

**COLLECTING FROM A BUSINESS:
Piercing the LLC or Corporate Veil**

BY:

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I. Piercing the LLC or Corporate Veil

A. LLC Structure and General Concepts

To collect against an LLC, creditors must first avoid or set aside the corporate entity by the procedure commonly known as “piercing the corporate veil” (“PCV”). Once a method reserved for corporations alone, the recent explosion of LLCs has led many courts, including Nebraska’s courts, to apply PCV to LLCs because of their procedural and structural similarities to corporations. To better understand how to collect from an LLC, collection lawyers must understand how an LLC functions.

“[O]ne of the main reasons for the popularity of corporations is that the stockholders are not personally liable for the debts of the corporation. The corporation, and it alone, is liable. A stockholder stands to lose what he has dedicated to the corporate enterprise and nothing more.”¹ When a corporation is merely the alter ego of a person, it may be disregarded.² Legal ownership alone, while relevant, is not dispositive and does not preclude a PCV claim when sufficient evidence exists to show an alter ego.³ The same principles apply to LLCs.

When it comes to LLC functions, “most matters are governed by the operating agreement entered into by the members of the L.L.C., and the LLC Act governs only when the operating agreement is silent.”⁴ “[T]he LLC Act provides that a member of a limited liability company is deemed to assent to the operating agreement.”⁵ This means creditors should initially obtain a copy of the operating agreement, if one exists, for any LLC from which they want to collect. The operating agreement for the LLC at issue will control most aspects of the LLC’s operations that could affect collection efforts, including: (1) the amount and frequency with which members receive distributions from the LLC; (2) what happens if a charging order is entered against a member’s LLC interest; (3) the amount and frequency with which members are required to make any

¹ *Wolf v. Walt*, 247 Neb. 858, 865, 530 N.W.2d 890, 896 (1995) (quoting 1 William M. Fletcher, Fletcher Cyclopedic of the Law of Private Corporations § 14 at 464 (rev. perm. ed. 1990)).

² *Medlock v. Medlock*, 263 Neb. 666, 677, 642 N.W.2d 113, 124 (2002).

³ *Id.* at 680, 642 N.W.2d at 126.

⁴ *Streck, Inc. v. Ryan Family*, 297 Neb. 773, 782-83 (2017).

⁵ *Streck, Inc.*, 297 Neb. at 783.

capital or other contributions to the LLC; and (4) events that will cause a member's dissociation or force the LLC to dissolve.

Practical Pointer: A creditor should have a full understanding of the ways their collection attempts will affect an LLC's functions *before* attempting to collect from a member or the LLC itself. It may not be worth a creditor's time to seek a charging order against a member's LLC interest if the operating agreement states the member will be dissociated from the LLC upon issuance of a charging order. But the operating agreement can provide invaluable information in a claim to pierce the corporate veil. This is especially true where the operating agreement provides for many LLC formalities and procedures that the member or members have ignored.

B. Key Principles for Piercing the Corporate Veil

"Proceedings seeking disregard of a corporate entity, that is, piercing the corporate veil to impose liability on a shareholder for a corporation's debt or other obligation, are equitable actions."⁶ Courts of equity will examine the whole transaction at issue, looking at substance over form, to protect the rights of an aggrieved creditor.⁷ In an appeal of an equity action, where credible evidence is in conflict on a material issue of fact, the appellate court considers and may give weight to the circumstances that the trial judge heard and observed the witnesses and accepted one version of the facts rather than another.⁸ The credibility of witnesses is a determination within the province of the trier of fact.⁹

There are a surprisingly small number of reported cases in Nebraska dealing with PCV.¹⁰ Of those reported cases, collection practitioners should pay special attention to

⁶ *Christian v. Smith*, 276 Neb. 867, 874-75, 759 N.W.2d 447, 456 (2008).

⁷ *Medlock*, 263 Neb. at 680, 642 N.W.2d at 126.

⁸ See *Torres v. Morales*, 287 Neb. 587, 843 N.W.2d 805 (2014).

⁹ *State v. Rocha*, 295 Neb. 716, 733 (2017).

¹⁰ Notable PCV cases include: *Thomas & Thomas Court Reporters v. Switzer*, 283 Neb. 19, 27, 810 N.W.2d 677, 685 (2012); *Howsden v. Roper Real Estate Co.*, 282 Neb. 666, 671-73, 805 N.W.2d 640, 645-47 (2011); *Christian v. Smith*, 276 Neb. 867, 883-85, 759 N.W.2d 447, 463-64 (2008); *Graham Graphics v. Baer Mktg. Int'l, Inc.*, 10 Neb. App. 382, 387-90, 631 N.W.2d 550, 555-57 (2001); *Baye v. Airlite Plastics Co.*, 260 Neb. 385, 395, 618 N.W.2d 145, 153 (2000); *Nelson v. Lusterstone Surfacing Co.*, 258 Neb. 678, 689, 605 N.W.2d 136, 145 (2000); *Wolf v. Walt*, 247 Neb. 858, 530 N.W.2d 890 (1995); *Global Credit Servs., Inc. v. AMISUB*, 244 Neb.

Christian v. Smith, 276 Neb. 867, 759 N.W.2d 447 (2008), because of its detailed analysis and well-written explanation of PCV concepts.

PCV claims can work in two directions, depending on the parties from whom the creditor seeks to collect. In ordinary PCV claims, the creditor seeks to satisfy a judgment against a business entity by reaching personal assets of a business owner or part-owner. In “reverse piercing” claims, the creditor seeks to satisfy a judgment against a business owner or part owner by reaching business entity assets.¹¹ A third party may also be bound by a court’s equitable judgment sustaining a PCV claim against a business entity if the entity’s “interests are so closely affiliated with the non-party’s interests that the interests are merged.”¹²

Nebraska has established several general rules regarding PCV:

Generally, a corporation is viewed as a complete and separate entity from its shareholders and officers, who are not, as a rule, liable for the debts and obligations of the corporation. A court will disregard a corporation's identity only where the corporation has been used to commit fraud, violate a legal duty, or perpetrate a dishonest or unjust act in contravention of the rights of another. A corporation's identity as a separate legal entity will be preserved, as a general rule, until sufficient reason to the contrary appears. A plaintiff seeking to pierce the corporate veil must allege and prove that the corporation was under the actual control of the shareholder and that the shareholder exercised such control to commit a fraud or other wrong in contravention of the plaintiff's rights. A plaintiff seeking to impose liability for a corporate debt on a shareholder has the burden to

681, 686-90, 508 N.W.2d 836, 842-44 (1993); *Carpenter Paper Co. v. Lakin Meat Processors*, 231 Neb. 93, 97, 435 N.W.2d 179, 181 (1989); *Southern Lumber & Coal v. M.P. Olson Real Estate and Constr. Co.*, 229 Neb. 249, 426 N.W.2d 504 (1988); *ServiceMaster Indus. v. J.R.L. Enterprises*, 223 Neb. 39, 388 N.W.2d 83 (1986).

¹¹ See *Medlock*, 263 Neb. at 677, 642 N.W.2d at 124-25 (citing *Towe Antique Ford Foundation v. I.R.S.*, 999 F.2d 1387 (9th Cir.1993); *Century Hotels v. U.S.*, 952 F.2d 107 (5th Cir.1992)).

¹² *Id.* at 685, 642 N.W.2d at 130 (citing *G.M. Leasing Corp. v. United States*, 429 U.S. 338, 97 S.Ct. 619, 50 L.Ed.2d 530 (1977)).

show by a preponderance of the evidence that the corporate identity must be disregarded to prevent fraud or injustice to the plaintiff.¹³

When determining whether to PCV, Nebraska courts look to a variety of factors as evidence of an entity's bad faith:

Some of the relevant factors in determining whether to disregard the corporate entity on the basis of fraud are (1) grossly inadequate capitalization, (2) insolvency of the debtor corporation at the time the debt is incurred, (3) diversion by the shareholder or shareholders of corporate funds or assets to their own or other improper uses, and (4) the fact that the corporation is a mere facade for the personal dealings of the shareholder and that the operations of the corporation are carried on by the shareholder in disregard of the corporate entity.¹⁴

An entity's capitalization is considered as the first factor in a claim to PCV:

Inadequate capitalization, means capitalization very small in relation to the nature of the business of the corporation and the risks entailed. Inadequate capitalization is measured at the time of incorporation. A corporation which was adequately capitalized when formed but which has suffered losses is not necessarily undercapitalized. Undercapitalization presents a question of fact that turns on the nature of the business of the particular corporation.¹⁵

An entity's solvency is a second factor in a PCV analysis: "[a] corporation is insolvent if it is unable to pay its debts as they become due in the usual course of its business, or if it has an excess of liabilities of the corporation over its assets at a fair valuation. Whether a corporation is insolvent is usually a question of fact."¹⁶

A third factor involves whether the entity properly used its own funds: "[w]hen a principal shareholder appropriates and uses corporate funds and property for his personal

¹³ *Id.* at 882-83, 759 N.W.2d at 462.

¹⁴ *Id.* at 883, 759 N.W.2d at 462.

¹⁵ *Id.* at 884, 759 N.W.2d at 462.

¹⁶ *Id.* at 884, 759 N.W.2d at 463.

purposes and thereby defrauds and causes damages to creditors, the shareholder can be held individually liable for corporate debt.”¹⁷

The fourth and final factor used by Nebraska courts in PCV claims involves whether an entity’s owners treated the entity separately and observed the entity’s business formalities:

If the corporation is a facade for the personal dealings of the shareholder and the operations of the corporation are carried on by the shareholder in disregard of the corporate entity, the shareholder may be individually liable for corporate debt. The separate entity concept of the corporation may be disregarded where the corporation is a mere shell, serving no legitimate business purpose, and is used as an intermediary to perpetuate fraud on the creditors.¹⁸

Practical Pointer: When examining whether a business entity is merely an alter ego used by the debtor for personal purposes, creditors should scrutinize the business entity’s corporate formalities. Does the business entity have employees? Does it hold corporate meetings? Does it prepare and file ordinary business and tax documents with state agencies? Does it maintain ordinary bank accounts for payroll, tax, and other purposes? Does it keep minutes of official meetings? Are there real votes on company issues among the entity’s owners? Does the entity use business accounts and funds to pay for its owners’ personal expenses? Does the entity have company policies, employee handbooks, or other official regulatory documents? Does the entity follow procedures set forth in its organizing documents, like an LLC Operating Agreement or Articles of Organization? Is there a significant transfer of money or assets between the business entity and its owners or insiders on a regular basis?

The key to proving a PCV claim is to provide the court with competent evidence regarding each of the factors mentioned above. The more evidence a party can present regarding a debtor’s use of an LLC as a “personal checkbook” or a vehicle for laundering

¹⁷ *Id.*

¹⁸ *Id.* at 885, 759 N.W.2d at 463.

personal funds, the greater the likelihood the court will be persuaded to knock down the corporate shield and hold the shareholder liable.

Practical Pointer: Creditors should determine early in a PCV case whether they need the expert witness services of a forensic accountant or other financial professional. A qualified accounting or financial expert will strengthen a creditor's presentation of evidence regarding solvency and inadequate capitalization. Because a Court and the debtor's counsel will closely scrutinize your expert's qualifications under Neb. Rev. Stat. § 27-702, a creditor should hire an expert whose qualifications and fees are proportional to the value of the judgment being collected. The bigger the judgment, the more qualified the expert should be.

PCV cases are won and lost on the facts. Because of this, it is crucial for a creditor's attorney to carefully review each fact that adds to or subtracts from the basis for each of the factors above. With careful screening before commencing litigation, a creditor's attorney can greatly enhance the chances of collecting a judgment. This careful screening is much more important given appellate courts' general deference to the factual findings of trial courts in Nebraska PCV cases.¹⁹

C. Sample Complaint to Pierce the Corporate Veil

Please see the end of these materials for a sample complaint to pierce the corporate veil.

¹⁹ *Torres v. Morales, supra.*

IN THE DISTRICT COURT OF DOUGLAS COUNTY, NEBRASKA

ANGRY CREDITORS, INC.,)
A Nebraska Corporation,)

Case No. _____

Plaintiff,)

v.)

COMPLAINT

PENNILESS DEBTOR LLC, a)
Nebraska LLC, and JACK)
SPARROW, an individual,)

Defendant.)

COMES NOW, Angry Creditors, Inc., Plaintiff and Judgment Creditor herein,
and for its cause of action against, Penniless Debtor LLC, Defendant and Judgment
Debtor, states as follows:

1. Plaintiff is a Nebraska Corporation in good standing that provides
consumer lending and financial services to Nebraska consumers primarily in the City of
Omaha, Nebraska.

2. Defendant Penniless Debtor LLC (“the LLC”) is a Nebraska LLC that
provides parrot and monkey training services to Nebraska consumers primarily in the
City of Omaha, Douglas County, Nebraska.

3. Defendant Jack Sparrow (“Mr. Sparrow”) is a pirate who resides in the
City of Omaha, Douglas County, Nebraska.

4. This Court has subject matter jurisdiction over this matter pursuant to Neb.
Rev. Stat. § 24-302 (Reissue 2016). This Court has personal jurisdiction over this matter
under Neb Rev. Stat. § 25-536 (Reissue 2016). Venue is proper in this county pursuant to

Neb. Rev. Stat. § 25-403.01 (Reissue 2016).

5. The LLC is indebted to Plaintiff in the principal amount of \$15 million, plus accrued interest, because of a judgment entered against the LLC in the Garden County District Court on February 14, 2015.

6. The judgment involved the LLC's conversion of four chests full of gold coins and precious gemstones from the plaintiff. A true and correct copy of the judgment is attached hereto, incorporated herein, and marked as Exhibit "A".

7. On April 1, 2017, the judgment of the Garden County District Court was transcribed and registered in the District Court for Douglas County, Nebraska, pursuant to Neb. Rev. Stat. § 25-1303 (Reissue 2016). A true and correct copy of the registered judgment is attached hereto, incorporated herein, and marked as Exhibit "B".

8. On information or belief, the LLC is Mr. Sparrow's business entity alter ego.

9. On information or belief, Mr. Sparrow is the sole member of the LLC.

10. On information or belief, the LLC was grossly undercapitalized at the time of its formation.

11. On information or belief, the LLC is currently insolvent, as it unable to pay any of its debts as they become due in the ordinary course of business.

12. On information or belief, Mr. Sparrow has diverted and continues to divert the LLC's funds and assets for his personal purposes.

13. On information or belief, the LLC is a façade for Mr. Sparrow's personal dealings

14. On information or belief, the LLC disregards all corporate formalities and operates the LLC's business without regard for the LLC as an entity.

15. On information or belief, other lawful means of collection against the LLC would be unduly burdensome, expensive, and inequitable to Plaintiff.

16. The Plaintiff has no adequate remedy at law.

WHEREFORE, Plaintiff requests that the Court enter an Order for the following relief:

- A. Enter an order piercing the corporate veil of the LLC in favor of the Plaintiff;
- B. Find and order that Mr. Sparrow's personal funds and assets may be seized and liquidated as necessary to satisfy the Plaintiff's judgment against the LLC;
- C. Award Plaintiff its costs in this matter, as allowed by law; and
- D. Grant such other or further relief as is just in this case.

Angry Creditors, Inc.
Plaintiff,

By: _____

[Attorney Signature Block]