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# LLCs and Veil Piercing

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## I. Introduction.

A strong and important concept underlying the law of entities such as limited liability companies ("LLCs") and corporations is that the entity, and not its owners, is liable for debts and obligations of the entity; that owners of the entity do not have liability, simply by virtue of owning the entity, for liabilities of the entity. Put another way, owners of such entities are shielded from creditors of the entity. The Texas Business Organizations Code (the "TBOC"),[1] the Texas statute that governs most Texas entities including LLCs contains a provision addressing this principle directly for LLCs. TBOC § 101.114 provides:

> Except as and to the extent the company agreement specifically provides otherwise, a member or manager is not liable for a debt, obligation or liability of a limited liability company, including a debt, obligation or liability under a judgment, decree, or order of a court.

There is a large body of common law stretching back before the beginning of LLCs that established circumstances in which the owners of corporations, the shareholders, have been held liable for the obligations of the corporation they own, despite the principle that owners are shielded from the entity's obligations. This body of law is commonly called "veil piercing" or "piercing the corporate veil." Some commentators have argued that it was the intent of the Texas legislation that established LLCs, as evidenced by the provisions cited above, to give owners of LLCs a greater shield from the entity's creditors than is provided to shareholders of corporations.[2] Certainly the entity name "limited liability" would imply as much. But despite this, after the introduction of the LLC in Texas, courts began applying veil piercing principals to subject owners of Texas limited liability companies based on corporate common law veil piercing principles.[3]

This paper will outline veil piercing principles and discuss Texas cases and legislation related to Texas LLCs.

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[1] TEX. BUS. ORGS. CODE ANN. § 1.001 ET SEQ.

[2] *See* B. Egan, *Choice of Entity Decision Tree After Margin Tax and Texas Business Organizations Code*, 42 TEX. J. BUS. L. 71, 173 (2007).

[3] In *McCarthy v. Wani Venture, A.S.*, 251 S.W.3d 573 (Tex. App.—Houston [1st Dist.] 2007, pet. denied), the plaintiff argued that because the Texas Limited Liability Company Act (the predecessor to the TBOC that was in effect at the time) did not state any circumstances under which a creditor could pierce the veil of a limited liability company, veil piercing did not apply to limited liability companies. The court disagreed and ruled that the corporate veil piercing principles also apply to limited liability companies.

## II. Background.

In order to appreciate and understand veil piercing for LLCs, we must first examine some common law and legislation related to corporations. One of the seminal Texas cases related to corporate veil piercing is the Texas Supreme Court case *Castleberry v. Branscum*.[4] In that case, the Texas Supreme Court identified six factors that could serve as a basis veil piercing:

> The corporate form normally insulates shareholders, officers, and directors from liability for corporate obligations; but when these individual abuse the corporate privilege, courts will disregard the corporate fiction and hold them individually liable. ... We disregard the corporate fiction ... when the corporate form has been used as part of a basically unfair device to achieve an inequitable result. ... Specifically, we disregard the corporate fiction:
>
> (1) when the fiction is used as a means of perpetrating fraud;
>
> (2) where a corporation is organized and operated as a mere tool or business conduit of another corporation;
>
> (3) where the corporate fiction is resorted to as a means of evading an existing legal obligation;
>
> (4) where the corporate fiction is employed to achieve or perpetrate monopoly;
>
> (5) where the corporate fiction is used to circumvent a statute; and
>
> (6) where the corporate fiction is relied upon as a protection of crime or to justify wrong.[5]

The *Castleberry* factors most often involved in veil piercing cases have been the first two factors: means of perpetrating fraud (often referred to as a sham to perpetrate a fraud) and tool or business conduit (typically referred to as the alter ego theory.)

In *Castleberry*, the Supreme Court made it clear that sham to perpetrate a fraud did not mean actual fraud. It set out a definition of constructive fraud that was vague and imprecise:

> The basis used here to disregard the corporate fiction, a sham to perpetrate a fraud, is separate from alter ego. It is sometimes confused with intentional fraud; however, "[n]either fraud nor an intent to defraud need be shown as a prerequisite to disregarding the corporate entity; it is sufficient if recognizing the separate corporate existence would bring about an inequitable result." ... Thus, we held in *Pacific American Gasoline Co. of Texas v. Miller* that note holders could disregard the corporate fiction without showing common law fraud or deceit when the circumstances amounted to constructive fraud. ... In *Tigrett v. Pointer*, the Dallas

[4] *Castleberry v. Branscum,* 721 S.W.3d 270 (1986).

[5] *Id*. at 271-272.

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