

CALIFORNIA LIMITED LIABILITY COMPANY REVIEW

PIERCING THE VEIL

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A significant reason for forming an LLC is to obtain liability protection for its

owners. Neither the members nor managers of an LLC formed in California have liability merely by reason of being members or managers. That liability protection contrasts with the joint and several liability of partners of a general partnership or the general partner of a limited partnership for the recourse liabilities of the partnership. The creditors of those partnerships potentially can take the homes of those partners to satisfy partnership claims.

However, the liability protection of an LLC does not provide absolute liability protection. As with an employee, officer or director of a corporation, an employee, member or manager of an LLC that participates in causing damage (whether or not intentionally) in one of those capacities may face exposure to liability from the damaged persons. Companies, including LLCs, often carry insurance for this reason, and may indemnify those persons for some or all of that liability. Additionally, even if a member of an LLC does not participate in causing the damage, a court in some instances might apply the

equitable doctrine of "alter ego", or more poignantly, "piercing the veil," to find the member personally liable despite the liability protection referenced above.

California is somewhat unique in that it has codified the "piercing the veil" standard in the LLC statutes. That statute imposes personal liability on a member of an LLC to the same extent as a shareholder of a corporation, except that where meetings of members or managers are not required, the failure to observe formalities regarding the calling or conduct of those meetings is not a factor to be considered in establishing that liability. Cal. Corp. Code Section 17101(b).

There is much that can be said about that provision. First, a California LLC seems to be a better liability shield than either a California corporation or an LLC formed in Delaware, Nevada or some other state, which may generally look to corporate law factors when evaluating whether to pierce the veil of that entity. Those entities should consider keeping a "neat" minute book with up to date resolutions and minutes reflecting entity actions and approvals, since they cannot rely upon a statutory exclusion to disregard meeting formalities. It may not be a "bad" idea

anyway for a California LLC to keep similar records for major decisions to record the proper approval for those decisions and any dissents. Second, a drafter of an operating agreement for a California LLC should think twice about omitting a provision disclaiming the need to hold meetings of members and managers or potentially lose the benefit of the exclusion. Third, members and the California LLC still must take action to uphold the separate status and liability protection of the LLC. For instance, the members should capitalize adequately the LLC at inception and not commingle assets or funds of the LLC with the personal assets of the members. If the members cannot keep the LLC assets separate from their own why should a court keep the liabilities separate.

The subject of "reverse piercing" and rights of creditors of members to reach assets of the LLC is the topic of another article.

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