

WHV Legal Updates

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Piercing The Corporate Veil – Do I Have Anything To Worry About?



Corporations and limited liability companies are formed for a number of reasons. One of the main reasons is to ensure that the owners of the company, the shareholders of a corporation and the members of a limited liability company (jointly referred to as the “owners” of a company), are not liable for the debts of the company. However, under certain circumstances, the owners can be liable for the debts of the company. So, what should owners be concerned about?

It is well settled law in the State of Ohio that the owners of a company, along with the officers and directors of a corporation and the manager of a limited liability company, are not liable for the debts of the company. This is because the corporate entity creates a dividing line between the assets and obligations of the company and those of its owners. This division allows the company to easily enter into contracts, acquire property for corporate purposes, etc. while at the same time preserving the limited liability of the owners.

The owners of a company are not immune from liability based on the actions of the company. In instances of extreme owner misconduct courts will allow parties to “pierce the corporate veil”. This is because it is the exception, not the rule, when an owner is responsible for the debts of a company.

The Ohio Supreme Court created a three-part test for courts to use in determining if the corporate veil of a company should be pierced. In order for an owner to be liable for debts of a company, all three parts of the test must be met. The three parts are: (1) the alter ego doctrine - control over the company by the owners was so complete that the company has no separate mind, will or existence of its own; (2) control over the company by the owners was exercised in such a manner as to commit a fraud, an illegal act or similarly unlawful act against the person seeking to pierce the corporate veil and (3) injury or unjust loss resulted to the plaintiff from such control or wrong doing.

In applying the first part of the test, courts consider a list of factors to aid in determining if the owners and the company are actually one in the same. Some of the factors are: if the company is inadequately capitalized, if the company failed to observe corporate formalities – such as a corporation holding yearly director and shareholder meetings, the diversion of funds or other company property for the owners personal use, the absence of any corporate records or resolutions and the like.

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If a plaintiff is able to prove that the company is the alter ego of the owners, his work is still not finished. He now must prove the second part of the test - that the owners exhibited control of the company to commit a fraud, illegal act or similarly unlawful act. If the second part is established, then it must be proven that such action resulted in injury or unjust loss to the plaintiff.

There are some easy steps to take to ensure that the corporate veil of your company will not be pierced. First, do not commit any fraudulent, illegal or unlawful acts. It is important to note that not every breach of contract is equal to a fraudulent or illegal act. Second, make sure that if your company is entering into contracts that it is not insolvent. Third, if your business is organized as a corporation, then respect and abide by the corporate formalities. Your corporation should conduct yearly meetings of the directors and shareholders. Appropriate decisions should be taken or memorialized in resolutions. If your business is organized as a limited liability company, the Ohio Revised Code does not require yearly meetings of the members to be conducted, but it is good practice to hold such meetings. It is also good to make or memorialize appropriate decisions with resolutions. Fourth, do not use the company's checking account to pay for personal expenses.

If you are the sole owner of the company or the ownership is limited only to a few people, it is easy to forget the requisite corporate formalities. If you find that you are falling into this trap, then change your thinking and imagine that you are only one of a number of owners in a company. This should bring more formality to your decision making process.

This article is not providing legal advice or creating an attorney-client relationship. If you have any questions or would like to learn more about this topic or if you have other legal questions, do not hesitate to contact Chris Corpus, Esq. at cacorpus@wegmanlaw.com.