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Want To Keep Your Car? (Spring 2008)

In light of the current state of our economy, it should come as no shock to anyone that creditors are becoming increasingly anxious regarding their extensions of credit. They are seeing more companies becoming “slow-pay” or “no-pay” debtors. Such anxiety causes a heightened level of creativity in the legal theories and claims asserted by creditors against the owners of entity debtors. The courts are seeing a resurgence of one long recognized method of attempting to seek repayment of debt from the owners of an entity - piercing of the corporate veil.

In many cases, the primary purpose of forming an entity under state law, whether in the form of a corporation, limited liability company, or other form, is to shield the assets of the owners of the entity from exposure to the debts and liabilities related to the operations of the entity. Generally, an owner of an entity is not held liable for the debts or liabilities of the entity. Creditors are limited to the entity’s assets for satisfaction of the debt or liability, and they cannot reach the real property or personal property assets of the owners of the entity. However, under some circumstances, creditors may attempt to pierce this “corporate veil” of entity protection. In these cases, creditors may allege that the entity form is being used to perpetrate a fraud, circumvent a statute or regulation, or to accomplish some other improper, wrongful, or inequitable purpose. The creditor will request that the court not observe the “corporate veil” created by the formation of the entity so that the acts of the entity are deemed to be the acts of the owners of the entity, thereby exposing the assets of that owner to the debts and liabilities of the entity. Veil piercing is also referred to as one individual or entity being the “mere instrumentality” of another, or also as the “alter-ego” of another.

North Carolina courts have allowed the piercing of the corporate veil when appropriate, and have allowed creditors access to the assets of individual owners, corporate parents, and even affiliated entities. The leading North Carolina case in this matter is Glenn v. Wagner, 313 N.C. 450 (1985). In this case, the North Carolina Supreme Court enumerated the following three elements which must be established by the creditor seeking to recover against an owner’s assets:

(1) Control, not mere majority or complete stock control, but complete domination, not only of finances, but of policy and business practice in respect to the transaction attacked so that the corporate entity as to this transaction had at the time no separate mind, will or existence of its own; and

(2) Such control 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 and unjust act in contravention of plaintiff’s legal rights; and

(3) The aforesaid control and breach of duty must proximately cause the injury or unjust loss complained of.

The Supreme Court further enumerated four factors which are to be considered in veil piercing cases. Those factors include:

(1) Inadequate capitalization;

(2) Non-compliance with corporate formalities;

(3) Complete domination and control of the corporation so that it has no independent identity; and

(4) Excessive fragmentation of a single enterprise into separate corporations.

The possibility of loss of entity protection strongly supports careful attention to the appropriate corporate funding and operational procedures. Certainly, piercing the corporate veil is not the only possible method for holding individuals (including shareholders, members, managers, directors, officers and others) as well as other entities responsible for the liabilities and debts of an entity. With the appropriate guidance, owners of business enterprises may reduce the risk of a successful veil piercing and keep personal assets from unintentionally being available to entity creditors or other claimants.

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