seeking to pierce the veil of the entity to hold the shareholder or member liable for the obligation of the entity to the injured person, the plaintiff is seeking to hold the shareholder or member liable for an obligation of the entity.[495] The shareholder or member will have no liability if the plaintiff has not or cannot establish that the entity owes something to the plaintiff. Logically, it does not appear that a shareholder's or member's liability for an obligation of the entity can be termed an external affair.

The policy of the Restatement is sound. Although a court may be inclined to apply the law of the forum if that law is more favorable to a plaintiff who is a resident of the forum state,[496] if the rule of the Restatement is not applied, a shareholder's or member's liability for such an obligation of the entity might vary depending on where the accident occurred or where suit is brought against the shareholder. This Article posits that applying the law of the forum state is not good policy because the prerogative of each state to determine when a limited liability entity may be formed and when limited liability should be disregarded should be respected as an important aspect of federalism and the desirability of promoting uniformity.

In a subsidiary question, the court in *Advanced Telephone Systems, Inc. v. Com-Net Professional Mobile Radio, LLC*[497] held that the plaintiff

494. CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 89–90 (1987); Edgar v. Mite Corp. & Mite Holdings, Inc., 457 U.S. 624, 645 (1982); Shaffer v. Heitner, 433 U.S. 186, 215, n.44 (1977); Rogers v. Guar. Trust Co. of N.Y., 288 U.S. 123, 130 (1933); VantagePoint Venture Partners 1996 v. Examen, Inc., 871 A.2d 1108, 1116–18 (Del. 2005); McDermott, Inc. v. Lewis & Altman, 531 A.2d 206, 215 (Del. 1987). Of course, Delaware has significant encouragement to expand the internal affairs doctrine as far as possible to protect the national and international applicability of the Delaware General Corporation Law to Delaware corporations. *See generally* Timothy P. Glynn, *Delaware's Vantage Point: The Empire Strikes Back in the Post-Post-Enron Era*, 102 NW. U. L. REV. 91 (2008); Matt Stevens, *Internal Affairs Doctrine: California Versus Delaware in a Fight for the Right to Regulate Foreign Corporations*, 48 B.C. L. REV. 1047 (2008); Norwood P. Beveridge, Jr., *The Internal Affairs Doctrine: The Proper Law of a Corporation*, 44 BUS. LAW. 693 (1988).

495. *See Dassault Falcon Jet Corp.*, 909 F. Supp. at 348 (stating that veil piercing "involves imposing liability on third-party shareholders").

496. *Supra* note 491 and accompanying text.

497. Advanced Tel. Sys., Inc. v. Com-Net Prof'l Mobile Radio, LLC, 846 A.2d 1264 (Pa. Super. 2004).

was not entitled to a jury trial on the issue whether the veil of a LLC should be pierced. Although the LLC in question was a Delaware LLC, the court held that entitlement to a jury trial, *vel non*, was a procedural issue, not a substantive issue, and applied Pennsylvania law to make this determination.[498]

VIII. CAUSAL RELATIONSHIP

The essence of this issue is what causal connection, if any, there must be between the improper actions that arguably support veil piercing and the harm suffered by the plaintiff who is asserting the veil piercing claim. Relatively few cases discuss causation explicitly — apparently because causation is obvious in most successful veil-piercing cases.

Instituform Technologies, LLC v. Cosmic TopHat, LLC[499] is discussed at several points in this Article.[500] The court stated that while the defendant may have failed to keep the entities in question separate from each other, the evidence did not show that he had failed to keep them separate from himself.[501] It would appear that the court was saying by this that the lack of separateness that plaintiff had established had not contributed to the harm suffered by plaintiff.

In re *Weddle* (*Elsaesser v. Cougar Crest Lodge, LLC*)[502] considered a plaintiff's claims that the defendant LLC received a preferential transfer when it recorded judgments it recovered against the individual debtors (who were members of the LLC). Since the judgments were recorded more than ninety days before the bankruptcy petition, the plaintiff could prevail on its preference claim only if it could prove that the LLC was an insider. The court rejected the plaintiff's argument that the LLC and the debtors were statutory insiders as defined in Section 101(31)(A) of the Bankruptcy Code, but the plaintiff also argued that the LLC and its managing member were alter egos. Because the managing member was the father of one of the individual debtors and was a per se insider, plaintiff argued that the LLC, as the managing member's alter ego, was an insider. Although the court noted some evidence of unity of interests, it granted summary

498. *Id.* at 1274–78.

499. *Insituform Tech., LLC*, 959 F. Supp. 2d at 1335.

500. *See supra* notes 227-32 and accompanying text (for its interesting take on separateness) and notes 304-10 and accompanying text (undercapitalization must be coupled with intent to avoid debts) and *infra* notes 620-22 and accompanying text (reverse veil-piercing).

501. *Insituform Technologies, LLC*, 959. F. Supp. 2d at 1345.

502. Elsaesser v. Cougar Crest Lodge, L.L.C. (*In re* Weddle), 353 B.R. 892 (Bankr. D. Idaho 2006).

judgment to the LLC because the plaintiff presented no evidence supporting its allegation that failure to treat the LLC and its managing member as alter egos would lead to inequitable results. In re Weddle's holding that the LLC and the debtors were not statutory insiders was criticized in a later case.[503]

The Delaware Chancery Court has indicated that the circumstances to piece the veil of an entity must be pervasive — not just stemming from a single transaction. Thus, the Delaware Court of Chancery explained the Delaware approach to piercing the corporate veil as follows:

> This Court will disregard the corporate form only in the "exceptional case." Determining whether to do so requires a fact intensive inquiry, which may consider the following factors, none of which are dominant: (1) whether the company was adequately capitalized for the undertaking; (2) whether the company was solvent; (3) whether corporate formalities were observed; (4) whether the controlling shareholder siphoned company funds; or (5) whether, in general, the company simply functioned as a façade for the controlling shareholder. Delaware courts also must find an element of fraud to pierce the corporate veil.[504]

In *Winner*, plaintiffs Winner Acceptance Corporation and Winner Group Leasing, Inc. (collectively, "Winner") leased thirty-seven trucks and trailers to Jubb's Mail Service, Inc. ("Jubb's"), which operated a rural mail route in Virginia.[505] As part of a Chapter 11 restructuring of Jubb's, Mid-Atlantic Postal Express, Inc. ("Mid-Atlantic") assumed Jubb's lease obligations to Winner.[506] Defendants included Postal Express of America, Inc., which guaranteed the lease obligations undertaken by Mid-Atlantic, Return on Capital ("ROC") or Return on Equity Group, Inc., and Edward Daspin ("Daspin"), described in plaintiffs' complaint as "a director, chief executive officer, and 'alter-ego' of Postal Express, ROC, and ROEG.[507] To acquire Jubb's mail route, the defendants needed the approval of

503. Redmond v. CJD & Assocs., LLC (*In re* Brooke Corp.), 506 B.R. 560 (Bankr. D. Kan. 2014).

504. Winner Acceptance Corp. v. Return on Capital Corp., No. 3088–VCP, 2008 WL 5352063 at *5 (Del. Ch. 2008) (citing Mason v. Network of Wilmington, Inc., No. Civ.A. 19434-NC, 2005 WL 1653954 at *3 (Del. Ch. 2005)).

505. *Winner Acceptance Corp*., 2008 WL 5352063 at *1.

506. *Id.*

507. *Id*. (stating that the complaint alleged that Postal Express was a wholly-owned subsidiary of ROC or ROEG, which "hold themselves out as merchant or investment banks incorporated in Delaware").

plaintiffs, the bankruptcy court, and the U. S. Trustee overseeing Jubb's bankruptcy.[508] To operate the route, defendants also needed access to the fleet of trucks leased to Jubb's by Winner.[509] At subsequent meetings, Daspin:

> Offered to make Postal Express a guarantor of Mid-Atlantic's obligations to Winner under the Fleet lease. Daspin allegedly represented that Postal Express was a "well funded and long-established 'Delaware transportation and logistics based holding company' under the total control of Daspin, ROC and ROEG" and that Daspin would personally oversee "the new business to be formed as part of the plan and Postal Express." Plaintiffs also were provided with certain unnamed "documents" and unspecified "information" concerning Postal Express's "viability and operations," upon which Winner claims to have justifiably relied.[510]

Within a year, Mid-Atlantic was no longer meeting its obligations under the lease.[511] "Winner also discovered that, far from being a long established and successful company, Postal Express actually had been formed" in the month preceding Jubb's bankruptcy filing.[512] Plaintiffs sued Mid-Atlantic for breach of the lease and obtained a judgment on November 30, 2004.[513] By mid-2005 Daspin told Winner that he had transferred the trucks to other operations of his, rejected Winner's demands to return the trucks, and asserted that he owned the trucks.[514] Winner began searching for the trucks and found them "scattered across the eastern seaboard having been abandoned in various states, such as Virginia, Georgia, Maryland, New Jersey, and New York."[515]

The court concluded its analysis of plaintiffs' alter ego claims as follows:

> Regarding the requisite element of fraud for piercing the corporate veil, Plaintiffs allege that after relying in late 2003 on the documents Daspin provided, they later discovered, for example, that Postal Express was not established until

508. *Winner Acceptance Corp*., 2008 WL 5352063 at *1.
509. *Id*.
510. *Id*. at *2.
511. *Id*. at *3.
512. *Winner Acceptance Corp*., 2008 WL 5352063 at *3.
513. *Id*.
514. *Id.*
515. *Id.*

> November 2003. Additionally, the Complaint avers that Defendants did not intend to continue the mail service or the lease payments when they gave assurances to Winner to the contrary. Instead, Daspin and the other Defendants "intended to abscond with the equity invested by Jubbs and Capitimino, abscond with the substantial payments from the United States Postal Service and to use the Fleet assets for their own gain and purposes." The Complaint further alleges that Daspin used the Fleet for his own purposes after Mid-Atlantic ceased making payments. Plaintiffs claim they "had received correspondence from Daspin, stating that he had transferred the Fleet to other of Daspin's operations in order to 'generate revenue.'" Daspin also claimed he himself owned the Fleet, despite the fact that Mid-Atlantic was allegedly a mere lessee. Moreover, Plaintiffs allege that "Defendants' direct acts, and their clandestine, fraudulent and wrongful activities, intentionally left Mid-Atlantic without any assets or ability to pay Plaintiffs any judgment, Mid-Atlantic's assets having been transferred to or otherwise coming under the exclusive control of Defendants." Additionally, Plaintiffs seek damages directly from Daspin, as well as from the other Defendants. These allegations provide a sufficient basis to support a claim for piercing the corporate veil, which falls within this Court's equitable jurisdiction.[516]

Winner clearly appears to be a case of "preventing '[f]raud or something like it.'"[517]

In *EBG Holdings LLC v. Vredezicht's Gravenhage 109 B.V.*,[518] EBG Holdings LLC ("EBG"), a Delaware LLC, sued one of its members, a Dutch LLC ("VG 109"), and the member's parent corporation ("NIBC"), seeking, inter alia, a declaration that VG 109 was NIBC's alter ego.[519] The court found that EBG had not:

> [M]ade a sufficient showing of fraud or other inequity to

516. *Winner Acceptance Corp*., 2008 WL 5352063 at *6.

517. Macey & Mitts, *supra* note 11 at 109 (citing Mobil Oil Corp. v. Linear Films, Inc., 718 F. Supp. 260, 268 (D. Del. 1989)).

518. EBG Holdings LLC v. Vredezicht's Gravenhage 109 B.V., No. 3184-VCP, 2008 WL 4057745 (Del. Ch. 2008).

519. *Id.* at *2 (providing that VG 109 owned 163,999 equity units representing approximately 2.5% of EBG's equity).

> justify a departure from the usual rule recognizing the corporate form. Even drawing all inferences in favor of EBG, it has not shown that NIBC's use of the corporate form for its VG 109 subsidiary constituted a 'sham and exist[s] for no other purpose than as a vehicle for fraud. To the contrary, NIBC has presented uncontroverted evidence that VG 109 predated the formation of EBG and serves as a broader investment vehicle, which has held other assets besides the membership interests in EBG. In fact, VG 109 was formed as a special purpose entity in July 2001, several years *before* the creation of EBG. In addition, VG 109 has observed a number of corporate formalities. It has, for example, filed separate US tax returns and maintains separate books and records. Moreover, although VG 109 and NIBC's alleged breach of contract may be unjust or wrongful, the requisite element of fraud under the alter ego theory must come from an inequitable use of the corporate form itself as a sham, and not from the underlying claim.[520]

The court also rejected the plaintiff's argument that NIBC should be subject to personal jurisdiction in Delaware because VG 109 was acting as NIBC's agent in Delaware.

Texas cases hold that, in addition to establishing alter-ego, the plaintiff must show that the defendant perpetrated an actual fraud for the defendant's personal benefit.[521] *Fin and Feather Club* involved an attempt by Fin and Feather Club to recover over $37,000 in unpaid club dues, assessments, and other charges from Dale and Don Leander.[522] The club shares had been transferred to Father and Sons Property, LLC, a single-member Texas LLC.[523] The court noted the lack of evidence showing that Father and Sons Property, LLC should be considered the alter ego of the individuals,[524] and, the court further noted, there was no evidence that, as required by Texas law,[525] the LLC was "used to commit an actual fraud on

520. *EBG Holdings LLC*, 2008 WL 4057745 at *12.

521. Fin & Feather Club v. Leander, 415 S.W.3d 548 (Tex. App. 2013); DDH Aviation, L.L.C. v. Holly, 2005 WL 770595 (N.D. Tex. 2005); *see also supra* notes 444-57 and accompanying text.

522. *Fin & Feather Club*, 415 S.W.3d at 551–52.

523. *Id.* at 552.

524. *Id.* at 555–56.

525. Shook v. Walden, 368 S.W.3d 604, 612–14 (Tex. App. 2012) (explaining that the Texas legislature amended the Texas statutes to limit application of alter-ego/veil piercing claims. Article 2.21 of the Texas Business Corporation Act was amended, and, as carried forward in Texas Business Organizations Code Section 21.223, provides that a shareholder may not be held liable for any *contractual* obligation of the corporation on the basis that the shareholder is or was the alter ego of the corporation or on the basis of actual or constructive fraud, a sham to perpetrate a fraud, or other similar

the plaintiff for the defendant's personal benefit."[526] Further, "to recover against a member of an LLC individually, the plaintiff must show dishonesty or purpose or intent to deceive."[527] *Shook v. Walden* rejected the plaintiffs' veil-piercing claim on the ground that plaintiffs had failed to present evidence that defendant had either used the entity to perpetrate an actual fraud or that he did so for his direct personal benefit.[528] In explaining the policy behind this requirement of Texas law, the court observed that the Texas Legislature had amended the Texas entity statutes to provide a different balance in veil-piercing cases than had been articulated in earlier Texas cases and stated:

> [A] claimant must prove that the individual used the corporate form to perpetrate actual fraud (i.e., that characterized by deliberately misleading conduct) for the individual's direct personal benefit. This balancing in part reflects a distinction, also reflected in [earlier cases], between the perceived relative equities of veil-piercing claimants who are asserting tort theories of recovery versus those suing in contract. The basic notion was that contract claimants, unlike most third parties suing in tort, had voluntarily chosen to deal with the corporation and, "[a]bsent some deception or fraud," would have had the opportunity to apportion, through negotiated contract terms, the risk that the entity would be unable to meet its obligations.[529]

A New York court has stated that a member must have "engaged in acts amounting to an abuse or perversion of the LLC form to perpetuate a wrong or injustice" to justify piercing the veil of an LLC.[530] A California court has held that "actual fraud is not required to invoke the alter ego doctrine" but that the doctrine will be applied to prevent an unjust and inequitable result.[531] Another California court held that alter ego liability

theory, or for any obligation of the corporation on the basis that the corporation failed to observe any corporate formality. Texas Business Organizations Code Section 101.002 makes Section 21.223 applicable to LLCs.).

526. *Fin & Feather Club*, 415 S.W.3d at 556 (citing Shaw v. Maddox Metal Works, Inc., 73 S.W.3d 472, 481 (Tex. App. 2002)).

527. *Id.* (citing Menetti v. Chavers, 974 S.W.2d 168, 174 (Tex. App. 1998)).

528. *Shook*, 368 S.W.3d at 622.

529. *Shook*, 368 S.W.3d at 620.

530. Grammas v. Lockwood Assoc., LLC, 944 N.Y.S.2d 623, 626 (N.Y. App. Div. 2012).

531. Stinky Love, Inc. v. Lacy, No. B163377, 2004 Cal. App. 2004 WL 1803273 (Cal. App. 2004) (upholding the trial court's judgment piercing an LLC's veil and holding Lacy, the LLC's founder and CEO, personally liable on a judgment against the LLC. The LLC contracted with Stinky

could apply even where the individuals did not directly own an interest in the LLC but were members of the sole member of the LLC and even though the individuals' indirect interest was only eighteen percent. "The ownership of even a single share in the corporate entity is sufficient to qualify one for alter ego liability."[532] Of course, the grounds for imposing alter ego liability must otherwise be present.[533]

In Ohio, to pierce the veil of a corporation of LLC, the plaintiff must show "(1) control over the corporation by those to be held liable was so complete that the corporation has no separate mind, will, or existence of its own, (2) control over the corporation by those to be held liable was exercised in such a manner as to commit fraud or an illegal act against the person seeking to disregard the corporate entity, and (3) *injury or unjust loss resulted to the plaintiff from such control and wrong*."[534]

Love, Inc. ("Stinky") to distribute Stinky's movie "Love Stinks." Various representatives of the LLC represented to Stinky on more than one occasion that Lacy had committed $30,000,000 in capital to the LLC. Lacy tried to raise $30,000,000 but was unsuccessful and instead capitalized the LLC with $1,000,000 of his own money and $150,000 from another company he controlled. Lacy and his family controlled one hundred percent of the LLC, and Lacy closely managed the details of the LLC's business and its expenditures. The distribution agreement between Stinky and the LLC required the LLC to spend $8,000,000 on prints and advertising and to pay $4,300,000, plus a portion of the gross receipts, for the distribution rights to the movie. The movie fared poorly, and Stinky never received any of the purchase price. Stinky obtained an arbitration award against the LLC for breach of contract in the amount of $4,300,000, and the award was confirmed by a judgment. Lacy filed bankruptcy, but the stay was lifted to allow Stinky to pursue Lacy. Following a bench trial, the court found Lacy was the alter ego of the LLC and amended the arbitration judgment to add Lacy as a debtor. The court of appeals noted that the alter ego doctrine applies to members of an LLC and stated that two conditions must be met to invoke the doctrine: (1) there is such unity of interest between the corporation and its equitable owner that the separate personalities of the corporation and its shareholder do not really exist; and (2) it would be inequitable to treat the acts in question as those of the corporation alone. The court listed various factors that are considered in applying the alter ego doctrine and concluded the evidence was sufficient to support the trial court's finding of alter ego. The court pointed to evidence of unity of interest and ownership based on the Lacy's family's control of the LLC and use of its assets for their own benefit (including paying off personal credit cards and other debts and maintaining family-owned realty). Stinky's accountant identified 750 related party disbursements totaling millions of dollars. The court found ample evidence of inadequate capitalization based on the minimal amount of capital committed to the LLC relative to its obligations under the distributorship agreement. Finally, the court found it unjust and inequitable that the LLC convinced Stinky to enter the distribution agreement based on repeated assurances of adequate capitalization and resources. The court stated that actual fraud is not required to invoke the alter ego doctrine and that the doctrine is not limited to tort cases.).

532. Triple "R" Service v. Watson, No. G033798, 2005 WL 1023236 at *10 (Cal. App. 2005).

533. *Id.* at *6 (noting the the court concluded that the two individuals duped the plaintiff into transferring certain equipment to the LLC before execution of a written purchase agreement, fabricated an evolving series of reasons for failing to make the contractually required payments, and treated the equipment as though it was their own property rather than property of the LLC. The court also stated that the transfer of the equipment to another entity without benefit to the LLC constituted evidence of several factors justifying veil piercing: commingling of assets, unauthorized diversion of corporate assets to other than entity purposes, treatment by a stockholder of corporate assets as his own, failure to maintain adequate records, use of the corporation as a mere conduit for an individual's business, and disregard of formalities and failure to maintain arm's length transactions with the corporation.).

534. Ossco Props., Ltd. v. United Commercial Prop. Grp., L.L.C., 968 N.E.2d 535, 540 (Ohio Ct. App. 2011) (citing Belvedere Condo. Unit Owners' Ass'n. v. R.E. Roark Cos., Inc., 617 N.E.2d 1075,

Occasionally, a court seems determined to avoid approving veil-piercing no matter what factors exist. For example, in *K.C. Properties of N.W. Arkansas, Inc. v. Lowell Investment Partners, LLC*,[535] on August 5, 2004, K.C. Properties of N.W. Arkansas, Inc. ("KC") and Lowell Investment Partners, LLC ("LIP") entered into an operating agreement for Ozark Mountain Water Park, LLC ("Ozark"). The operating agreement provided that LIP owned fifty-one-percent of Ozark and that KC owned forty-nine-percent. Pinnacle Management Services, LLC ("Pinnacle") was named the manager of Ozark. Ozark was created for the purpose of "operation of the water park at or near the intersection of Interstate 540 and Highway 264 in Lowell, Arkansas."[536] The park was to occupy 16.58 acres out of an approximately 34-acre tract owned by Pinnacle Hills Realty, LLC ("PHR"). The members of PHR were Schwyhart, LLC, Graham, LLC, and J.B. Hunt, LLC. The members of PHR were also the members of Pinnacle. The property for the water park was to be sold to Ozark for $3,000,000. On the same day, Ozark entered into a contract with Buildings, Inc. ("Buildings") to construct the water park at cost plus six percent.

On September 10, 2004, PHR agreed to sell the entire 34 acres to Parker Northwest Properties, LLC for $8,250,000. KC and Buildings sued LIP, Pinnacle, the managers of Pinnacle, Ozark, and the members of Pinnacle and PHR. The Arkansas Supreme Court affirmed the circuit court's grant of summary judgment to the defendants on the plaintiff's veil-piercing claim despite admissions by defendants that one of the defendant LLCs had no members, no operating agreement, books, or records and no assets, all of its bills were paid by another LLC whose members were several of the individual defendants, that no capital contributions were made, and that no loans to the LLC were made by any member.[537] In an apparent non-sequitur, the court responded to this litany of bad factors by stating "However, based on our case law, [Pinnacle], LIP, and the individual LLCs are separate and distinct legal entities regardless of whether they include the same people."[538] Perhaps the real reason for the court's decision was its next sentence: "Further, there have been no facts presented by Appellants upon which the individual LLCs can be held liable for the actions of PMS and LIP."[539]

1077 (Ohio 1993) (emphasis added)). In 2008, the Ohio Supreme Court modified the second prong of the quoted test to read "fraud, an illegal act, or a similarly unlawful act." Dombroski v. Wellpoint, Inc., 895 N.E.2d 538, 540 (Ohio 2008).

535. K.C. Properties of N.W. Arkansas, Inc. v. Lowell Investment Partners, LLC, 280 S.W.3d 1 (Ark. 2008).

536. *Id.* at 6.

537. *K.C. Properties of N.W. Arkansas, Inc.*, 280 S.W.3d at 16.

538. *Id*.

539. *Id*.

Arguably, this was the court's way of saying that the plaintiff failed to show how the bad factors contributed to the harm suffered by plaintiff. The court, however, also made a confusing statement in response to plaintiffs' argument that Pinnacle, through the individuals and their LLCs, caused PHR to sell the property intended for the water park and that these actions of Pinnacle should be imputed to LIP because Pinnacle was the manager of LIP, and the individual defendants were the managers of Pinnacle. The court stated: "The [individuals'] LLCs were acting in their capacity as members of PHR when they sold the property to another party and were not acting on behalf of either [Pinnacle] or LIP."[540] This statement is strange because PHR was the seller of the property. If one gets past the court's description of the seller of the property and other somewhat unclear language in the court's opinion, the case appears to be one in which KC, had it been properly advised, could have sought contractual guarantees that the property it wanted would not be sold out from under it. If appropriate contractual guarantees were not forthcoming, KC would have known that it needed to keep looking for suitable property. Having not taken commercially reasonable steps to protect itself, KC could not convince the court on the basis of the apparently inconsequential lack of formalities and good recordkeeping that it should be bailed out.

In *Polaris Industrial Corporation v. Kaplan*,[541] the Nevada Supreme Court considered a case arising from a promissory note originally issued by National Marketing Services ("NMS"), a now-defunct Nevada corporation, to Polaris Industrial Corporation ("Polaris") for amounts owing on an account. The note was later assumed by Commercial Resources, Inc. ("CRI"), another Nevada corporation no longer in existence. In 1979, Polaris brought an action on the note against both corporations and their two shareholders and officers, Bob Davis and Michael Kaplan. Polaris alleged Davis and Kaplan were the alter egos of NMS and CRI. Summary judgment was entered for Polaris against the corporations. Polaris then amended its complaint to add as defendants Cambist Corporation and respondent Jerome Kaplan alleging they, too, were the alter egos of NMS and CRI. Cambist Corporation and Bob Davis defaulted. The case proceeded to trial against respondents Michael and Jerome Kaplan. The district court concluded Polaris had not borne its burden of proof in demonstrating the Kaplans were the alter egos of NMS and CRI. Judgment was entered for the defendants.

In reviewing the district court's decision, the court in *Polaris* made several observations, including the following:

540. *Id.* at 9.
541. Polaris Industrial Corp. v. Kaplan, 747 P.2d 884 (Nev. 1987).

> The district court found that the corporation paid Kaplan's personal obligations, that Kaplan made withdrawals of funds for his own use without following corporate procedures and that certain corporate formalities were not observed. These findings point to a unity of interest between the individual and the corporation. [The Supreme Court then stated:] *However, these actions must also be the cause of Polaris's injury and must have sanctioned a fraud or promoted an injustice before the corporate veil can be pierced.* (emphasis added)[542]
>
> *The record does not reflect how failure to issue stock or keep proper corporate minutes sanctioned a fraud or promoted an injustice to Polaris.* It also does not establish that an injustice necessarily resulted from the corporation's payment of Kaplan's personal debts. Kaplan testified the payments were in lieu of salary. We also note the district court did not specifically find that the corporations were undercapitalized. (emphasis added)[543]

Although Macey and Mitts[544] do not discuss *Polaris*, the following statement from their article indicates that they would certainly agree with the court's statements:

> [I]t seems nothing short of bizarre to impose liability on a shareholder on the grounds that the corporation has not been scrupulous about keeping minutes or other records unless there is some connection between the sloppy or non-existent record-keeping and the harm to the plaintiff, which generally there is not.[545]

The Wyoming Supreme Court has stated that the corporate form may be disregarded "*to prevent unjust or inequitable consequences*."[546] The court further stated that "[f]or a corporation to be accorded treatment as a separate entity, it must exist and function as such and not be the alter ego of the person owning and controlling it and cannot be used or ignored just to

542. *Polaris Industrial Corp*., 747 P.2d at 887.

543. *Id*.

544. Macey & Mitts, *supra* note 11.

545. *Id*. at 108. Note that the court in *Polaris* did approve piercing the veil on grounds other than the lack of formalities, i.e., corporate insiders treated the corporation's funds as their own, leaving corporate debts unpaid. *See supra* notes 257-63 and accompanying text.

546. Amfac Mechanical Supply Co. v. Federer, 645 P.2d 73, 79 (Wyo. 1982) (emphasis added).

fit the convenience of the individual."[547] Fraud is not required — "[i]t is sufficient if the refusal to recognize the fact of the identity of the corporate existence by the individual *brings about an inequitable result*."[548] In this case, C & B Plumbing and Heating, Inc. ("C & B") owed Amfac Mechanical Supply Company ("Amfac") $11,000. Amfac sued Carl and Beverly Federer, the sole shareholders of C & B, to collect the debt of C & B from them.

Although the *Amfac* court found that there was inadequate capitalization and disregard of formalities, the crucial facts supporting the court's determination that veil-piercing was appropriate in this case were that Carl Federer sometimes billed for plumbing work in his personal name and sometimes billed in the name of C & B. Further, payments for plumbing work sometimes were deposited directly into the Federers' personal bank account.[549] In addition, the Federers placed themselves in a preferred position by taking $1,000 per month out of C & B to repay themselves for a loan they had made to the corporation but did not pay anything to Amfac.

Amfac was followed in *Miles v. CEC Homes, Inc.*[550] In that case, the court affirmed the district court's piercing of the veil of Meadowbrook Development, Inc. ("Meadowbrook") and holding its majority shareholder, Maurice Miles liable for an unpaid obligation of Meadowbrook. Factors that the court emphasized were that Miles moved funds into and out of the Meadowbrook accounts at his whim without any documentation, that Meadowbrook constructed buildings for Miles without being reimbursed for its expenses, and that there was unauthorized diversion of assets of Meadowbrook for personal purposes.[551] These actions by Miles left Meadowbrook without funds to pay its obligations.

In *Naples v. Keystone Building and Development Corporation*,[552] the Connecticut Supreme Court discussed the instrumentality and identity tests. Although the court noted that plaintiffs had satisfied the first required element of the instrumentality test, i.e., that the individual defendant controlled the affairs of the LLC, and acknowledged the plaintiffs' reliance on the close relationship between the individual's personal finances and those of his LLC and the individual's failure to comply with corporate formalities by failing to maintain minutes and other records such as an

547. *Id*. (citing *Cohen v. Williams*, 318 So.2d 279, 281–82 (Ala. 1975)).
548. *Id*. (emphasis added).
549. *Amfac Mechanical Supply Co.*, 645 P.2d at 78.
550. *Miles v. CEC Homes, Inc.*, 753 P.2d 1021 (Wyo. 1988).
551. *Id.* at 1024.
552. Naples v. Keystone Building and Development Corporation, 990 A.2d 326 (Conn. 2010).

operating agreement.[553] The plaintiffs' piercing claim failed, however, because the court found that the evidence did not show that the individual used his control in an improper way so as to violate the plaintiff's rights or cause injury to the plaintiffs.[554] The court stated that the plaintiffs failed to point to any evidence that the LLC did not serve a legitimate business purpose or that failure to pierce its veil would perpetrate injustice.

A bankruptcy court in Nevada provided a comprehensive look at what causation is required and why in *In re Giampietro*.[555] In that case, James Giampietro had formed a single-member LLC, Chianti Café, LLC ("Chianti") to acquire the assets of AE Restaurants Associates, LLC ("AE"), an LLC owned by Dr. Allen Anes, and to be the transferee of AE's restaurant lease. Chianti and AE negotiated a contract under which Chianti would buy AE's assets. $20,000 was placed into escrow, and the closing and transfer of the assets were to occur as soon as Chianti acquired a liquor license.[556] The contract failed to close, for reasons that were disputed. Chianti sued AE in Nevada state court for return of the $20,000 escrow deposit. AE counterclaimed for breach of contract and ultimately obtained a judgment against Chianti for $130,000. By the time AE obtained this judgment and attempted to add Mr. Giampietro as a defendant, Mr. Giampietro had filed for bankruptcy.[557]

AE then filed an adversary proceeding in bankruptcy seeking to deny Mr. Giampietro's discharge.[558] AE would have standing to pursue denial only if it is a creditor of Mr. Giampietro, and AE would be considered a creditor of Mr. Giampietro only if it could establish that Chianti is the alter ego of Mr. Giampietro.[559]

The court discussed the parties' disagreement over whether Mr. Giampietro was to guarantee Chianti's obligations to AE under the Agreement, stating:

> Dr. Anes was adamant that he understood that Mr. Giampietro was to guarantee Chianti Café's obligations under the agreement, and AE introduced evidence that Dr. Anes, on behalf of AE, had requested and obtained a financial statement from Mr. Giampietro (actually, AE obtained a copy of a financial statement that Mr. Giampietro

553. *Id.* at 341.
554. *Id.* at 342.
555. *In re* Giampietro, 317 B. R. 841 (Bankr. Ct. D. Nev. 2004).
556. *Id.* at 844.
557. *In re Giampietro*, 317 B. R. at 844.
558. *Id*.
559. *Id.* at 844–845.

> had given to Bank of America earlier during 2000). Mr. Giampietro was equally adamant that he never agreed to give AE a guaranty of Chianti Café's obligations to AE. In Mr. Giampietro's favor is that fact that the Agreement nowhere mentions a guaranty by Mr. Giampietro of Chianti Café's obligations to AE. Moreover, while a copy of the signed Agreement as well as drafts of the Agreement were produced, no guaranty signed by Mr. Giampietro was produced, nor was a draft of any proposed guaranty. Mr. Giampietro did, however, introduce a signed guaranty in favor of the landlord. His credible testimony was that: the landlord insisted on Mr. Giampietro's guaranty as a condition of consenting to the lease transfer; and Chianti Café needed to have the landlord bound to honor Chianti Café as a tenant in order to apply for a liquor license. Dr. Anes' testimony essentially was that he, on behalf of AE, did not distinguish between Chianti Café, LLC and Mr. Giampietro. This testimony, however, is somewhat undercut by other parts of his testimony in which he stated that he wanted a guaranty from Mr. Giampietro — why obtain a guaranty unless there were two entities? His testimony was further discredited by his and AE's conduct in the subsequent state court litigation. In that litigation, Chianti Café, LLC was the initial plaintiff and AE the initial defendant; in its answer and counterclaim, AE never sought to name Mr. Giampietro individually. Finally, Dr. Anes knew, or he and his advisors should have known, that any guaranty would have had to have been in writing, since the Nevada statute of frauds requires "[e]very special promise to answer for the debt, default or miscarriage of another" to be evidenced by some writing signed by the guarantor.[560]

The court then discussed the unity of interest existing between Mr. Giampietro and Chianti:

> Here, while at all times relevant Chianti Café was a separate entity, there is no question that Mr.Giampietro "influenced and governed" the activities and actions of Chianti Café. Chianti Café was a one-person limited liability company, formed to acquire the Portabello

560. *In re Giampietro*, 317 B. R. at 850–851.

> restaurant. It did whatever James Giampietro wanted, because he was the sole flesh-and-blood person who was connected with it.
>
> It is also clear that there was a unity of interest, at least from the Chianti Café side. Chianti Café was owned wholly by James Giampietro, and Mr. Giampietro made all the business decisions. Other creditors of Mr. Giampietro, however, would not consider Chianti Café "inseparable" from James Giampietro; indeed, the $20,000 escrow deposit made by Chianti Café was as effectively separate from Mr. Giampietro's creditors as would be any other voluntary transfer. While this feature may limit the class of creditors that could assert an alter ego claim, cases still treat it as present when, from the complaining creditor's perspective, the entity they dealt with and the putative alter ego possessed the same unity of ownership and interest.[561]

The court then discussed why there must be a causal connection between the harm suffered by a plaintiff and the actions of the defendant in a veil-piercing case:

> Nevada courts have focused on "the element of reliance, or more particularly, on 'reasonable reliance' by the complaining creditor upon debtor conduct which would indicate either the absence of a corporate form or the assumption of liability by a person or entity controlling an openly visible corporation."[562]

Accordingly, the court stated that whether the plaintiff here had shown that:

> recognition of Chianti Café's separate existence would sanction fraud or promote injustice — resolves itself into an examination of the AE's reasonable expectations at the time the parties signed the Agreement.
>
> On this score, AE's proof fails. AE negotiated a contract that it knew was to be signed only by Chianti Café, a limited liability company. It accepted this contract knowing that the landlord had requested — and would receive — a separately signed guaranty by Mr. Giampietro that was in addition to a

561. *Id.* at 851–852 (internal citations omitted).
562. *In re Giampietro*, 317 B. R. at 856.

> formal assumption of the lease obligations by Chianti Café. The Agreement itself contains no requirement that Mr. Giampietro provide a guaranty at the closing of the transaction; indeed, Dr. Anes testified that the chief contingency was obtaining a liquor license. That the parties did not contemplate a separate guaranty is further shown by the fact that the Agreement contains an integration clause, raising at least the presumption that the Agreement contained all of the material closing conditions to the transaction.
>
> Chianti Café, not Mr. Giampietro, then deposited a $20,000 cashier's check for the earnest money deposit into escrow, albeit it is true that Mr. Giampietro was the remitter for that check. Such informal contributions to capital are to be expected in the formation stages of a business, and Mr. Giampietro testified that he intended to document the formalities as soon as he had taken possession and opened up the business. What matters here is not so much that Mr. Giampietro did not assiduously and contemporaneously document each act taken on behalf of Chianti Café — *what matters is that AE did not rely upon, or even care about, the lack of formality*.[563]

The court concluded its analysis as follows:

> At least at the time of the signing of the Agreement, it appears that AE was dealing with Chianti Café and Mr. Giampietro as two entities. This division continued throughout the sad coda to that signing. When the transaction fell apart, it was Chianti Café — not Mr. Giampietro — who sued to recover the $20,000 earnest money deposit. In response, AE counterclaimed against Chianti Café — not Mr. Giampietro. And it waited over a year before it even attempted to add Mr. Giampietro to the action.
>
> These facts lead to the conclusion that, at all times relevant, AE treated Chianti Café as a separate legal individual. While they expected Mr. Giampietro to continue to run Chianti Café, they took no steps to ensure that state of affairs (such as a clause in the Agreement that Mr.

563. *In re Giampietro*, 317 B. R. at 857 (emphasis added).

> Giampietro would manage the restaurant, or that the agreement would be in default if Mr. Giampietro transferred his membership interest in Chianti Café to another person). In short, AE "received 'exactly what [it] bargained for,'" and thus the denial of recourse to Mr. Giampietro is not unjust.[564]

In *In re Liberty Coal Company, LLC (Frazier v. Sikeston Board of Municipal Utilities)*,[565] two public utilities (the "Utilities") wanted to reopen the Brushy Creek Mine in Saline County, Illinois. Each of the Utilities was a member of the Western Fuels Association, Inc. ("WFA"), a Wyoming nonprofit corporation that functions as a fuel-supply cooperative for its members.[566] WFA's members own coal-powered electric generators and are rural cooperative utilities and municipal utilities.[567] WFA created and owned all the voting stock in two corporations relevant to this case: Western Fuels — Illinois, Inc. ("WFI") and Western Fuel Services Corp. ("WFSC").[568] The Utilities owned one-half of WFI's preferred stock but owned no stock in WFSC.[569] The Utilities wanted to develop two coal seams at the Brushy Creek Mine, one to supply coal for their needs and one to sell to raise money to pay legacy costs of the mine, which had been closed since 1999.[570] The Utilities had been involved in operating (through a third-party lessee) the Brushy Creek Mine from late 1979 through 1999.[571] Also associated with the prior operations of the Brushy Creek Mine was the Cities Trust, which was established by the Utilities in 1978 to acquire an interest in Marion Coal Sales, LP.[572] Marion's purpose was to generate commission revenue from the Brushy Creek Mine. The Utilities were the only beneficiaries of the Cities Trust, and WFI was the original trustee.[573]

The Utilities wanted to be protected from liability in the reopening of the mine.[574] To that end, a new entity was formed to reopen the mine, Liberty Coal Co., LLC, a Colorado LLC.[575] Shortly after formation of

564. *Id.* at 857–858 (citing *Lipshie v. Tracy Inv. Co*., 93 Nev. 370, 378, 566 P.2d 819, 824 (Nev. 1977)).
565. *In re* Liberty Coal Company, LLC, No. 09-CV-0371-MJR, 2010 WL 1415998 (S.D. Ill. 2010).
566. *In re Liberty Coal Company, LLC*, 2010 WL 1415998 at *3.
567. *Id*.
568. *In re Liberty Coal Company, LLC*, 2010 WL 1415998 at *3.
569. *Id*.
570. *Id.* at *3–*4.
571. *Id.* at *4.
572. *In re Liberty Coal Company, LLC*, 2010 WL 1415998 at *4.
573. *Id*.
574. *Id*.
575. *Id.*

Liberty Coal, the Utilities amended the Cities Trust agreement to replace WFI as trustee with WFSC and authorizing WFSC to acquire one hundred percent of the membership interests in Liberty Coal.[576] The Utilities each agreed to pay one-half of WFSC's expenses (including attorney fees) incurred in connection with acquiring the membership interest in Liberty Coal and in the performance of any rights or duties associated with ownership of the membership interest.[577]

On the same day, Liberty Coal and Cities Trust executed an operating agreement for Liberty Coal. The operating agreement provided that Cities Trust would be responsible for making such capital contributions as determined from time to time unanimously by Liberty Coal's Board of Governors and approved by Liberty Coal's members. Cities Trust was also authorized to make loans to Liberty Coal. Liberty Coal's Board of Governors consisted of three persons, one appointed by each of the Utilities and the third being the general manager of WFA.[578]

Liberty Coal obtained $9,100,000 in bank financing that was guaranteed by WFI and the Cities Trust. Cities Trust also guaranteed Liberty Coal's equipment leases. One of the Utilities loaned $1,840,000 to Liberty Coal, and WFI loaned Liberty Coal $1,660,000. Liberty Coal also received approximately $5,000,000 in government grants.[579]

Although the Brushy Creek Mine made a profit in one year, it did not become profitable. Liberty Coal declared bankruptcy in July 2006. None of the parties to the Brushy Creek Mine reopening received value from Liberty Coal, and the Utilities and WFI suffered substantial losses.[580] The bankruptcy trustee for Liberty Coal filed this action seeking to impose liability for Liberty Coal's debts on the Utilities, Cities Trust, WFSC, and WFI on the theory that they were the alter egos of Liberty Coal.[581] The court stated that even if it assumed that the veil-piercing factors alleged by plaintiff were true, plaintiff had submitted no evidence that any of the alleged factors had caused plaintiff's damages.[582] With respect to the trustee's argument that Liberty Coal was undercapitalized, the court stated:

Granted, undercapitalization would be inherently prejudicial because, by definition, "*undercapitalization occurs when a corporation or limited liability company is unreasonably funded at startup such that it would be unable to pay its liabilities and obligations when they become due*."[583]

576. *Id.* at *4–*5.
577. *Id.* at *5.
578. *In re Liberty Coal Company, LLC*, 2010 WL 1415998 at *5.
579. *In re Liberty Coal Company, LLC*, 2010 WL 1415998 at *6–*7.
580. *Id.* at *7–*8.
581. *Id.* at *1.
582. *Id.* at *11.
583. *Id.* at *9 (emphasis added).

The court further stated with respect to undercapitalization:

> Mere underestimation of required startup capital does not rise to the level of fraud or wrongdoing. As the text of *Phillips* indicates, a plaintiff would need to provide evidence of more than mere negligence in starting the corporation. The plaintiff would have to show fraud or wrongdoing associated with the undercapitalization. For example, she could have shown that the defendants undercapitalized to defeat the rightful claim of a creditor or that they undercapitalized and held themselves out as adequately capitalized. Frazier only argues that the venture was not properly funded at startup, not that the defendants funded the venture in a fraudulent manner or in a way to defeat creditor's rights. This undercapitalization is not a fraud and was not used to defeat the rightful claims of creditors.[584]

The opinion in this case also reports what may the silliest argument ever made in a veil-piercing case. The plaintiff argued that the court's veil-piercing analysis was flawed because it did not discuss the factors in the same order the court in *In re Phillips* did.[585]

In re Weddle (Elsaesser v. Cougar Crest Lodge, L.L.C.)[586] considered a bankruptcy trustee's attempt to establish that the defendant LLC and its ninety percent member, Foster Manning were alter egos. If the trustee succeeded in this argument then the LLC would be a statutory insider under bankruptcy law, and the trustee would then have a basis for pursuing a preferential transfer claim. Although the court thought that there might be genuine issues of material fact on the unity of interest factor,[587] the court granted the LLC's motion for summary judgment that it was not an insider because plaintiff had not presented any evidence that recognizing the LLC as a separate entity would lead to an inequitable result.[588]

In *Advanced Telephone Systems Inc. v. Com-Net Professional Mobile*

584. *In re Liberty Coal Company, LLC*, 2010 WL 1415998 at *9–*10 (citing *In re Phillips*, 139 P.3d 639 (Colo. 2006). The court in *Frazier* applied Colorado law because Liberty Coal was a Colorado LLC).

585. *In re Liberty Coal Company, LLC*, 2010 WL 1415998 at *10–*11.

586. *In re* Weddle (Elsaesser v. Cougar Crest Lodge, L.L.C.), 353 B.R. 892 (Bkrtcy, D. Idaho 2006).

587. *Id.* at 898.

588. *Id.* at 898–899.

Radio LLC,[589] the court denied the plaintiff's veil-piercing claim.[590] In discussing the plaintiff's claim, the court noted that the evidence at trial had established lack of formalities but "the law nevertheless requires that this lack of formalities led to some misuse of the corporate form."[591]

The federal district court for the District of Oregon stated that it would allow the piercing of the limited liability veil of an LLC where:

- the defendant controlled the debtor;
- the defendant engaged in improper conduct; and
- as a result of the improper conduct, the plaintiff either entered into a transaction that it otherwise would not have entered into, or the plaintiff was not able to collect a debt against an insolvent entity.[592]

In this case, the court found that the defendant, who was the sole manager and member, clearly controlled the LLC. The court also found "improper conduct" where there was "commingling assets and a general disregard of [the LLC's] form and status as a separate legal entity."[593] The trial court could not determine the third factor on motions and left it for determination at trial.

In *J.C. Compton Company v. Brewster*[594] defendant was not liable on a veil-piercing claim because, although the jury found that defendant, through its improper conduct, caused plaintiff to enter into a contract with defendant's LLC, that the LLC was grossly undercapitalized, and that the undercapitalization caused the LLC to default on its obligations to the plaintiff, the jury also found that the improper conduct and undercapitalization did not cause plaintiff any damages.[595] The jury's finding that the improper conduct and undercapitalization did not cause plaintiff any damages seems strange because the jury, as noted, did find that the LLC was grossly undercapitalized and that the undercapitalization caused the LLC to default on its obligations. The court spent little time on the veil-piercing claim but devoted most of its opinion to finding that there

589. Advanced Telephone Systems Inc. v. Com-Net Professional Mobile Radio LLC, 846 A.2d 1264 (Pa. Super. 2004).

590. *Id.* at 1267.

591. *Id.* at 1279 (citing Kaplan v. First Options of Chicago, Inc., 19 F.3d 1503, 1521 (3d Cir.1994)) (explaining that "[n]ot every disregard of corporate formalities or failure to maintain corporate records justifies piercing the corporate veil").

592. BLD Prods. Ltd. v. Technical Plastics of Oregon, LLC, CV 05-556-KI, 2006 WL 3628062 (D. Ore. 2006).

593. *BLD Prods. Ltd*., 2006 WL 3628062 at *5.

594. J.C. Compton Company v. Brewster, 59 P. 3d 1288 (Or. App. 2002).

595. *Id.* at 1290.

was sufficient evidence to support the jury's finding that defendant had agreed to assume the LLC's debts to plaintiff.[596] As plaintiff appears to have received the relief from this holding that he would have received under his veil-piercing claim, the court did not have to spend what little time it did on that claim. Accordingly, this case does not appear to be good authority that the kind of behavior the defendant engaged in will not ordinarily result in a successful veil-piercing claim.

Estate of Hurst v. Moorehead, LLC[597] states that piercing the veil of an entity under the instrumentality rule requires that the control and breach of duty necessary for application of the instrumentality "must proximately cause the injury or unjust loss complained of."[598] The court further stated, with respect to imposing personal liability on an individual owner:

> [A] finding that an individual member of a limited liability company personally engaged in certain conduct, such as fraud or misrepresentation, is necessary to support the imposition of individual liability against that member under N.C. Gen. Stat. § 57C-3-30(a), a finding of actual fraud against an individual member is not required to support the imposition of alter ego liability under the instrumentality rule. Rather, the requisite element for piercing the corporate veil under the instrumentality rule requires a finding that the individual member used his control over the entity "to commit fraud *or wrong*, to perpetrate the violation of a statutory or other positive legal duty, *or a dishonest and unjust act in contravention of [the] plaintiffs' legal rights[.]*"[599]

IX. REVERSE VEIL PIERCING

In an outsider reverse pierce, the creditor seeks to access the assets of the entity in order to satisfy the owner's debt to the judgment-creditor. In the context of a corporation, outsider reverse piercing has traditionally been rare in that the judgment-creditor has had as an available remedy the seizure and sale of the judgment-debtor's stock. That seizure and sale has afforded a mechanism by which the judgment-creditor could at least in part be made whole. In reverse veil piercing, owner creditors seek payment

596. *Id.* at 1292–93.
597. Estate of Hurst v. Moorehead, LLC, 748 S.E.2d 568 (N.C. App. 2013).
598. *Id.* at 574.
599. *Estate of Hurst*, 748 S.E.2d at 575 (citing *Glenn v. Wagner*, 313 N.C. 450, 454, 329 S.E.2d 326, 330 (1958) (emphasis in original)).

from entity assets. It is the reverse of "veil piercing" where a creditor of an entity seeks payment of the entity debt from an owner. In the LLC context, it can be defined as an approach where creditors seek payment from assets of the LLC to satisfy a debt of a member.[600] Reverse veil piercing has been accepted by some courts and rejected by others. *In re Phillips*[601] identified two types of reverse piercing:

> (i) 'inside claims' involving a 'controlling insider who attempts to have the corporate entity disregarded to avail the insider of corporate claims against third party claims" which allow a shareholder to disregard the corporate form of which he is a part; and
>
> (ii) 'outside claims' which occur when a corporate outsider 'pressing an action against a corporate insider seeks to disregard the corporate entity [and] to subject corporate assets to the claim,' involving an outsider seeking to obligate a corporation for the debts of a dominant shareholder or other corporate insider.[602]

The *Phillips* court limited its review to 'outside claims.' California courts have rejected reverse veil-piercing.[603] The Texas Court of Appeals in *Adams v. McFadden*[604] rendered what is in effect a reverse veil piercing decision in an opinion of doubtful validity. In that case, the court held that the limited liability company involved was liable for the damages caused by Joy Adams on the ground that Ms. Adams was a "vice-principal of the corporation."[605] The court treated the limited liability company as a corporation for this purpose because Ms. Adams had testified at trial that the entity was a limited liability corporation and that she was the president and sole stockholder.[606]

The court in *Chicago Title Company v. Metropolitan Property Holdings, LLC*[607] rejected an attempt by the California Franchise Tax Board to reach the assets of an LLC to satisfy ta liabilities of an individual owner,

600. *See* Carter G. Bishop, *Reverse Piercing: A Single Member LLC Paradox*, 54 S.D. L. REV. 199 (2009); Larry E. Ribstein, *Reverse Limited Liability and the Design of Business Associations*, 30 DEL. J. CORP. L. 199 (2005).

601. *In re* Phillips, 139 P.3d 639, 644–45 (Colo. 2006).

602. *Id.*

603. *See* Blue Water Sunset, LLC v. First View, LLC, No. B204012, 2008 WL 5394933 (Cal. App. 2 Dist. Dec. 9, 2008); Chicago Title Company v. Metropolitan Property Holdings, LLC, No. B206217, 2009 WL 711767 (Cal. App. 2 dist. March 19, 2009).

604. Adams v. McFadden, 296 S.W.3d 743 (Tex. App. 2009).

605. *Id.* at 762–63.

606. *Id.* at 762.

607. Chicago Title Company v. Metropolitan Property Holdings, LLC, No. B206217, 2009 WL 711767 (Cal. App. 2 Dist. March 19, 2009).

noting that the Tax Board was attempting an outside reverse pierce of the LLC's view, and that another California appellate court, in a case of first impression in California, had specifically declined to accept outside reverse veil-piercing.[608] *Middlesex Retirement System, LLC v. Board of Assessors of Billerica*[609] rejected an argument that real estate owned by an LLC should be deemed to be owned by the LLC's sole member, Middlesex Retirement System ("MRS"), a governmental entity, and thus exempt from property tax. The LLC did not argue that any of the factors that would cause it to be treated as the alter ego of MRS were present. The court noted that MRS could have purchased the land itself, in which case it would have been entitled to a tax exemption.[610] The court noted that the record did not disclose why MRS had formed the LLC, but observed: "If, for example, MRS created LLC as a shield against claims of premises liability, it may not properly ask to lower that shield to avoid the tax consequences of its decision."[611] This case offers a cautionary tale to the many nonprofits which place real estate in a single member LLC for liability protection.

In *Auntie Ruth's Furry Friends Home Away From Home, Ltd. v. GCC Property Management*,[612] the court refused to disregard the separate existence of a commonly owned corporation and LLC for purposes of applying a right of first refusal provision in a lease and held that the transfer of the property from the lessor corporation to a commonly controlled LLC constituted a sale of the property that triggered the right of first refusal.

Klein v. Weidner,[613] approved a reverse veil-piercing action by a former spouse to recover assets from her ex-husband's LLC where the LLC observed no formalities, the LLC's assets were routinely used to pay personal expenses of the ex-husband and his new wife, and the ex-husband had stated his intention to hide his assets from his former spouse.

In re Ekstrom[614] rejected the Debtor's claim that Ireland Bank should be treated as a secured creditor in his bankruptcy. The Debtor argued that even though legal title to the property on which Ireland Bank held a mortgage was held by EZ Livin' Inn, LLC, Debtor personally borrowed the funds from Ireland Bank, made all payments on the debt, and owns one

608. *Id*. at n. 7 (citing Postal Instant Press, Inc. v. Kaswa Corp., 162 Cal. App. 4th 1501, 1513 (2008), review declined by California Supreme Court on Aug. 27, 2008).

609. Middlesex Retirement System, LLC v. Board of Assessors of Billerica, 453 Mass. 495 (2009).

610. *Id*. at 500.

611. *Id*. at 503 and note 6.

612. Auntie Ruth's Furry Friends Home Away From Home, Ltd. v. GCC Property Management, No. A08-1602, 2009 WL 2926485 (Minn. App. 2009).

613. Klein v. Weidner, No.08-3798, 2010 WL 571800 (E.D. Pa. 2010).

614. *In re* Ekstrom, No. 08-07750-SSC, 2010 WL 1254893 (Bankr. D. Ariz. 2010).

hundred percent of the interests of the LLC. Debtor argued that his "equitable interest" was sufficient to make Ireland Bank a secured creditor for purposes of Debtor's Plan. The court disagreed, stating:

> It is undisputed that title to the property is vested in EZ Livin' Inn, LLC. The membership interests in EZ Livin' Inn, LLC are held by the Debtor, his wife and Standard Management, LLC. The EZ Livin' Inn, LLC is owned by the Ekstrom Family Limited Partnership. The Debtor holds a 49.5 percent limited partnership interest in the partnership. The Debtor's wife also holds a 49.5 percent limited partnership interest. A one percent general partnership interest in the Ekstrom Family Limited Partnership is held by Standard Management LLC. The Debtor's interest in the Ekstrom Family Limited Partnership was contributed to the Dennis Ekstrom Living Trust. The Debtor is essentially requesting that the Court disregard several legal entities to determine that Ireland Bank is a secured creditor of the Debtor.[615]

After discussing *In re Hecker,*[616] the court observed:

> Here, we also have an experienced businessman who created numerous limited liability companies. The Debtor has created such entities for estate planning purposes, but the Debtor's requested relief is similar to veil piercing; that is, the Debtor wishes to shield certain assets from the reach of creditors. The Debtor has enjoyed the benefits of limited liability, and must now accept the consequences of such estate planning.[617]

Courts should categorically reject an effort to reverse pierce to permit the owners to enjoy the benefit of entity assets. One is reminded of the classic description of chutzpah, namely killing your parents and then throwing yourself on the mercy of the court because you are an orphan.[618]

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615. *Id.*at *11.

616. In re Hecker, 414 B.R. 499 (Bankr. D. Minn. 2009).

617. *In re* Ekstrom, 2010 WL 1254893 at *11.

618. *See, e.g.*, Wingate v. Celebrity Cruises, Ltd., 79 So. 3d 180, 183 n. 5 (Fla. Dist. Ct. App. 2012); Steven B. Spector, *"Chutzpah and the Law,"* 87 LAW LIBR. J. 357, 375 (1995); *see also* J. A. Simpson & E. S. C. Weiner, 3 THE OXFORD ENGLISH DICTIONARY 209 (2d ed. 1991) (defining the term "chutzpah"). Thanks to Tom Rutledge for providing this reference in the materials for the presentation on "Piercing the Unincorporated Veil" at the 2014 Annual Meeting of the ABA Business Law Section, *supra* notes 12-13 and accompanying text.

Instituform Technologies, LLC v. Cosmic TopHat, LLC[619] rejected plaintiff's arguments in a patent infringement action that the veil of an LLC should be pierced. Plaintiff's last argument on this point was that defendant's "prior conduct in this litigation" meant "that alter-ego liability is necessary to 'prevent the injustice that would arise if [the defendant] transferred or disposed of assets through or via [the], LLC in an effort to defeat collection activities.'"[620] The court responded that this kind of misconduct could be combatted only through reverse veil piercing,

> which the Georgia Supreme Court has rejected, in part because "more traditional theories of conversion, fraudulent conveyance of assets, respondeat superior, and agency law are adequate to deal with situations where one seeks to recover from a corporation for the wrongful conduct committed by a controlling stockholder without the necessity to invent a new theory of liability."[621]

As recently observed by the Kentucky Supreme Court in *Turner v. Andrew*,[622] responding to the assertion that the single member of an LLC should be able to pursue on his own account a claim for lost profits suffered by the LLC: "The LLC and its solitary member, Andrew, are not legally interchangeable. Moreover, an LLC is not a legal coat that one slips on to protect the owner from liability but then discards or ignores altogether when it is time to pursue a damage claim."[623]

As a general proposition, courts have rejected efforts by members to ignore the LLC and to treat its assets as their own. In *Abrahim & Sons Enterprises v. Equion Enterprises, LLC*,[624] Shell Oil Company and Texaco Inc. formed Equilon Enterprises, a limited liability company, and transferred all of their western refining and marketing assets and gas station leases to Equilon. Plaintiffs, a group of independent dealers who operate gas stations from Shell or Texaco sued, alleging that the transfer of the leases to Equilon violated California Business & Professions Code § 20999.25(a), which prohibits a franchisor from selling, transferring, or

619. *Instituform Technologies, LLC*, 959 F. Supp. 2d at 1335. Also discussed *supra* notes 499-501 and accompanying text (causation), notes 304-10 and accompanying text (undercapitalization must be coupled with an intent to avoid debts), and notes 227–32 and accompanying text (interesting take on separateness).

620. *Instituform Technologies, LLC*, 959 F. Supp. 2d at 1346.

621. *Instituform Technologies, LLC*, 959 F. Supp. 2d at 1346 (citing Acree v. McMahan, 584 S.E.2d 873, 874 (Ga. 2003)).

622. Turner v. Andrew, 413 S.W.3d 272 (Ky. 2013).

623. *Id.* at 276.

624. Abrahim & Sons Enterprises v. Equion Enterprises, LLC, 929 F.3d 958 (9th Cir. 2002).

assigning an interest in a premises to another person unless he or she first makes a boa fide offer to sell that interest to the franchisee. The court reversed the trial court's grant of summary judgment to the defendants, giving short shrift to all of Shell and Texaco's arguments — Equilon was a separate legal entity, was undoubtedly a "person," and it was irrelevant that the transfer to Equilon was a tax-free exchange.

In *In re Bianchini (Bianchini v. Ryan)*,[625] a judgment had been entered in a prior lawsuit against the debtor in New Jersey based on the jury's finding that several entities owned by the debtor, including an LLC, were the debtor's alter egos created to shield assets or for other unjust purposes and that the assets of any of them should be used to satisfy debts of any other. A judgment lien was recorded on property owned by the LLC, and the property was later conveyed to the debtor. In this bankruptcy proceeding, the debtor sought to treat the LLC's property as his own at the time the judgment lien was recorded so that he could claim his property as exempt under Section 522(b)(2) of the Bankruptcy Code. The court rejected the debtor's claim, stating that it did construe the New Jersey judgment as declaring that the debtor was the owner of the LLC's property at that time. The court noted that the debtor was attempting to "reverse pierce" the LLC's veil to treat the LLC's assets as his own. The court observed that many jurisdictions recognized both offensive and defensive reverse veil-piercing but then stated that equitable principles govern veil piercing in Connecticut and concluded that Connecticut courts would not allow piercing the veil between the debtor and the LLC to allow the debtor to benefit by disregarding the record title to the property when the debtor had placed record title to the property in the LLC for unjust purposes. The court, however, commented in a footnote that if record title to the property was still in the LLC at the date of the bankruptcy petition and the trustee sought to pierce the LLC's veil for the benefit of the debtor's creditors, that would have been a different matter.

Professor Carter Bishop has suggested that reverse veil piercing may be an appropriate remedy to help a creditor of the member of a single-member LLC where the creditor obtains ownership of all of the member's transferable interest.[626] The problem that arises in a state whose LLC statute provides that the transferor remains the sole member and the creditor becomes only an assignee is that the member retains control over the LLC and, for example, whether it will make distributions or dissolve. This will not be a problem in states that have amended their LLC statutes to

625. *In re* Bianchini (Bianchini v. Ryan), 346 B. R. 593 (Bankr. D. Conn. 2006).

626. Carter G. Bishop, *Reserve Piercing: A Single Member LLC Paradox*, 54 S.D. L. REV. 199 (2009).

avoid just such situations. For example, a member of a Delaware LLC ceases to be a member upon assignment of all of the member's interest.[627] An LLC dissolves if the LLC has no members,[628] but the dissolution may be revoked by the assignee of the last member.[629] In Colorado, a member ceases to be a member upon assignment of all of the member's interest,[630] and an LLC will dissolve ninety days after it ceases to have a member unless the assignee or assignees of the last remaining member agree to admit a member.[631] Statutory provisions like those in Delaware and Colorado facilitate the management of an LLC that no longer has a member. The assignee of the last remaining member may admit himself or another person as a member. That new member may then either continue the LLC or dissolve it.

X. DIRECT LIABILITY OF OWNERS IN CERTAIN CIRCUMSTANCES

In some cases, statutes and agency law impose direct liability on the owners of entities. A veil piercing/alter-ego action is not generally required for the imposition of such liability. This Article discusses examples of such liability below under DeFacto Doctrine, Undisclosed Principal, Liability for Improper Distributions, Liability for Unpaid Taxes, and Liability Under Other Federal and State Statutes.

A. DE FACTO DOCTRINE

The Model Business Corporation Act states: "All persons purporting to act as or on behalf of a corporation, knowing there was no incorporation under this Act, are jointly and severally liable for all liabilities created while so acting."[632]

Several states, such as Colorado,[633] have similar provisions. *Adams v. Mt. Pleasant Bank & Trust Co.*[634] involves shareholder liability for debts incurred during a two year period following expiration of a corporation's

627. DEL. CODE ANN. tit. 6, § 18-702(b)(3).
628. DEL. CODE ANN. tit. 6, § 18-801(a)(4).
629. DEL. CODE ANN. tit. 6, § 18-806(3)
630. COLO. REV. STAT. § 7-80-702(2).
631. COLO. REV. STAT. §§ 7-80-801(c)(2), 7-80-701(2).
632. MODEL BUS. CORP. ACT § 2.04.
633. All persons purporting to act as or on behalf of a corporation without authority to do so and without good faith belief that they have such authority shall be jointly and severally liable for all liabilities incurred or arising as a result thereof. COLO. REV. STAT. §7-102-104. Colorado applies a similar rule to LLCs. COLO. REV. STAT. § 7-80-105.
634. Adams v. Mt. Pleasant Bank & Trust Co., 355 N.W.2d 868 (Iowa 1984).

old charter and before reincorporation. The court held that in the absence of a clear statutory mandate to the contrary, limited liability did not exist for liabilities incurred during the interim period. The Iowa statute similar to section 105 of the 1969 version of the Revised Model Business Corporation Act was held not to provide protection against such liabilities. The court also stated that Iowa does not recognize the concept of de facto corporations in the context of an expiration of a corporation's charter.

What if the owners of a planned but not formed corporation or limited liability company begin acting in the name of the unformed entity in a state that does not have a statutory provision like that of RMBA §2.04 or C.R.S. §§7-80-105, 7-102-104? Unless a third party dealing with an owner of an unformed entity agrees otherwise, the owner will be personally liable on a contract entered into in the name of the unformed entity:

> Unless the third party agrees otherwise, a person who makes a contract with a third party purportedly as an agent on behalf of a principal becomes a party to the contract if the purported agent knows or has reason to know that the purported principal does not exist or lacks capacity to be a party to a contract.[635]

In *AT&T Advertising, L.P. v. Winningham*,[636] the defendant was liable because before he signed contracts on behalf of an LLC, the LLC was cancelled by the Oklahoma Secretary of State. Accordingly, the LLC was not a legal entity existing at the time defendant signed the contracts and did not shield defendant from liability.

Peinado v. Barnett, discussed previously,[637] cited lack of valid formation of the LLC in that case as a ground for imposing liability on the owner. The facts of other opinions discussed in this Article also would appear to raise issues of acting on behalf of an entity that has not been validly formed, but that was not cited as a basis for liability.[638]

B. UNDISCLOSED PRINCIPAL

635. RESTATEMENT (THIRD) AGENCY §6.04.

636. AT&T Advertising, L.P. v. Winningham, 280 P.3d 360 (Okla. Civ. App. Div. 2012).

637. *Supra* note 396 and accompanying text.

638. *Kalashian*, 2004 Cal. App. Unpub. LEXIS 10789 at *3; *Minton*, 364 P.2d at 473 (court's stated ground for its holding imposing personal liability on the owner of a corporation was undercapitalization, but Macey & Mitts, *supra* note 11 at n. 43, argue that "a much more compelling basis" was the corporation's having only one director rather than the statutorily mandated minimum of three); in *New Horizons Supply Coop*., 1999 Wisc. App. LEXIS 108, the court seemed to be somewhat skeptical that the LLC before it had in fact been formed, but imposed liability on the member for failing to follow the statutory procedures for dissolving an LLC.

If an owner of the entity (or someone else acting on behalf of the entity) fails to disclose that they are acting on behalf of an entity, the person so acting may be liable under the agency law theory of undisclosed principal.

In *Water, Waste & Land, Inc. d/b/a Westec v. Lanham*,[639] the court held that Larry Clark and Donald Lanham were personally liable where they entered into a contract without disclosing that they were acting on behalf of Preferred Income Investors, LLC, a Colorado limited liability company ("Preferred"). Lanham and Clark were members and managers of Preferred. Clark contacted and contracted with Westec for engineering services. Clark's business card included his name, address, and the initials "PII," but not the name of the LLC or his title.

In reaching its decision in this case, the court said that agency law applies in the LLC context, "notwithstanding the LLC's statutory notice rules," continuing:

> Under the common law of agency, an agent is liable on a contract entered on behalf of a principal if the principal is not fully disclosed . . . . If both the existence and identity of the agent's principal are fully disclosed to the other party, the agent does not become a party to any contract which he negotiates . . . . But where the principal is partially disclosed (i.e., the existence of a principal is known but his identity is not), it is usually inferred that the agent is party to the contract.[640]

The court went on to say, "The duty of disclosure clearly lies with the agent alone; the third party with whom the agent deals has no duty to discover the existence of an agency or . . . the identity of the principal."[641] As a result, the court reversed the judgment of the District Court and reinstated the judgment of the County Court which had held Lanham and Clark personally liable as agents for (at best) a partially disclosed principal.[642] Of particular note in this case is the court's holding that the duty of disclosure lies solely with the agent and is not affected by the provisions of C. R. S. §7-80-208:

639. Water, Waste & Land, Inc. d/b/a Westec v. Lanham, 955 P.2d 997 (Colo. 1998).
640. *Water, Waste & Land, Inc. d/b/a Westec*, 955 P.2d at 1001.
641. *Id.*
642. *See* RESTATEMENT (THIRD) AGENCY §6.03.

> The fact that the articles of organization are on file in the records of the secretary of state is notice that the limited liability company is a limited liability company and is notice of all other facts stated therein that are required to be stated in the articles of organization by section 7-80-204.[643]

The facts of *Water, Waste & Land* illustrate the policy underlying liability for acting for an undisclosed principal. As Clark's business card did not disclose that he was acting on behalf of an LLC, and he failed otherwise to inform Westec, there was no way for Westec to check the publically available information nor any way for Westec to evaluate whether the LLC was credit worthy and otherwise suitable to be a contractual counter party. Case law expresses the policy that a contractual party who knowingly contracts with an entity and doesn't take commercially reasonable protective steps cannot later seek to hold the owners of the entity liable under an alter-ego/veil piercing theory.[644] If a party to a contract can't evaluate the entity because the other party to the contract has not disclosed the existence of the entity, the party who has failed to disclose the existence of the entity should not be permitted to hide behind the liability shield of the entity.

Thames & Company v. Eicher,[645] is a decision of the Mississippi Supreme court that a later decision of the same court described as a case in which the court "did not pierce the corporate veil . . . but instead found Rogers personally liable as the agent of an undisclosed principal."[646] This is confusing and it is not entirely clear what theory the court applied in Thames, but it appears to be more of an alter ego case than an undisclosed principal case. In Thames, plaintiffs believed they were negotiating the purchase of a house from a Mrs. Rogers and only learned at closing that the seller was actually a corporation, Thames & Company. The court stated:

> Mrs. Rogers contends that she was not the builder-vendor of

643. *Water, Waste & Land, Inc. d/b/a Westec*, 955 P.2d at 1001 (stating: "[W]e conclude that where an agent fails to disclose either the fact that he is acting on behalf of a principal or the identity of the principal, the notice provision of our LLC Act, section 7-80-208, cannot relieve the agent of liability to a third party. When a third party deals with an agent acting on behalf of a limited liability company, the existence and identity of which has been disclosed, the third party is conclusively presumed to know that the entity is a limited liability company and not a partnership or some other type of business organization. Where the third party does not know the identity of the principal entity, however, the situation is fundamentally different because the third party is without notice and the law does not contemplate that he has any way of finding the relevant records.).

644. *Supra* notes 90-139 and accompanying text under *Tort Liability Versus Contract Liability*.

645. Thames & Company v. Eicher, 373 So.2d 1033 (Miss. 1979).

646. Restaurant of Hattiesburg, LLC v. Hotel & Restaurant Supply, Inc., 84 So.3d 32, 47 n. 2 (Miss. Ct. Apps. 2012).

> the house but a mere agent for Thames, the original builder-vendor of the house. However, according to the Eichers' testimony, they knew only of Mrs. Rogers (and not Thames) during all the negotiations until the occasion of closing out the house purchase. The facts show here that the corporate appellant, Thames, was no more than the alter ego of Mrs. Rogers. She held all of the stock in the company, and when deposed on February 21, 1978, was unable to recall who the directors and stockholders of the corporation were. She furnished construction funds for the corporation which appeared to be without substantial capital. The evidence established that the corporation held no regular meetings and there were no minutes pertaining to its operation. Testimony reveals that Mrs. Rogers treated the corporation almost as though it did not exist and upon the evidence, we cannot say that the court erred in looking past and beyond the corporate structure and allowing Mrs. Rogers to be held individually, along with Thames, liable for the defective house.[647]

Pinebrook Properties, Ltd v. Brookhaven Lake Property Owners Association[648] also considered a situation in which the manager of an LLC sent a letter to the limited partners[649] without indicating that he had signed the letter in a representative capacity. The court stated: "However, failing to sign the letter with 'president,' or putting the corporate name on the letter, is a corporate formality. Failure to comply with corporate formalities is no longer considered in determining alter ego and is therefore no evidence of alter ego."[650]

The court also made some interesting observations concerning veil-piercing. In reversing the trial court's holding that the veil of the limited partnership should be pierced the court stated:

> The theory of alter ego, or piercing the corporate veil, is inapplicable to partnerships. Under traditional general partnership law, each partner is liable jointly and severally for the liabilities of the partnership. The Texas Legislature has altered this general scheme and statutorily created

647. *Thames & Company*, 373 So.2d at 1035.
648. Pinebrook Properties, Ltd v. Brookhaven Lake Property Owners Association, 77 S.W.3d 487 (Tex. App. 2002).
649. The LLC in question was the sole general partner of a Texas limited partnership.
650. *Pinebrook Properties, Ltd*, 77 S.W.3d at 500 (citing TEX. BUS. CORP. ANN. art. 2.21(A)(3)).

> limited partnerships which are governed by the Texas Revised Limited Partnership Act (TRLPA). Under TRLPA, "a general partner of a limited partnership has the liabilities of a partner in a partnership without limited partners to persons other than the partnership and the other partners." Under the Texas Revised Partnership Act, "all partners are liable jointly and severally for all debts and obligations of the partnership . . . ." Therefore, in a limited partnership, the general partner is always liable for the debts and obligations of the partnership. Limited partners are not liable for the obligations of a limited partnership unless the limited partner is also a general partner or, in addition to the exercise of the limited partner's rights and powers as a limited partner, the limited partner participates in the control of the business. However, if the limited partner does participate in the control of the business, the limited partner is liable only to persons who transact business with the limited partnership reasonably believing, based on the limited partner's conduct, that the limited partner is a general partner.[651]

The court then stated with respect to piercing the veil of the LLC general partner:

> Having determined Pinebrook Properties cannot be the alter ego of Musgrave, we now turn to the trial court's finding that Pinebrook Management, which is a limited liability company, is the alter ego of Musgrave . . . . . "Except as and to the extent the regulations specifically provide otherwise, a member or manager is not liable for the debts, obligations or liabilities of a limited liability company including under a judgment decree, or order of a court." In determining if there is evidence legally sufficient to support the trial court's finding, we look to see if there is such unity between Musgrave and Pinebrook Management that the separateness has ceased to exist, and whether holding only Pinebrook Management liable, as the general partner of Pinebrook Properties, would result in injustice. We must look to the relationship between Musgrave and Pinebrook Management to see if alter ego is shown from the total dealings of Musgrave and Pinebrook Management — for example, if the

651. *Pinebrook Properties, Ltd*, 77 S.W.3d at 499.

> corporate and individual properties have been kept separate; the amount of financial interest, ownership, and control the individual maintains over the corporation; and whether the corporation has been used for personal purposes. The evidence of alter ego between Musgrave and Pinebrook Management presented by the Owners is that Pinebrook Management had no checking account, had not filed a tax return, and that Musgrave sent a letter to the lot owners, signing his own name and not designating that he signed it in any other capacity. However, the Owners failed to cite any authority holding that failure to have a checking account, or failure to file tax returns, establishes alter ego. There is no evidence provided that Musgrave commingled funds or that his assets and those of Pinebrook Management were not kept separate. The evidence clearly shows Pinebrook Management has never had the need, or been required, to file a tax return. This is no evidence that Pinebrook is the alter ego of Musgrave.[652]

Longview Aluminum, L.L.C. v Indus. Gen., L.L.C.[653] held that the times that defendants clearly indicated that Michigan Avenue Partners, L.L.C. was a limited liability company were sufficient to put the plaintiff on notice that it was dealing with an LLC rather than a partnership notwithstanding some references to the entity that were ambiguous. Unlike the plaintiff in *Water, Waste & Land*,[654] the plaintiff in *Longview Aluminum* knew the name of the entity and therefore had notice that the entity was an LLC pursuant to 805 ILCS § 180'5-70.[655] *Empire Office Machines, Inc. v. Aspen Trails Associates LLC*[656] is another case holding that lack of precision in signing a contract will not result in individual liability if the other party to the contract knew that the person signing was doing so for an entity.

C. LIABILITY FOR IMPROPER DISTRIBUTIONS

Limited liability company statutes commonly provide that an LLC

652. *Pinebrook Properties, Ltd*, 77 S.W.3d at 500 (internal citations omitted).

653. Longview Aluminum, L.L.C. v. Indus. Gen., L.L.C., No. 02 C 0168, 2003 WL 21518585 (N.D. Ill. July 2, 2003).

654. *Supra* notes 639-43 and accompanying text.

655. "The fact that the articles of organization are on file in the Office of the Secretary of State is notice that the limited liability company is a limited liability company and notice of all other facts set forth herein."

656. Empire Office Machines, Inc. v. Aspen Trails Associates LLC, 322 P.3d 424 (Mont. 2014).

cannot make a distribution if the LLC is insolvent or becomes insolvent as a result of the distribution.[657] A member who receives a distribution knowing that it improper is liable to return the distribution to the LLC.[658] This Article previously discussed a 2009 decision of the Colorado Court of Appeals holding that a non-member manager (Trowbridge) was potentially liable to a creditor, remanding to the trial court to determine "Whether it is equitable to hold Trowbridge personally liable for the LLC's improper actions by piercing the corporate [*sic*] veil."[659] In connection with another claim, the Court of Appeals also directed the trial court to determine: "Whether the LLCs were or became insolvent when Trowbridge distributed LLC assets to the nonparty members and, if so, whether Trowbridge breached the common law duty of an LLC manager to avoid favoring personal interests over the LLC's creditors' claims."[660] In 2010, the Colorado Supreme Court reversed another Court of Appeals decision and also overruled a portion of the Court of Appeals' finding in *Sheffield*, holding that "[t]o the extent *Sheffield* holds that an LLC's manager has a fiduciary duty to the LLC's creditors, it is overruled."[661]

In 2010, another panel of the Court of Appeals reversed a trial court dismissal of a complaint seeking to hold members liable to creditors for allegedly wrongful distributions.[662] The trial court had determined that § 7-80-606(2) of the Colorado LLC Act provided a remedy to the entity, not to creditors, and therefore dismissed for lack of standing. In overruling the

657. *See, e.g.*, DEL. CODE ANN., tit. 6 §18-607(a). RULLCA §406. Prototype LLC Act §405(a)(2). The Revised Prototype Limited Liability Company Act is an ongoing project of the LLCs, Partnerships and Unincorporated Entities Committee of the Business Law Section of the American Bar Association. The most recent version was published in THE BUSINESS LAWYER (Nov. 2011).

658. *See, e.g.*, Del. Code Ann. tit. 6 §18-607(b). Delaware has a three-year statute of limitations on the member's obligation to return an improper distribution. Del. Code Ann., tit. 6 §18-607(c).

659. *See Sheffield Services Co.*, 211 P.3d at 714.

660. The trial court had previously found that "Trowbridge's overall conduct resulted in a clear financial benefit to him, which was not properly documented because of his elaborate scheme of concealment." *Id.* at 722. The *Sheffield* panel went on to state that "[w]hether the conduct in question is that of a corporate director, as in *LaFond,* [LaFond v. Basham, 683 P.2d 367 (Colo. App. 1984)] or an LLC manager, as in this case, the injustice wrought by adherence to the corporate or LLC fiction is the same: the director's or manager's actions in using corporate or LLC assets for personal gain would defeat a creditor's valid claim." *Id*. at 721. The *Sheffield* Panel then referred to the District Court's finding at page 24 of the Amended Order: "The fair inference to be drawn from the overall conduct is that there was a clear financial benefit to the Defendant Trowbridge, although perhaps not documented, from this elaborate scheme of concealment." *Id*. at 724. To clarify this issue, one of the *Sheffield* panel's directions to the District Court on remand was to determine "whether Trowbridge breached the common law duty of an LLC manager to avoid favoring personal interests over the LLC's creditors' claims." *Id*. In *Weinstein v. Colborne Foodbotics, Inc.*, *infra* note 661, the Colorado Supreme Court specifically overruled *Sheffield* on this question.

661. Weinstein v. Colborne Foodbotics, Inc., 302 P.3d 263 (Colo. 2013).

662. *Colborne Corporation v. Weinstein*, 304 P.3d 570 (Colo. App. 2010), *reversed by Weinstein*, 302 P.3d at 263.

trial court, the Court of Appeals relied on *Ficor, Inc. v. McHugh*,[663] a case under the repealed Colorado Corporations Code which provides that a director may (in some circumstances) be liable to the corporation for a wrongful distribution.[664] The Colorado Supreme Court reversed the Court of Appeals decision[665] holding that since "the LLC Act and the Colorado Business Corporation Act are two different statutes with different schemes and purposes, and because a corporate shareholder is not equivalent to an LLC member, the legislature is free to choose a statutory limitation on an LLC's creditors different from what it chooses for a corporation's creditors."[666] The Court held that, absent express statutory authority, an LLC's creditor may not assert a claim against the members of the LLC for unlawful distributions.

In reaching its decision in *Weinstein v. Colborne Foodbotics, Inc.*, the Colorado Supreme Court specifically overruled the Court of Appeals' finding in *Sheffield*, holding that "[t]o the extent *Sheffield* holds that an LLC's manager has a fiduciary duty to the LLC's creditors, it is overruled."[667] The Colorado Supreme Court in Weinstein held that "an LLC's creditor may not enforce a claim against the members of the LLC for unlawful distribution."[668] It appears that this holding means that the operating agreement of a Colorado LLC could reduce or eliminate a member's liability for an unlawful distribution or reduce the period for which the member is liable. The Revised Uniform Limited Liability Company Act ("RULLCA"), on the other hand states that a creditor may enforce a member's obligation to return a contribution,[669] but it appears that the operating agreement of an LLC that is subject to RULLCA may eliminate this obligation.[670] The Prototype LLC Act[671] does not provide that a creditor may enforce a member's obligation to return a contribution but states that an operating agreement may not reduce the two year period

663. Ficor, Inc. v. McHugh, 639 P.2d 385, 393 (Colo. 1982).

664. COLO. REV. STAT. ANN. § 7-5-114(3) (repealed effective July 1, 1994). This provision was similar to that currently found in the Colorado Business Corporation Act at COLO. REV. STAT. § 7-108-403. The court in *Ficor*, 639 P.2d at 385, found that the provision was intended to be for the benefit of the creditor, and the fact that the statute specifies liability to the corporation, not the creditor, was irrelevant, at least on the facts in *Ficor*, where all the creditors were represented in the case.

665. *Weinstein*, 302 P.3d at 263.

666. *Weinstein*, 302 P.3d at 268 (citing CML V, LLC v. Bax, 28 A.3d 1037, 1043 (Del. 2011)) (holding that creditors of an LLC did not have the right to bring a lawsuit on the LLC's behalf even though creditors for a corporation did).

667. *Weinstein*, 302 P.3d at 263.

668. *Id.* at 269.

669. RULLCA § 403(b).

670. RULLCA § 110 does not restrict what an operating agreement may do to §§ 403 and 406.

671. The Revised Prototype Limited Liability Company Act is an ongoing project of the LLCs, Partnerships and Unincorporated Entities Committee of the Business Law Section of the American Bar Association. The most recent version was published in THE BUSINESS LAWYER (Nov. 2011).

during which the member is so obligated.[672]

D. LIABILITY FOR UNPAID TAXES

Liability may arise for Federal employment and withheld income taxes. "Any person required to collect, truthfully account for, or pay over" taxes, who willfully fails to do so, faces liability not only for the amount of the tax but a 100% penalty as well."[673]

Internal Revenue Code ("IRC") § 6672(d) states:

> Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to the other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over.

The penalty applies only to those funds withheld from employees and not to the employer's portion of the taxes. The withheld funds are referred to as "trust fund" taxes and typically include income tax, social security, and Medicare payments withheld from employees. The penalty is imposed on "responsible persons" and is collected from a responsible person only if the tax cannot be collected from the employer.[674] Potentially responsible persons include an officer or employee of a corporation or a member or employee of a partnership.[675] The question is whether the person possessed sufficient control over the entity's affairs to avoid the nonpayment of the trust fund taxes.[676] An individual does not have to have day to day control of the administration and affairs of the business to be a responsible person.[677] "Responsibility is a matter of status, duty or authority."[678] If a person has sufficient authority to ensure that taxes are paid, that person

672. RULLCA § 110(c)(9).

673. Internal Revenue Code of 1986 §§3102(a) (withheld employment taxes), 3402(a) (liability for taxes withheld or collected), 6672(a) (one hundred percent penalty for failure to collect and pay over tax; exception for volunteer directors of tax-exempt organizations ((§6672(e))), 7501 (liability for taxes withheld or collected).

674. Caterino v. United States, 794 F.2d 1, 3 (1st Cir. 1986) (*cert denied* 480 U. S. 905 (1987)).

675. I.R.C. § 6671(b).

676. Harrington v. United States, 504 F.2d 1306, 1311 (1st Cir. 1994).

677. *Harrington*, 504 F.2d at 1315.

678. Davis v. United States, 961 F.2d 867, 873 (9th Cir. 1992).

cannot avoid liability by delegation to another.[679] Knowledge of non-payment of taxes, reliance on statements of another who is known to be unreliable, failure to investigate after having received notice of non-payment, and failure to make reasonable inquiry concerning the status of trust fund taxes when the business is in financial difficulty all may establish willfulness.[680]

A person is a responsible for trust fund taxes only while the person is a responsible person. A party who acquires control of an employer with delinquent taxes is not responsible for the taxes that were due before the acquisition.[681]

Employers may achieve some protection by contracting with a third-party payor.[682] Although using a third-party payor does not relieve the employer of liability, the cited regulation does give the IRS authority to pursue the third-party payor directly.

In egregious circumstances, failure to pay trust fund taxes may result in criminal penalties.[683] *United States v. Easterday*[684] determined that Easterday could be convicted of a crime even though he may have been able to prove that his company didn't have enough funds to pay the payroll taxes.

Recent amendments to the applicable regulations have made single-member LLCs the responsible party for employment and withheld taxes on employees of the LLC. The owner is still treated as a self-employed person and presumably will be the first target of the IRS if the LLC fails to satisfy its withholding and payment obligations with respect to its employees.[685]

E. Liability Under Other Federal and State Statutes

Several states have adopted statutes that impose liability on the constituent members and managers of an entity when the taxes are not paid by the entity.[686] As a noted commentator, Allan G. Donn, has explained, federal and state statutes impose direct liability on entity owners and affiliates under employment laws, liability for wage claims of employees,

679. Muck v. United States, 3 F.3d 1378, 1381 (10th Cir. 1993); Kinnie v. United States, 994 F.2d 279, 284 (6th Cir. 1993).

680. Vinick v. United States, 110 F.3d 168, 171–73 (1st Cir. 1997).

681. Slodov v. United States, 436 U.S. 238, 259 (1978); *In re* Rossiter, 167 B.R. 919 (Bankr. C. D. Cal. 1994).

682. Treas. Reg. § 31.3504-2 (2014).

683. United States v. Brennick, 949 F. Supp. 32 (D. Mass. 1996).

684. United States v. Easterday, 564 F.3d 1004, 1010 (9th Cir. 2009).

685. I.R.B. 2007-39 at 675 (T.D. 9356). Treas. Reg. §301.7701-2(c)(2)(iv) (2016).

686. Thomas R. Rutledge, *"Limited Liability (or Not); Reflections on the Holy Grail,"* 51 S.D. L. REV. 417, 443 (2006).

environmental laws, and pension funding.[687]

F. LIABILITY FOR THE OWNER'S OWN ACTIONS AND FOR ACTIONS OF THE ENTITY'S EMPLOYEES AND AGENTS

An owner who is active in the entity's business is responsible for his or her own actions, including torts.[688] In *Sanchez v. Mulvaney*[689] plaintiffs sued Hypersonic Construction, LLC, the general contractor they had contracted with to construct a drive-in restaurant and also brought negligence and veil-piercing claims against one of the members of the LLC. The court upheld summary judgment for the individual defendant on the veil-piercing claim but not on the claim involving allegations of his own tortious or fraudulent actions. If the owner is an agent of the entity and commits the tort while acting for the entity, the entity will also be liable.[690]

In *Retropolis, Inc. v. 14th Street Development LLC*[691] the defendant avoided a veil-piercing claim because the plaintiff presented minimal evidence of misuse of the LLC, but the court noted that the defendant could be held liable to the extent the plaintiff brought tort claims against him because "a corporate officer who participates in the commission of a tort can be held personally liable even if the participation is for the corporation's benefit."[692]

In *16 Jade Street, LLC v. R. Design Construction Co., LLC,*[693] in a case of first impression, the Supreme Court of South Carolina held that a member of an LLC could be personally liable for torts committed in the course of working for the LLC.

In *In re Sanner (Birdwell v. Fort McDowell Sand and Gravel),*[694] the court applied Arizona veil-piercing cases in determining that the founder and manager of the defendant LLC was not liable under an alter ego theory. The bankruptcy trustee argued that it was unnecessary to pierce the veil of the LLC because the individual was a party to a plan to engage in conclusive bidding under Section 363(n) of the Bankruptcy Code and was directly liable for his own conduct. The court characterized the trustee's

687. Allan G. Donn, *Is the Liability of Limited liability Entities Really Limited?* RESEARCH HANDBOOK ON PARTNERSHIPS, LLCS AND ALTERNATIVE FORMS OF BUS. ORGS. 99, 110–13 (Edward Elgar Publishing 2015) (Robert W. Hillman and Mark J. Loewenstein, eds.).

688. Valley Dev. Co. v. Weeks, 364 P.2d 730, 734 (Colo. 1961).

689. Sanchez v. Mulvaney, 274 S.W.3d (Tex. App. 2008).

690. RESTATEMENT (THIRD) AGENCY §§ 7.03(2), 7.03 cmt. b, 7.03(2)(a), 7.07.

691. Retropolis, Inc. v. 14th Street Development LLC, 17 A.D.3d 209 (1st Dept. 2005).

692. *Id.* at 211.

693. 16 Jade Street, LLC v. R. Design Construction Co., LLC, 728 S.E.2d 448 (S.C. 2012).

694. *In re* Sanner (Birdwell v. Fort McDowell Sand & Gravel), 218 B.R. 941 (D. Ariz. 1998).

argument as "merely an attempt to make an end run around the protections accorded shareholders, directors, and officers by the corporate form and is not supported by any credible evidence."[695] Moreover, the agreement setting forth the bidding plan was signed on behalf of the LLC by a representative of the LLC acting in his representative capacity and not in an individual capacity.[696]

An owner may also face liability for negligent hiring, supervision, and retention of employees, contractors, and other agents.[697]

G. Opinion Considerations

Any attorney contemplating rendering an opinion with respect to the enforceability of an LLC's company agreement or of the liability of the members of the LLC should carefully consult the Supplemental TriBar Opinion Report: Reports on LLC Memberships Interests ("TriBar 2011").[698] TriBar 2011 notes that purchasers of LLC interests sometimes request an opinion that, as members of the LLC, they will have no liability to third parties for debts, obligations, and liabilities of the LLC.[699] TriBar 2011 notes that this type of opinion is not normally addressed in corporate opinions and expresses the hope that, over time, opinions on the personal liability of LLC members to third parties for liabilities of the LLC will cease to be requested or given.[700] TriBar 2011 then states that, "as matters now stand," an opinion on liability of LLC members to third parties should be combined with the TriBar 2011 suggested opinion on liability of LLC members for payments and contributions to the LLC.[701] TriBar 2011 suggests the following language for the combined opinion:

> Under [name of LLC statute under which LLC was formed] (the "Act"), Purchasers have no obligation to make further payments for their purchase of LLC Interests or contributions to LLC solely by reason of their ownership of LLC Interests [or their status as members of LLC] and no personal liability for the debts, obligations, and liabilities of LLC, whether arising in contract, tort, or otherwise, solely by reason of being members of LLC [except in each case as

695. *In re Sanner*, 218 B.R. at 947.
696. *Id*.
697. Restatement (Third) Agency §§7.03, 7.05.
698. *See Supplemental TriBar Opinion Report: Reports on LLC Memberships Interests*, 66 Bus. Law. 1065 (2011).
699. *Id*. at 1074.
700. *Id*.
701. *Id*. at 1071–74.

> provided in their Subscription Agreements or the Operating Agreement] [and except for their obligation to repay any funds wrongfully distributed to them].[702]

An opinion giver should resist any request to change the suggested reference to the LLC statute under which the LLC statute. For example, if an opinion is being given with respect to a Delaware LLC, if the opinion began "Under Delaware law" instead of "Under the Delaware LLC Act," the opinion giver might be viewed as giving an opinion that the members will not be liable under any theory of Delaware law, including its law on veil-piercing and alter ego liability. Any lawyer who is requested to give an opinion along the lines discussed in this Article should include a careful consideration of TriBar2100 and the other helpful commentaries on LLC opinions.[703]

XI. CONCLUSION

The cases discussed in this Article are largely consistent with Macey and Mitts's conclusion that, notwithstanding the many factors discussed or, at least, mentioned in many opinions that courts approve veil-piercing for one of three reasons. Macey and Mitts argue that their analysis shows that whatever rationale may have been stated in opinions, "the entire universe of piercing cases can be explained as judicial efforts to remedy one"[704] of three problems:

- Courts pierce the corporate veil "to bring corporate actors' behavior into conformity with a particular statutory scheme;"[705]
- Courts "also pierce to remedy what appears to be fraudulent conduct that does not satisfy the strict elements of common law fraud;"[706]
- The third ground on which courts pierce the corporate

702. *Supra* note 698 at 1075. TriBar 2011 notes that some opinion givers do not include the last bracketed language because they do not believe that an obligation to repay a wrongful distribution is solely attributable to ownership of LLC interests and that such an obligation is not "solely" by reason of being a member because it depends on the recipient's knowledge that the distribution is unlawful. *Id*. at 1072 and note 42. TriBar 2011's view is that "an express exception for the obligation of members to repay wrongful distributions is not necessary, but its inclusion is not objectionable." *Id*.

703. For an excellent example of such commentary, see Norman M. Powell, *Opining on Limited Liability Company Series*, THE PRACTICAL LAW. (Aug. 2014). Despite the title, Powell's article is a useful source for any LLC opinion.

704. Macey & Mitts *supra* note 11 at 4–6.

705. *Id.* at 4.

706. *Id*. at 5.

> veil is “the promotion of what” Macey and Mitts term “accepted bankruptcy values.”[707]

Macey and Mitts further state:

> [W]e believe that our taxonomy can produce a coherent account of veil-piercing cases, and are thus more optimistic than Stephen Bainbridge, who famously called for the abolishment of the doctrine. Unlike Bainbridge, we believe that there are strong public policy rationales for retaining veil piercing in certain situations. We hesitate to conclude that a century of jurisprudence represents a colossal mistake on the part of the courts in all 50 states. Rather, we suggest that three public policy rationales provide a systematic justification of veil piercing and that courts regularly decide in accordance with these rationales, even if they do not say so expressly.[708]

This Article has also discussed cases that do not appear consistent with Macey and Mitts. These cases include *Martin v, Freeman*[709] and *Axtmann v. Chillemi*,[710] which appear to stand for the dubious proposition that an entity must have adequate capital at all times sufficient to respond to unexpected large liabilities, as well as the opinions that appear to place some weight on the tax status of the entity in question.[711] This Article has also questioned the analysis of Macey and Mitts on occasion.[712] One may hope that that *Martin v. Freeman*, *Axtmann v. Chillemi*, and the cases considering tax status will not be followed in the future but that courts will apply thoughtful analyses that take into account business realty. This should include careful attention to the arguments made by Macey and Mitts.[713] Attorneys who are advising clients would also do well to consider the arguments of Macy and Mitts as well as the opinions that explain what factors are particularly important. Many of the cases discussed in this Article list many factors but often focus in on particular actions of the defendants that clearly did or did not harm the plaintiff. Also, as should be obvious without reading any cases is that an advisor should caution a client

707. Macey & Mitts *supra* note 11 at 5.
708. Macey & Mitts *supra* note 11 at 22.
709. *See supra* notes 272-80 and accompanying text.
710. *See supra* notes 312-29 and accompanying text.
711. *See supra* notes 404-28 and accompanying text.
712. *See supra* notes 135-39 and accompanying text and notes 287-91 and accompanying text.
713. *See supra* note 11.

who appears to be intending to use an entity to frustrate the reasonable expectations of creditors or to skirt a statutory or regulatory scheme. Courts have little patience with clear instances of abuse of the LLC form. Two representative cases discussed in this Article are *Double Constr. Co. v. Advanced Home Builders, LLC*[714] and *Tzovolos v. Wiseman*.[715] In *Double Constr. Co.*, the owners of the LLC refused to pay for work the plaintiff had clearly done and that had been certified by the municipal engineer. In addition, the owners of the LLC unjustifiably refused to pay for paving work done by another contractor. In *Tzovolos*, the defendant took action on behalf of an LLC without complying with the LLC agreement's provisions for majority member approval and used his dominant position to take restaurant equipment that he knew he was not entitled to. In addition, one of the factors the court in *Tzovolos* cited as showing a lack of separateness among the defendant entities was that "each of the entities was represented by a single law firm . . . even when they had conflicting interests and when at least one . . . was insolvent."[716] Moreover, although LLC statutes often provide that failure to follow formalities is not to be considered in piercing the veil of an LLC, clients should be cautioned to make sure that third parties understand that they are dealing with an LLC, and maintaining financial records that clearly differentiate between the LLC's receipts and disbursements and those of the members will often be crucial in successfully opposing a veil-piercing claim. The cases citing tax status and filings as a factor in veil-piercing suggest that it is advisable that each single-member LLC have its own tax identification number and, if it is to be handling receipts and disbursements, a bank account in its own name.[717] An attorney who is advising the owner of a single-member LLC should caution the owner that, although the LLC is disregarded for income tax purposes,[718] the LLC is nevertheless a state law entity. The attorney should advise the owner to be sure to enter into contracts in the name of the LLC and to be sure that third parties know that they are dealing with an LLC. Moreover, an attorney who is engaged to defend a single-member LLC and or its owner against an alter ego claim should be prepared to argue clearly to the court that the LLC's permitted tax status should not be considered. If a client is entering into a commercial contract to be performed by an entity,

714. *See supra* note 197 and accompanying text.

715. *Supra* note 205 and accompanying text.

716. *Tzovolos*, 16 A.3d at 841.

717. See cases discussed *supra* notes 404-28 and accompanying text.

718. Treas. Reg. § 301.7701-2(b) (1996) (unless the single-member LLC elects to be treated as a corporation for tax purposes). Moreover, a single member unincorporated entity that is disregarded for income tax purposes is not disregarded for employment tax purposes and certain excise tax purposes. Treas. Reg. §§ 301.7701-2(c)(2)(iv) (1996) (employment taxes) & 303.7701-2(c)(2)(v) (1996) (certain excise taxes).

the client's attorney should caution the client either to insure that the entity has the resources necessary to perform under the contract or to seek personal guarantees from the owners. Otherwise, the cases discussed under Section III.C. Tort Liability Versus Contract Liability[719] may foreclose a later attempt to hold the owners liable under a veil piercing/alter-ego claim.

719. *See supra* notes 90-139 and accompanying text.