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Can't Touch This: A Guide to Protecting Owners and Sister Entities from Liability

This Summer, the Pennsylvania Supreme Court decided a case, *Mortimer v. McCool*, that should give anyone with common ownership in a multi-entity business portfolio some concern. This Client Alert explores corporate veil piercing, recent developments, and how to best protect yourself and your entities' assets from being subject to liability.

Mortimer v. McCool

In the case, the plaintiff, Mortimer, sued a restaurant for serving alcohol to a patron who then drove into her, injuring her. The restaurant was owned by McCool Properties, LLC (McCool Properties), which in turn was owned by a family, the McCools. McCool Properties had a contractual management agreement for use of a liquor license owned by 340 Associates, LLC (340 Associates), an entity that the McCools also owned.

Mortimer obtained a combined judgment of $6.8m against 340 Associates. However, 340 Associates had no significant business assets beyond its liquor license. To collect the judgment, Mortimer sought to pierce the corporate veil of 340 Associates to reach the McCools, *and then also* pierce the corporate veil of the alleged sister company owned by the McCools, McCool Properties, to get at its assets.[i]

The Pennsylvania Supreme Court had to determine whether Mortimer, as matter of law, could pursue this "triangular" veil piercing under a theory of "enterprise liability."

While the Court held that it did not apply in this particular case, it did rule that, as a matter of law, enterprise liability *was* a permissible form of veil piercing. In so doing, Pennsylvania joined 10 other states in recognizing some form of triangular veil piercing.[ii]

What is Corporate Veil Piercing?

Why is any of this compelling? The answer is that one of the many benefits of forming a corporation or LLC is that they are considered separate and distinct legal entities from their owners. Should legal trouble arise, liability is traditionally limited to only the assets of the entity. As such, its owners are protected from any personal liability, as are the assets of any other entities the owners own. This risk is further mitigated as layers or links in the ownership chain increase.

1. Vertical (Traditional) Veil Piercing

However, this liability protection is not endless. Indeed, under certain circumstances, an entity's corporate veil may be pierced, suspending the traditional protection, and subjecting its owners to personal liability. This is known as "vertical" veil piercing, as the plaintiff is trying to go a level up, beyond the entity, to reach the assets of its owners. Vertical veil piercing may even transcend multiple levels of ownership in the plaintiff's pursuit of the deepest pockets.[iii] For example, if LLC 1 is being sued, and its sole member is LLC 2, the plaintiff may pierce the veil all the way up the chain of ownership – from LLC 1, to LLC 2, and then to LLC 2's owners – if circumstances so require.

Nonetheless, at each level, the plaintiff must demonstrate why the veil should be pierced.[iv] To be sure, because the very essence of corporations and LLCs is to limit the liability for claims to the entities themselves, piercing any level of protection is no easy feat.[v] Even so, due to the potential for significant personal liability, a veil piercing claim is among the most dreaded legal threats in a plaintiff's arsenal.

2. Enterprise Liability

Mortimer's decision underscores a still further concern: the expanding recognition across jurisdictions of enterprise liability, which permits the veil piercing of one entity to reach its owners, and then to pierce again – not up the chain, but down and across it – to reach the assets of a sister entity – a second entity that has the same ownership as the first.[vi]

Whereas vertical piercing is the generally recognized piercing method by all states, enterprise liability is a newer concept. Given its breadth, it has been categorically barred in some states,[vii] including Alabama, Ohio, and Missouri.[viii]

However, as *Mortimer* underscores, various forms of enterprise liability are growing in recognition across jurisdictions.[ix] For this reason, it is especially vital to outline how best to protect oneself from a veil piercing claim, especially in jurisdictions that recognize a form of enterprise liability, since more layers or links in the ownership chain will no longer necessarily guaranty the same protection in these jurisdictions.

How to Pierce the Corporate Veil

Generally, courts look to similar factors in determining whether the company is merely an "alter ego" of the owner, subjecting the veil to be vertically pierced.[x] Factors considered include: (1) undercapitalization; (2) substantial intermingling of corporate and personal affairs; (3) failing to adhere to corporate formalities; and (4) abuse of the corporate form to perpetrate a fraud.[xi] A brief discussion and some examples follow:

Keep Your Company Sufficiently Capitalized

Courts often look to whether an entity is undercapitalized.[xii] The trend is that "[c]apitalization is inadequate, as would support piercing the corporate veil, when it is very small in relation to the nature of the entity's business and the risks attendant to such businesses."[xiii]

For example, in *Blackwell v. Superior Safe Rooms*, the Indiana court found a company was undercapitalized because the owner never put any significant money into it – indeed, the only money deposited into the company's bank account was the minimum deposit amount necessary. The most money the company had in the account was approximately $300.[xiv] As a result, the court found such undercapitalization necessitated piercing the veil.[xv]

Never Intermingle Funds

Courts also look to whether owners intermingle the company's affairs with their personal affairs.[xvi] For example, in *Snapp v. Castlebrook Builders, Inc.*, the company's owner co-mingled corporate funds with his personal funds, and used corporate funds to pay for "his personal credit cards, personal medical treatment, his truck, and his daughter's apartment."[xvii] Consequently, the court found there was sufficient evidence to pierce the corporate veil.[xviii]

Strictly Follow Corporate Formalities

Courts also look to whether a company has adhered to and maintained corporate formalities.[xix] Courts often consider whether the company: (a) kept proper business records; (b) held formal meetings; (c) had officers and directors who acted in the best interest of the company; and (d) used corporate property for personal purposes.[xx]

For example, in *Snapp*, the court found the corporation had not followed proper formalities when its owner had “failed to issue shares for corporation and did not carefully keep his yearly corporate meetings in minutes.”[xxi] This determination supported the court’s ruling to pierce the corporate veil.[xxii]

All courts consider roughly the same parameters in their review of a corporate veil piercing claim. However, because courts do not all apply the exact same standard, and because some may consider more factors than others, many courts tend to treat adherence to (or neglect of) corporate formalities as an umbrella term.[xxiii] Therefore, it is especially important for companies to strictly follow all generally accepted corporate formalities, no matter the jurisdiction.

Stay Away From Fraud

This one is obvious. Generally, all jurisdictions also look to whether ownership exercised control over the entity to perpetrate a fraud.[xxiv] For example, in *Snapp*, the court found a corporation was used to perpetrate fraud where the owner intentionally misrepresented the actual costs of the transaction as being lower than they actually were.[xxv] Also, while the corporation’s owner had normally provided contracts for his transactions, he did not in this case. The court inferred that the owner intentionally neglected to do so specifically to overcharge the plaintiff. Additionally, the owner fully falsified bills to overcharge the plaintiff for items he did not actually owe.[xxvi] In short, the owner used the entity simply as a vehicle to defraud the plaintiff, hoping the corporate veil would protect him. The court would not tolerate such abuse of the corporate form, and permitted the veil to be pierced.[xxvii]

Sister Entities In Enterprise Liability

To pierce the veil of another entity with the same ownership, the two entities must be definitively “sister entities”, which are those “engaged in a unitary commercial endeavor.”[xxviii] While this is usually determined by common ownership, the real litmus test is ascertaining exactly who exercises dominion and control over both entities.[xxix]

For example, in *Mortimer*, two brothers and their father owned one entity but only the two brothers owned the separate entity.[xxx] The court found that since the father indeed had no control over the separate entity, they were definitively not sister entities, ending any possibility of enterprise liability.[xxxi] However, the court implied that if the father did have "meaningful control" of the entity owned solely by the brothers, the two companies could have been considered "sister entities" for which enterprise liability could be found.[xxxii]

Therefore, owners of affiliated entities should not simply rely on formal titles to keep such entities from being considered "sister entities" for purposes of enterprise liability. Meaningful, actual control is the salient consideration, not formal titles.

Bottom Line Takeaways For Protecting The Assets Of Affiliated Companies

All in all, by (1) being sufficiently capitalized, (2) not intermingling the funds of corporate and personal accounts, (3) strictly following corporate formalities, (4) not using the entity to perpetrate fraud, and (5) ensuring formal divisions of responsibility are not overridden by a common owner's meaningful, actual control over the enterprise of sister entities, corporate veils will likely remain protected from piercing.[xxxiii]

If you have any questions regarding how to best protect yourself and your entities' assets from being subject to liability, please contact Gutnicki LLP for assistance.

The Firm

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Endnotes

[i] Mortimer v. McCool, 255 A.3d 261, 265-66 (Pa. 2021).
[ii] See id. at 266, 280.
[iii] See In re The Heritage Org., L.L.C., 413 B.R. 438, 513 (Bankr. N.D. Tex. 2009).
[iv] See id.
[v] See Mortimer, 255 A.3d at 268.
[vi] See id. at 285.
[vii] See Dill v. Rembrandt Grp., Inc., 474 P.3d 176, 184 (Colo. Ct. App. 2020).
[viii] See Madison Cty. Commc'ns Dist. v. CenturyLink, Inc., No. CV 12-J-1768-NE, 2012 WL 6685672, at *4 (N.D. Ala. 2012); Minno v. Pro-Fab, Inc., 905 N.E.2d 613, 617 (Ohio 2009); Kiesel Co. v. J & B Props., Inc., 241 S.W.3d 868, 872 (Mo. Ct. App. 2008).
[ix] See, e.g., Mortimer, 255 A.3d at 266, 280.
[x] See id. at 270, 278; see also Dill, 474 P.3d at 183.
[xi] See Mortimer, 255 A.3d at 278.
[xii] Id.
[xiii] Blackwell v. Superior Safe Rooms LLC, No. 20A-PL-2081, 2021 WL 2820988, at *8 (Ind. Ct. App. 2021).
[xiv] Id.
[xv] See id. at *10.
[xvi] See, e.g., Mortimer, 255 A.3d at 278; see also Dill, 474 P.3d at 183.
[xvii] Snapp v. Castlebrook Builders, Inc., 7 N.E.3d 574, 596 (Ohio Ct. App. 2014).
[xviii] Id. at 597.
[xix] See, e.g., Mortimer, 255 A.3d at 278; see also Dill, 474 P.3d at 183.
[xx] See Mortimer, 255 A.3d at 269; Dill, 474 P.3d at 183; Snapp, 7 N.E.3d at 596; see also Ted Harrison Oil Co. v. Dokka, 617 N.E.2d 898, 902 (Ill. App. Ct. 1993).
[xxi] Snapp, 7 N.E.3d at 596.
[xxii] See id. at 597.
[xxiii] See Mortimer, 255 A.3d at 269; Dill, 474 P.3d at 183; Snapp, 7 N.E.3d at 596; see also Ted Harrison Oil Co., 617 N.E.2d at 902.
[xxiv] See, e.g., Mortimer, 255 A.3d at 278.; Dill, 474 P.3d at 184.
[xxv] Snapp, 7 N.E.3d at 596-97.
[xxvi] Id.
[xxvii] See id. at 596-97.
[xxviii] Mortimer, 255 A.3d at 266.
[xxix] See id. at 287: see also Dill, 474 P.3d at 186.
[xxx] Mortimer, 255 A.3d at 265-66.
[xxxi] Id. at 287.
[xxxii] See id.
[xxxiii] See Mortimer, 255 A.3d at 278, 287.