

# JOHN CUNNINGHAM'S LLC NEWSLETTER FOR TAX AND FINANCIAL PROFESSIONALS

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## ***WHAT YOUR LLC CLIENTS SHOULD DO TO PROTECT THEIR LIABILITY SHIELD YOUR***

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Dear Colleagues:

Most of us have clients who conduct their businesses as LLCs. The main reason why many of these clients use LLCs in their businesses is to obtain the LLC statutory “liability shield” – i.e., the shield that protects their homes, securities and other assets from claims against their business.

However, the protection afforded by this shield is not automatic; LLC owners have to do various things in order to maximize its protection and to prevent third parties from “piercing the veil” of their LLC.

Set forth below are seven “anti-veil-piercing” guidelines that I often provide to my LLC clients. In case it’s useful to you, I’m also attaching a copy of these guidelines as a Word document.

If you agree with the content of the guidelines, you may want to provide them to your LLC clients. And you should feel quite free to do so; I make no copyright claim for them.

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## **SEVEN THINGS YOU SHOULD DO TO PROTECT YOUR LLC FROM VEIL PIERCING**

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The main reason many New Hampshire business people use LLCs to conduct their businesses is to obtain an LLC liability shield. If you’re an LLC member or manager, this statutory shield will protect your personal assets from claims against your LLC unless these claims result from your own misconduct in doing the LLC’s business.

However, as a growing body of LLC case law makes clear, there is always the risk that in certain circumstances, a court may “pierce the veil” of your LLC. That is, if you fail to comply with LLC anti-veil-piercing guidelines, the court may simply disregard your LLC liability shield and hold you personally liable for claims against your LLC even if, in conducting the LLC’s business, you *haven’t* engaged in personal misconduct.

To avoid LLC veil piercing, here are the seven guidelines you should follow:

**Guideline 1. DON'T USE YOUR LLC TO COMMIT FRAUD OR OTHER SERIOUS MISCONDUCT**

The courts will often pierce an LLC's veil if, in their view, any of the members has used the LLC to commit fraud or other deliberate and serious misconduct but seeks to rely on the LLC liability shield to avoid personal liability. Thus, to avoid veil piercing (and, obviously, for many other strong legal and ethical reasons as well), you and all of your LLC co-members should avoid any such misconduct.

However, not only deliberate but also *unintentional* misconduct may lead the courts to pierce an LLC's veil. That's why you should comply not only with Guideline 1 but also with the other six guidelines in this article.

**Guideline 2. MAKE SURE THAT YOUR PERSONAL BOOKS, RECORDS AND BANK ACCOUNTS ARE MAINTAINED SEPARATELY FROM THOSE OF YOUR LLC**

The legal theory that is the basis for the LLC liability shield is that LLCs and their members are independent legal persons separate and distinct from one another. To protect your LLC liability shield, you should take every reasonable means to implement and document this separateness. For example:

- You should keep separate books and records and separate bank accounts for, on the one hand, your own personal affairs and, on the other, the business and affairs of your LLC.
- You shouldn't withdraw money from your LLC's account for personal use, nor should you deposit money in that account, without making and maintaining accurate written records of these transactions that reflect arm's-length terms.

**Guideline 3. DON'T USE LLC PROPERTY AS IF IT WERE YOUR OWN PERSONAL PROPERTY**

In small, informal LLCs, it can be tempting for members to use LLC property as if it were their personal property. However, any such use can support a plaintiff's veil-piercing claim. Thus, whenever you make significant personal use of your LLC's property, you should document that use and compensate the LLC for it as if you were a third party.

**Guideline 4. WHEN YOU DEAL WITH THIRD PARTIES, MAKE IT CLEAR TO THEM THAT THEY ARE DEALING WITH AN LLC, NOT WITH YOU AS AN INDIVIDUAL**

In dealing with suppliers, customers and other third parties, you should make it clear to them that they are doing business with your LLC and not with you as an individual.

Thus, for example, you should ensure that the initials "LLC" or the like appear after the name of your LLC in its stationery and invoices, on its business cards and on other printed material that you prepare for your LLC and communicate to third parties. In addition, you should generally

refer to your company in conversations with clients, suppliers and others as “my LLC” rather than merely as “my company” or the like. And if your LLC does business under a “DBA” (technically, a trade name with no “LLC” after it), you should make sure this DBA is registered with the New Hampshire Secretary of State as the trade name of the LLC.

Similarly, when signing letters and contracts for your LLC, you should always do so expressly in your legal capacity as an LLC member or manager and not as an individual. Thus, the signature block of LLC contracts should normally be as follows:

XYZ, LLC

By: \_\_\_\_\_  
Manager

You may want to depart from the above practices when marketing considerations or other common sense concerns dictate. For example, the initials “LLC” may look out-of-place on a street sign identifying a store that does business as an LLC or in a newspaper advertisement for the store. However, you should be aware that any failure to tell the world that your company is an LLC may create an increased risk of veil piercing.

**Guideline 5. IN DEALING WITH THIRD PARTIES, DON’T REFER TO YOUR CO-MEMBERS AS YOUR “PARTNERS”**

The personal relationship among the members of multi-member LLCs is often similar to the relationship among the partners of a general partnership. However, under the general partnership law of New Hampshire and all other states, each general partner of a general partnership has unlimited personal liability for claims against the general partnership and against all of the other partners. Thus, if you refer to co-members of your LLC as your partners, this may support a claim by a plaintiff in a lawsuit against you that you have general partner liability.

Thus, if you are a member of a multi-member LLC and you are dealing with customers and other third parties, you shouldn’t refer to the co-owners of your LLC as your partners. Refer to them instead as your co-members.

**Guideline 6. MAKE SURE THAT AT THE TIME OF ITS FORMATION AND THEREAFTER, YOUR LLC IS ADEQUATELY CAPITALIZED**

A court may be inclined to pierce the veil of an LLC if the LLC lacks adequate capitalization – that is, if its aggregate equity contributions from members, its business assets, its cash flow, its insurance and its other financial resources are inadequate to pay its reasonably foreseeable debts when due. Thus, make sure your LLC is adequately capitalized.

**Guideline 7. MAKE SURE YOUR LLC FOLLOWS ALL APPLICABLE FORMALITIES IMPOSED BY THE RELEVANT LLC ACT**

Unlike corporate statutes, LLC statutes impose very few formalities on LLCs. For example, LLC statutes do not require LLCs to hold annual meetings of members, and no LLC statute requires LLCs to issue certificates of membership to their members.

However, to the extent that the LLC statute under which an LLC is formed does impose formalities, you should make sure that you comply with these formalities and that you document this compliance.

For example, most LLC statutes, including the New Hampshire LLC Act, contain provisions requiring LLCs to maintain specified types of records (e.g., tax returns and member lists) at a specified LLC office. If your LLC is a New Hampshire LLC, make sure you comply with these provisions.