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Insights

Three Minute Update - Protecting Your Business: Piercing the Corporate Veil

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By: Michael E. Williams and Corben A. Lee

Corporations and limited liability companies offer, as a primary benefit to using an entity form for operating a business, limited liability protection to the owners for the entity's actions, debts, and other obligations. This concept means that the debts and liabilities of the entity belong to the entity, – and as such, an entity's owner is not personally liable for them. As you can imagine, this concept is instrumental for an entrepreneur as it allows them to separate the risk of the business from the owner's personal assets. Unfortunately, circumstances could arise where your actions effectively forfeit that limited liability protection, and in those instances, a court may hold you personally responsible for the entity's actions or debts. This legal doctrine is known as "piercing the corporate veil."

Factors Courts Will Consider When Piercing the Corporate Veil

In general, courts are hesitant to overrule the limited liability protection offered by a corporation or limited liability company. However, they still may pierce the corporate veil and impose liability on the owners of an entity to prevent fraud and financial injustice to others. While laws vary in each state, here in Indiana, "the burden is on the seeking party (usually the plaintiff) to pierce the corporate veil to prove that the corporate form was so ignored, controlled or manipulated that it was merely the instrumentality of another that the misuse of the corporate form would constitute a fraud or promote injustice." To make this determination, courts will examine a variety of factors, including the following:

- Whether the entity was undercapitalized;
- Whether the entity maintained adequate corporate records;
- Whether the owners took part in fraudulent activity or used the entity to promote fraud, injustice, or illegal activities;
- Whether the owners use the entity to make payment for individual obligations;
- Whether the owners comingled personal assets and affairs of those of the entity;
- Whether the owners and board failed to observe required corporate formalities; or
- Other shareholder acts or conduct by ignoring, controlling, or manipulating the corporate form.

How to Protect Yourself as a Business Owner

With those key factors in mind, and a keen understanding of the business, an attorney can help a business entity develop policies and procedures that help preserve and strengthen an identifiable barrier between an entity and the owners. Below are some quick tips that can help prevent a court from piercing the corporate veil:

- All contracts should be in the entity's name, not in the owner's name, and be signed an authorized representative signing in that capacity and not in their individual capacity.
- The entity should have sufficient capital and other resources to support its operations and pay its obligations as they become due in the ordinary course of the business.
- The owner should conduct all business in the entity's name, not in an individual's name.
- The entity should hold meetings of its owners and board regularly and at least annually.
- The entity should keep current records of its corporate actions and adopt organizational documents.
- All business assets should be owned solely by the entity and not by an owner or, if owned by an owner, should be documented and on reasonable market terms.
- All bank accounts should be in the entity's name, and the entity's name should appear on all checks, deposit slips, and other banking transactions.
- Checks should be endorsed in the entity's name before deposit.
- If the entity borrows any money or enters into any lease or any other contract, it should, if at all possible, be done in the name of the entity alone and no owner should individually sign the contract or guarantee its performance. Under some circumstances, a lender, lessor or other business counterparty may require you (and possibly your spouse), to co-sign or guarantee a company loan or business obligation, but you should avoid this if at all possible. You are individually liable for any entity debts that you personally guarantee.

Just like all other business tools and assets, the limited liability entity requires attention and maintenance in order to perform at its best. Despite common misconceptions, the act of forming an entity does not by itself guarantee you the personal protection of limited liability. As such, it is vitally important to seek proper legal advice and follow corporate formalities in order to be shielded personally by that legal protection when it may be needed. Failure to preserve the barrier could lead to piercing of the veil and , allow the personal assets, such as homes and bank accounts, of owners to be used to pay damages or debts incurred by the entity.

If you have any questions regarding the information in this article or with protecting your assets, please contact **Michael E. Williams**, **Corben A. Lee**, or any member of our **Business, Acquisitions, & Securities Practice**.

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