

“Piercing the Corporate Veil” A Primer and Update

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- I. What jurisdiction's law applies?
 - A. Generally, the law of the state of incorporation or formation applies, based on the “internal affairs doctrine.” *Kellers Systems, Inc. v. Transport International Pool, Inc.*, 172 F.Supp. 2d 992 (N.D. Ill. 2001); *Restatement (Second) Conflict of Laws*.
 - B. *Multi-Media Holdings, Inc. v. Piedmont Center, 15 LLC*, 262 Ga. App. 283 (2003) applying Georgia law to pierce the corporate veil of a Delaware corporation where the contacts with the state of incorporation were not as significant as the factors pointing to Georgia.
 - C. In some cases, Federal common law may apply.
- II. Illinois law – two requirements must be met (*Gallagher v. Reconco Builders, Inc.*, 91 Ill.App.3d 999, 415 N.E. 2d 560 (1980))
 - A. Unity of interest and ownership such that the separate personalities of the corporation and the individual no longer exist
 - B. Adherence to the fiction of separate corporate existence would sanction a fraud or injustice
- III. Factors in applying the two-part test
 - A. Inadequate capitalization
 - B. Failure to issue stock
 - C. Failure to observe corporate formalities
 - D. Nonpayment of dividends
 - E. Insolvency of the debtor corporation at the time

- F. Non-functioning of other officers or directors
 - G. Absence of corporate records
 - H. Commingling of funds
 - I. Diversion of assets
 - J. Failure to maintain arm's length relationships among related entities
 - K. Whether the corporation is a mere façade for the operation of the dominant shareholders
- IV. Reverse piercing
- A. *In re Rehabilitation of Centaur Insurance Co.*, 158 Ill. 2d 166, 632 N.E.2d 1015 (1994), holding that a corporation may not assert an alter ego action against its own shareholders.

Flynn v. Allis Chalmers Corp., 262 Ill. App. 3d 136, 634 N.E.2d 8 (1994)
 - B. *Knickman v. Midland Risk Services-Illinois, Inc.*, 298 Ill. App. 3d 1111, 700 N.E.2d 458 (1998)
- V. Limited liability companies
- A. Prior to 1998: “a member of a limited liability company shall be personally liable for any act, debt, obligation or liability of the limited liability company . . . to the extent that a shareholder of an Illinois business corporation is liable in analogous circumstances under Illinois law.” 805 ILCS 180/10–10(a) (1994).
 - B. Since 1998: “the debts, obligations, and liabilities of a limited liability company, whether arising in contract, tort, or otherwise, are solely the debts, obligations, and liabilities of the company. A member or manager is not personally liable for a debt, obligation, or liability of the company solely by reason of being or acting as a member or manager.” 805 ILCS 180/10–10(a) (1998).
 - C. Section 10-10(c): “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 is not a ground for imposing personal liability on the members or managers for liabilities of the company.” 805 ILCS 180/10–10(c) (1998).

- D. *SIPC v. R. D. Kushmir & Co.*, 274 B.R. 768, 2002 Bankr. LEXIS 203 (N.D. Ill. 2002)
 - E. Some state statutes (*e.g.*, Minnesota, Colorado) specifically apply the concept of piercing the corporate veil to limited liability companies. *West's Encyclopedia of American Law*, excerpt online at www.wld.com/conbus/weal/wlimlcom.htm
 - F. In other jurisdictions (*e.g.*, Connecticut, Louisiana, Georgia, California), courts have generally applied the concept of piercing the corporate veil to LLCs.
- VI. Protecting the veil
- A. Provide adequate capital for the entity's intended purposes.
 - B. Document the capital infusion.
 - C. If the entity is a corporation, issue certificates or clearly provide documentation that the shares are uncertificated
 - D. At a minimum, prepare annual minutes for meetings of shareholders and directors. Even better, adopt resolutions reflecting approval of all major corporate actions. Even LLCs should take steps to document action by appropriate records.
 - E. Pay dividends when possible. Obviously, with respect to C corporations there are tax consequences to doing so, but consideration should be given to this factor.
 - F. Do not install other directors and officers who will be there simply for window dressing. Either involve directors and officers in their respective roles or do away with the positions.
 - F. Do not blur the entities' identities. Use separate letterhead. Don't use the same or similar name or logo for related companies.
 - G. Maintain separate bank accounts and do not commingle funds.
 - H. Deal with related entities at arm's length
 - I. Do not divert assets.
 - J. Do not favor a related creditor.

VII. Other issues - recent cases

- A. *International Financial Services Corp. v. Chromas Technologies Canada, Inc.*, (7th Cir., Jan. 23, 2004). Jury found defendant Chromas was the alter ego of defendant Didde Web Press Corporation and liable for breach of contract to produce a printing press. The Seventh Circuit ruled that the issue of piercing the corporate veil is an equitable remedy to be determined by the court.
- B. *Harris Custom Builders, Inc. v. Hoffmeyer*, 2001 U.S. Dist. LEXIS 10032 (N.D. Ill. 2001). Piercing the corporate veil may not be brought in a supplementary proceeding in Federal court, citing *Pyshos v. Heart-Land Development Co.*, 258 Ill.App.3d 618, 630 N.E.2d 1054, 1058, 196 Ill.Dec. 889 (Ill. App. Ct. 1994) and *Lange v. Misch*, 232 Ill.App.3d 1077, 598 N.E.2d 412, 415, 174 Ill.Dec. 215 (Ill. App. Ct.), *appeal denied*, 606 N.E.2d 1227 (1992). Cf. *Flip Side Productions, Inc. v. Jam Productions, Ltd.* (1990 U.S. Dist. LEXIS 15411 (N.D. Ill. Nov. 8, 1990).

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Additional Cases

Dimmett & Owens Financial v. Superior Sports Products, 196 F. Supp. 2d 731 (N.D. Ill. 2002)

APS Sports Collectibles, Inc. v. Sports Time, Inc., 299 Fed.3d 624 (2002)

Main Bank of Chicago v. Baker, 86 Ill. 2d 188, 427 N.E.2d 94, 56 Ill. Dec. 14 (1981)

People v. V&M Industries, 298 Ill.App. 3d 733, 700 N.E.2d 746 (1998)

Falcon Associates, Inc. v. Cox, 298 Ill.App. 3d 652, 699 N.E.2d 203 (1998)

Fiumetto v. Garrett Enterprises, Inc., 321 Ill.App.3d 946, 749 N.E.2d 992 (2001)

Fentress v. Triple-Mining, Inc., 261 Ill.App.3d 930, 938, 635 N.E.2d 102, 200 Ill. Dec. 1, 7 (1994)

Pederson v. Paragon Pool Enters., 214 Ill.App.3d 815, 574 N.E.2d 165, 158 Ill. Dec. 371 (1st Dist., 6th Div. 1991)

Webb v. Webb, 180 Ill.App.3d 619, 536 N.E.2d 206, appeal denied, 127 Ill.2d 643, 545 N.E.2d 134, 136 Ill. Dec. 610 (1989)