

Limited Liability Companies: Could your personal assets be at risk?
- by Tricia Davis, Esq

The limited liability company ("LLC") has become the most popular form for organizing business and investment activities. The LLC has so much to offer, including personal protection from business debts, the tax advantages of a partnership, flexible distribution of profits and losses and, of course, simplicity of maintenance. While this relatively new formation creates an obvious advantage for many businesses, there is still some uncertainty as to what extent corporate formalities must be maintained.

To best understand the current issues affecting limited liability companies, it is important to consider the history of the statute and the standards that have been applied in other states. In 1994, Pennsylvania enacted the Pennsylvania Limited Liability Company Act ("Act"). By passing the Act, Pennsylvania joined the vast majority of other states that recognize an LLC. By its language, Pennsylvania's Act does not require LLCs to observe strict corporate formalities, such as holding meetings and maintaining minutes. Therefore, it has come as a shock to many practitioners that some courts have recently held that an LLC member could be found personally liable for the debts of the LLC for failing to observe *corporate* formalities. This concept of holding an individual liable for the acts of a corporation is known as "piercing the corporate veil" – a concept previously limited to corporations and not applicable to LLCs. However, to the surprise of many, courts all over the country have begun to apply the traditional corporate veil piercing to LLCs to create personal liability on the members for debts of the LLC.

The first reported case in which a plaintiff sought to pierce the veil of an American LLC was the 1997 Utah case – *Ditty v. CheckRite, Ltd., Inc.* In the last nine years, the number of additional rulings on substantive LLC veil piercing has continued to grow; so much so that many believe this will catch on as a trend in Pennsylvania. In the cases where courts have concluded that piercing the corporate veil is appropriate in the LLC context, the courts analyzed numerous factors such as undercapitalization, lack of substantive separation, and failure to respect corporate formalities.

Since case law has proven that in some instances, courts are willing to hold LLC members individually liable for failure to observe corporate formalities, it is advisable for LLCs to implement and respect corporate formalities if they are not doing so already. For example, to reduce the risk of veil piercing, an LLC should maintain written minutes of all meetings and elections. In addition, all pension plans, trust agreements, loans, leases, major purchase contracts, insurance contracts, and any other significant

agreements and transactions should be entered into on behalf of the LLC and should be reflected by appropriate minutes in the LLC's minute book.

Of course, the level of precautions that an LLC should follow will vary depending on the business. In general, based on the factors considered by courts in recent veil piercing cases, some precautions to follow include: (1) ensure that members do not commingle personal funds or property with that of the LLC; (2) confirm that the company is always held out as a separate legal entity; (3) review the LLC's operating agreement to be certain that none of the company's actions violate the operating agreement; and (4) ensure that members do not use the LLC's assets for solely personal use.

Each of these steps is vital to maintaining the LLC's own distinct integrity separate and apart from each of its employees and members. Adhering to these formalities requires time and some expense, but this prevention will help you to protect your personal assets and those of the individuals acting on behalf of the LLC.

Tricia Davis is an attorney in Bernstein Law Firm, P.C.'s business law department and can be reached at (412) 456-8126 or tdavis@bernsteinlaw.com.