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# LLC Collection:
# Piercing the Veil


Prepared and Presented by:

Meghan McDonnell, Tucker Ellis LLP
Tod Northman, Tucker Ellis LLP



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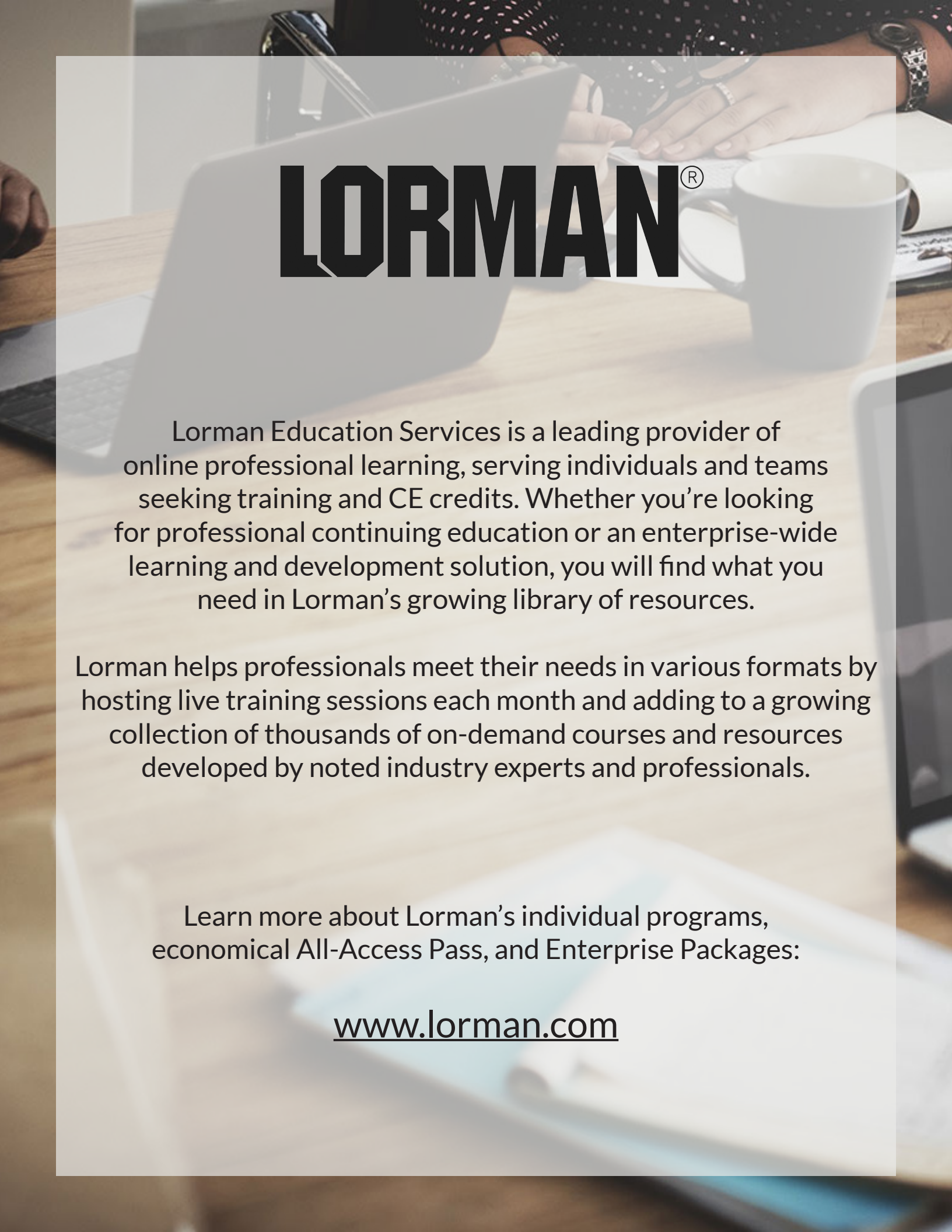

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# AGENDA

Agenda

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# Limited Liability Company Collections: Piercing the Veil



Tod Northman, Partner
Meghan McDonnell, Associate
Tucker Ellis LLP

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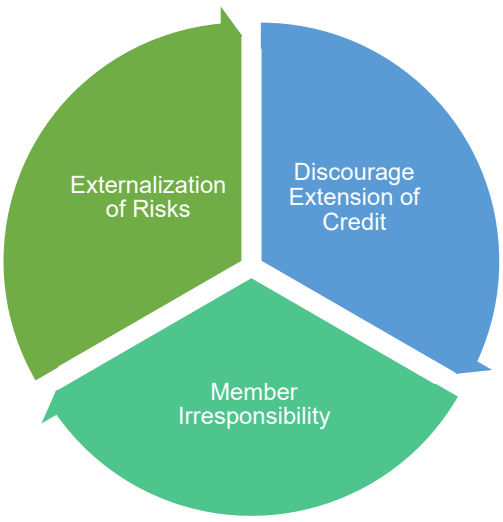
# Reasons for Limited Liability

- Investment of Passive Capital
- Uniform Share Valuation
- Centralized Delegated Management
- Diversification
- Reduce Monitoring Costs (of other owners)
- Enhanced Transferability






# Systemic Costs of Limited Liability



# Creditor Protection Solutions (Part 1)

| | |
|---|---|
| Contractual Solutions | Debt Covenants<br>Secured Debt |
| Laws affecting probability that firm acts contrary to creditors and/or can pay (Capital Regulations) | Minimum capital requirements<br>Distribution Constraints<br>Capital Maintenance Requirements |
| Fiduciary Duty Constraints (e.g., Manager and Member liability) | |



# Creditor Protection Solutions (Part 2): Expanding the Pool of Available Assets

- Fraudulent Conveyance
- Equitable Subordination
- Piercing the Corporate Veil

## Fraudulent Conveyance: Uniform Fraudulent Transfer Act (UFTA)

a) A transfer made … by a debtor is fraudulent as to a creditor, whether the creditor's claim arose before or after the transfer was made … If the debtor made the transfer … [with intent to defraud]

(1) without receiving reasonably equivalent value in exchange for the transfer… and the debtor:

(i) was engaged or about to engage in a business transaction for which the remaining assets of the debtor were unreasonably small … or

(ii) or intended to incur … or reasonably should have believed that he [or she] would incur debts beyond his [or her] ability to pay as they came due.



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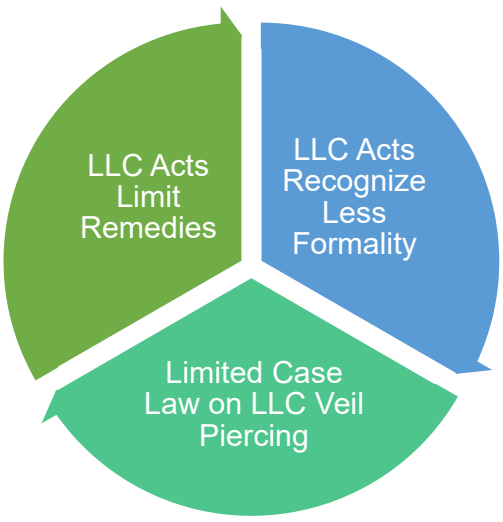
## Comparison of Corporate and LLC Veil Piercing



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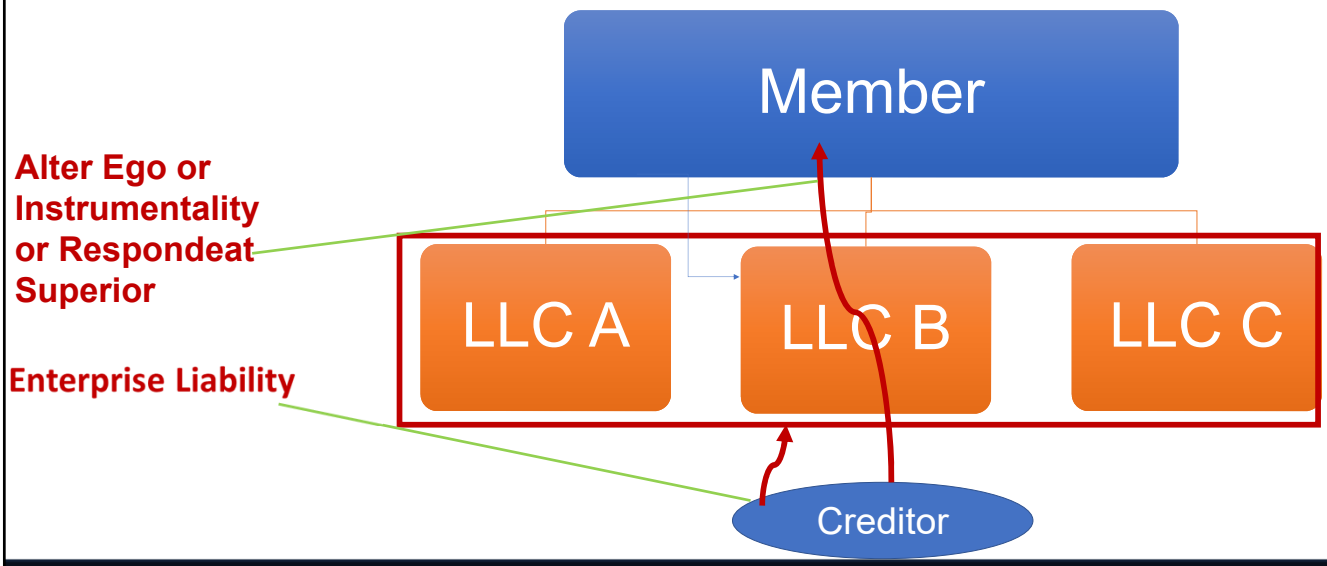
# Additional Reasons to Bring Veil Piercing Claim

- **To expand discovery sources**
  - By expanding discovery to information relating to the piercing claim, a plaintiff may obtain information that is also useful to proving the underlying claim
- **Increase the costs of discovery**
  - By adding a piercing claim, a plaintiff can gain leverage in settlement negotiations by increasing the burden and cost of discovery and litigation on the defendant
- **Jurisdictional Piercing**
  - A plaintiff may establish jurisdiction over the LLC more easily than over shareholders/members
  - Piercing through the LLC allows plaintiff to overcome jurisdictional hurdle



# Piercing the Veil: Theories of Liability



## Piercing Preliminaries: Threshold Questions

- LLC Must Be Liable
  - You do not “pierce” when plaintiff is saying the member (or manager/officer) personally did something to him
  - The entity must be at fault/owe money
- LLC Must Be Unable to Pay



## Seven Deadly Sins

- How to get your veil pierced



# Greed





# Sloth



# Gluttony





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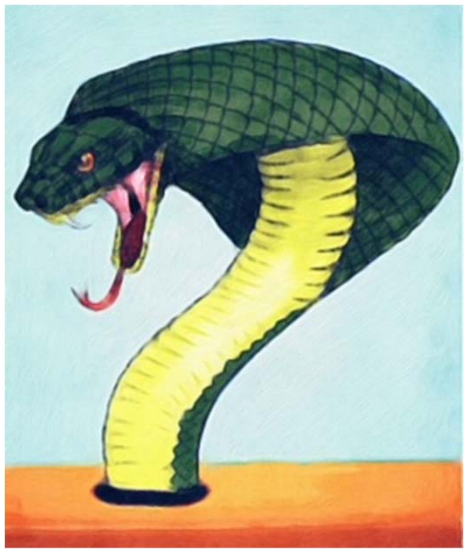
# Envy





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# Pride







# Wrath





# Piercing the Entity Veil – Principal-Agent

Grounds member liability in idea that member should be liable when crosses line from member to being a principal with firm as agent.

## Requirements

- Control (necessary but not sufficient)
- LLC acting on behalf of principal
  - Gain to member, but not through distributions
  - Courts look for abuse of entity form, misappropriation of funds

## Instrumentality Rule

- Control of LLC by owner that is so complete that entity has no separate mind
- Such control is used to commit a fraud, wrong, or other violation of plaintiff's rights
- Control and breach was proximate cause of plaintiff's injury

# Alter Ego Test: Two Factors

Single Economic Entity: there is a "unity of interest and ownership" between the LLC and its owner, and

Fraud/Injustice: it would be unfair if the acts in question are treated as those of the LLC alone

("sanction fraud" or "promote injustice")

Factors:

- Commingling of funds and other assets, failure to segregate funds of the separate entities, and the unauthorized diversion of corporate funds or assets to other than corporate uses
- Treatment by an individual of the assets of the LLC as his own (e.g., paying personal debts with corporate funds)
- Failure to follow corporate technicalities, such as maintaining records, holding board or shareholder meetings, or having officers
- Failure to adequately capitalize an LLC, the total absence of corporate assets, and undercapitalization
- Manipulation of assets and liabilities between entities so as to concentrate the assets in one and the liabilities in another
- Contracting with another with intent to avoid performance by use of a corporate entity as a shield against personal liability





# *In re Opus East, LLC*, 538 B.R. 30 (Bankr. D. Del 2015)



Opus Group

Opus E., LLC

Various Other Regional Opus LLCs

# Piercing to Opus Group or Other Opus Entities: Analysis of Liability Factors

Opus Group is Sole Member of Opus E, LLC

Opus Group observed entity formalities

Opus E was undercapitalized to survive 2008 Financial Crisis

Opus Group received distributions from Opus E

Primary rationale for entity structure was to insulate sibling and parent entities from liability

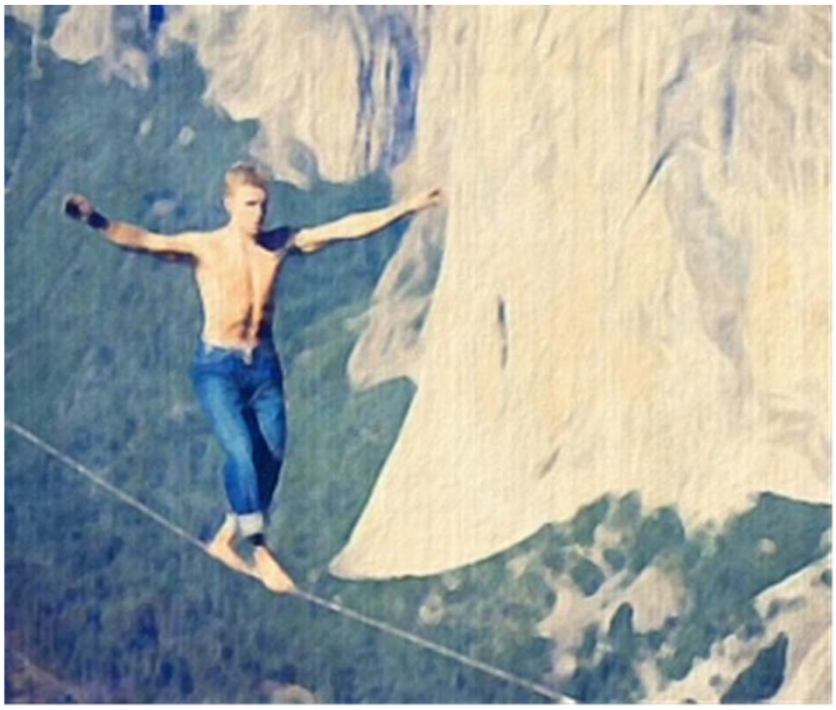
All LLCs use the same name and marketed as a integrated enterprise

**BUT**: fact Opus E cannot pay debts is not enough – would allows piercing in every instance where LLC cannot pay its debts



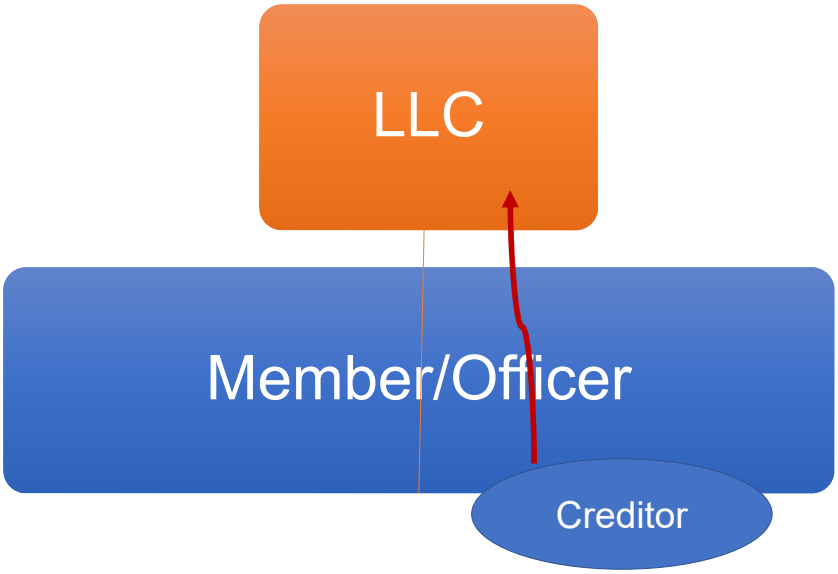
# In re Opus: Lingering Questions

- Here we also have intentional thin capitalization— Why isn't that enough?
- Should it matter if 10 separate LLCs formed (each with its own minimum insurance requirement) only to avoid liability exposure of one big LLC?
- Should it matter if creditors are personal injury tort creditors as to how we apply veil piercing?
- (Why) should intent matter?
- Should we care if the firm was undercapitalized from the start or money siphoned out?





## Reverse Piercing



## Reverse Piercing

- "Insider" reverse piercing occurs when a member urges the court to disregard the LLC as a separate entity in order to obtain personal ownership of the company's assets.

- "Outsider" reverse piercing occurs when "an outside third party, frequently a creditor, urges a court to render a company liable in a judgment against its member" by applying the "traditional veil-piercing doctrine" to allow a third-party creditor "to satisfy the debts of an individual out of the [company's] assets." *Sky Cable, LLC v. DIRECTV, Inc.,* 886 F.3d 375, 386 (4th Cir. 2018).

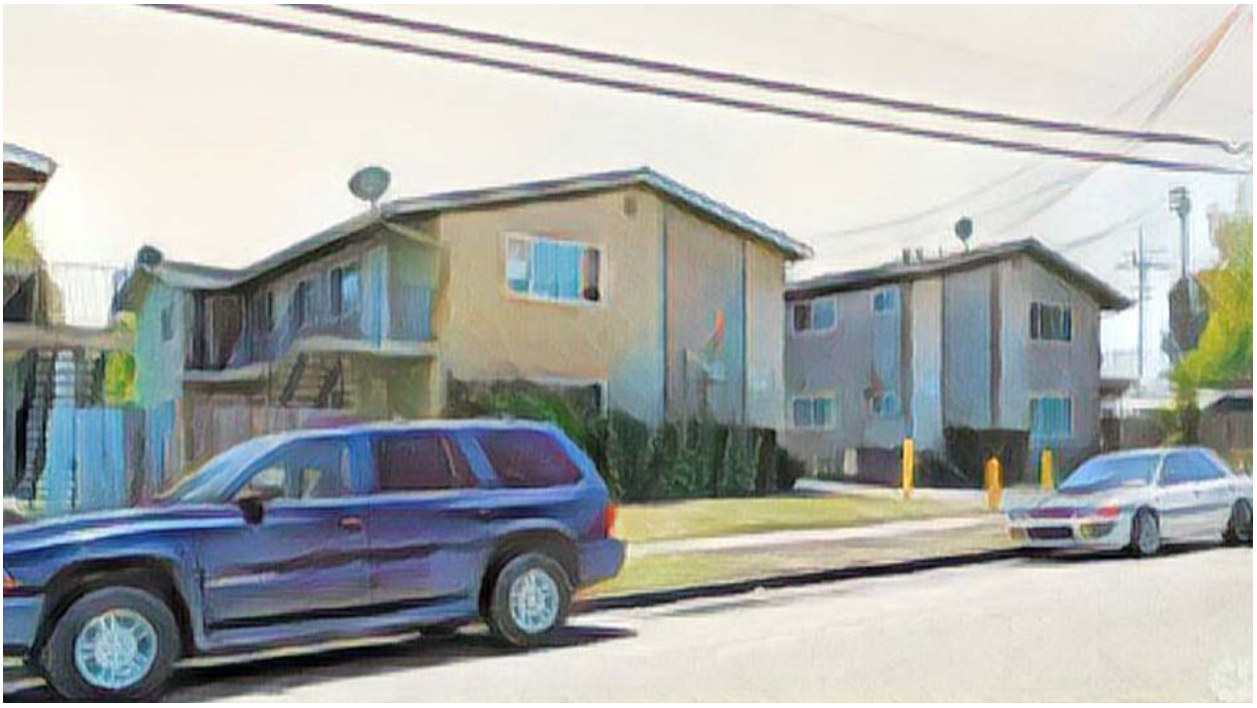


## Reverse Piercing for LLCs

- Creditors must often overcome state's LLC charging statute which often "provides the exclusive remedy for a judgment creditor seeking access to the financial interest of an LLC's member." *Sky Cable, LLC v. DIRECTV, Inc.,* 886 F.3d at 384–85.

- Charging statute usually limits judgment creditor's recourse to the debtor "distributions." *See* 6 Del. Code § 18-703(a).

- Charging statute's limitation of remedies does not distinguish between single and multiple member LLCs. See 6 Del. Code § 18-703(a).

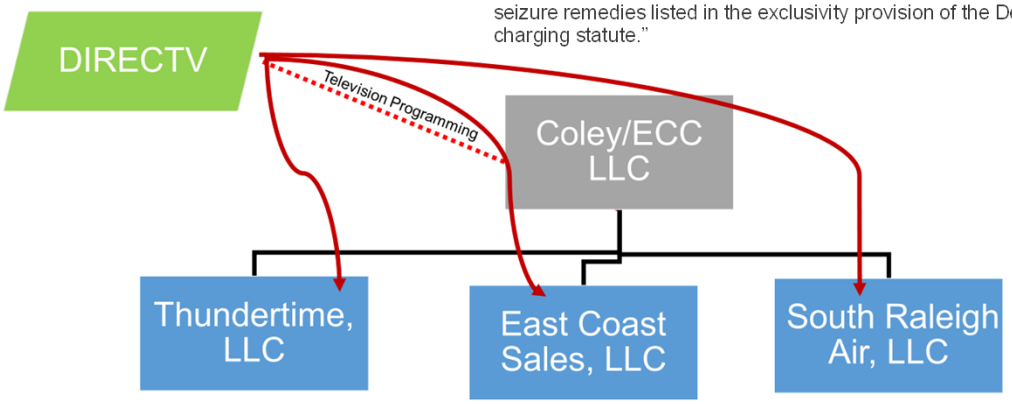




# Sky Cable, LLC v. DIRECTV, Inc.,
## 886 F.3d 375 (4th Cir. 2018)

"Our conclusion is not altered by the defendants' contention that Delaware's LLC charging statute, 6 Del. Code § 18–703, is the exclusive remedy for a judgment creditor seeking access to the assets of an LLC's member. "

"[B]ecause piercing the veil of an LLC effectively eliminates the legal status of the LLC in very narrow circumstances in which fraud or other injustice has been established, that remedy is unlike the various common law seizure remedies listed in the exclusivity provision of the Delaware LLC charging statute."







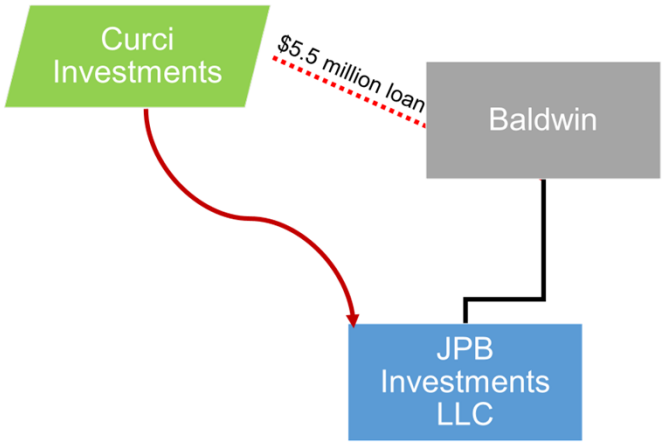
# Curci Investments, LLC v. Baldwin,

**14 Cal. App. 5th 214, 221 Cal. Rptr. 3d 847 (Ct. App. 2017)**

"Although Baldwin caused JPBI to distribute approximately $178 million to him and his wife […] not *a single distribution* has been made since the October 2012 entry of judgment on the Curci note"

"Baldwin effectively has complete control over what JPBI does and does not do…Since the time judgment was entered in Curci's favor, Baldwin has used that power…to cease making distributions to JPBI's himself and his wife, despite having made $178 million in such distributions in the six years leading up to the judgment."

"Reverse veil piercing is a means of reaching the LLC's assets, not the debtor's transferable interest in the LLC. That Corporations Code section 17705.03 does not preclude reverse piercing is underscored by the drafters' comments to the Revised Uniform Limited Liability Company Act, *224 (Corp. Code, s 17701.01 et seq.) from which the statute was adopted without substantive change."







## *Manichaean Capital, LLC v. Exela Technologies, Inc.*, 2021 WL 2104857 (Del. Ch. May 25, 2021)

**Why Reverse Pierce?**

- Delaware LLC Act seemingly prohibits reverse veil piercing
- All parties had experienced, sophisticated counsel to protect their rights

**Why recognize reverse piercing here?**

- Exela undercapitalized SourceHOV Holdings
- No corporate separateness
- Credit facility was structured to avoid creditor claims and was entered into in anticipation of appraisal judgment





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# Questions?



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## Tod Northman
## Tucker Ellis LLP

- Tod Northman has more than 30 years of diverse business and corporate law experience in corporate structuring, commercial law, business transactions, emerging technology, contract negotiation and dispute resolution, mergers and acquisitions, and real estate.
- With a skillful combination of negotiations and corporate counseling, Tod helps guide clients through difficult situations with pragmatic advice and a can-do attitude. Tod represents publicly traded and privately held companies in diverse industries across the country and has particular expertise in the aviation and autonomous vehicles industries.
- In his aviation practice, Tod represents cargo conversion companies, maintenance and repair organizations, financial institutions, family offices, high-net worth individuals, and middle-market businesses in connection with the acquisition and disposition of corporate and commercial aircraft portfolios and the related financing and/or leasing thereof. He also advises clients on conversion contracts, maintenance, service and supply contracts, leases, and FAA and DOT regulatory matters.
- In his autonomous vehicles practice, Tod focuses on advising businesses on acquisitions, contract negotiation, corporate structure, artificial intelligence technology, and regulatory compliance.
- Contact: tod.northman@tuckerellis.com; 216.696.5469



## Meghan McDonnell
## Tucker Ellis LLP

- Associate in the Cleveland hallway of Tucker Ellis LLP
- Focuses on commercial litigation, with experience in FINRA arbitration and bankruptcy practices
- Clerked in the U.S. Bankruptcy Court for the Northern District of Ohio
- J.D., cum laude, The Ohio State University Moritz College of Law
- Contact: meghan.mcdonnell@tuckerellis.com; 216.696-4788

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