

Current Utah LLC Corporate Veil Jurisprudence

Andrew Lillywhite
Business and Estate Attorney with
Hillyard, Anderson & Olsen
Andrew@HAO-Law.com
(435) 752-2610



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Entity Separate and Apart from its Owners

The general rule is that a corporation and a limited liability company is an entity separate and apart from its owners.

Purposes:

- (1) protect investors from the liabilities of the business,
- (2) protect the investors of the business from the creditors of the other investors, and
- (3) protect the business itself from the creditors of the investors.



Entity Separate and Apart from its Owners

Investors are assured that they can lose only up to what they invest in the business, and they will not lose their investment to another investor's creditors. A business is also assured that its separate identity will be honored.

For these reasons, courts are reluctant to pierce the corporate veil whether from the front door or the back—especially if there is some other adequate means of relief. Following are Utah cases that provide guidance on when it is appropriate to reluctantly pierce the veil of a corporation or LLC.



The Norman Test

***Norman v. Murray First Thrift & Loan Co.*, 596 P.2d 1028, 1030 (Utah 1979).**

- Created a two-part alter-ego test (“*Norman Test*”):
 - (1) Formalities Requirement: requires show of such unity of interest and ownership that the separate personalities of the corporation and the individual no longer exist.
 - (2) Fairness Requirement: requires show that observance of the corporate form would sanction a fraud, promote injustice, or condone an inequitable result.



Fairness vs. Formalities Requirements

***Messick v. PHD Trucking Service, Inc.*, 678 P. 2d 791 (Utah 1984)**

- The Fairness Requirement of the *Norman Test* is addressed to the conscience of the court, and the circumstances under which it will be met will vary with each case.
- The Formalities Requirement is established by showing the corporation's failure to observe statutory formalities.

***Salt Lake City Corp. v. James Constructors*, 761 P. 2d 42 (Utah 1988)**

Later cited *Messick v. PHD Trucking Service, Inc.* for these propositions.



Colman Factors

Colman v. Colman, 743 P.2d 782, 786 (Utah Ct.App.1987)

Provided factors deemed significant, although not conclusive, in determining whether Formalities Requirement (primarily) of the *Norman* test has been met include:

- (1) undercapitalization of a one-[person] corporation;
- (2) failure to observe corporate formalities;
 - Failure to observe corporate formalities includes such activities as commencement of business without the issuance of shares, lack of shareholders' or directors' meetings, lack of signing of consents, and the making of decisions by shareholders as if they were partners.
- (3) nonpayment of dividends;
- (4) siphoning of corporate funds by the dominant stockholder;



Colman Factors

- (5) nonfunctioning of other officers or directors;
- (6) absence of corporate records;
- (7) the use of the corporation as a facade for operations of the dominant stockholder or stockholders; and

Failure to distinguish between corporate and personal property, the use of corporate funds to pay personal expenses without proper accounting, and failure to maintain complete corporate and financial records are looked upon with extreme disfavor.

- (8) the use of the corporate entity in promoting injustice or fraud.



Meaning of Colman Factors

***Jones & Trevor Mktg., Inc. v. Lowry*, 2012 UT 39 (June 29, 2012)**

- The *Colman* Factors are “merely helpful tools and not required elements.”
- “[I]t is possible that evidence of even one of the *Colman* factors may be sufficient to suggest both elements of a party's alter ego theory and therefore preclude summary judgment.”
- Accordingly, “courts should evaluate the entire relationship between a corporation and its officers in determining whether to pierce the corporate veil.



Dissent Points-Out Failure to Allege Alter-Ego

***Yuanzong Fu v. Rhodes*, 2013 UT App 120, ¶ 42, J. McHugh dissent (May 16, 2013)**

“Nothing in Complaint alleging facts that could support piercing corporate veil to hold Rhodes responsible under alter ego theory.



Clarification of which Colman Factors are associated with which prongs of the Norman Test

d'Elia v. Rice Dev., Inc., 2006 UT App 416

- Attributed *Colman* Factors to Formalities Prong of *Norman* Test.

Preferred Product Placement Corporation v. Right Way Nutrition, LLC, No. 2: 11-cv-00496 (D. Utah Feb. 17, 2015)

- Explained that the first seven of the *Colman* Factors go to the Formalities Requirement of the *Norman* Test; the eighth factor (use of the corporate entity in promoting injustice or fraud) goes to the Fairness Requirement.



The Limited Liability Company

- **The LLC was born in Wyoming in 1977, and gained widespread acceptance later on.**
 - Florida followed in 1982.
 - In 1988 IRS issued Revenue Ruling stating it would treat LLCs as partnerships for tax purposes. Rev. Rul. 88-76, 1988-2 C.B. 360.
 - Others following in or after 1988.
 - By 1996, almost all states had enacted an LLC statute.
- **Compare that with the Corporation with ancient origins and with statutes and case law developing over hundreds of years.**



LLC Piercing Affirmed

d'Elia v. Rice Dev., Inc., 2006 UT App 416

- Affirmed trial court's refusal to pierce the "corporate" veil of an LLC.
- Rice Development, L.L.C. was formed in 1993, and governed by Utah Uniform Limited Liability Company Act (the "Old Utah LLC Act").



Alter-Ego Theory Applies to LLCs Says the Utah Court of Appeals

Lodges at Bear Hollow v. Bear Hollow Rest., 2015 UT App 6 (Jan. 2, 2015)

- The Court announced in a footnote: it appears to be the law in Utah that alter-ego theory for piercing the corporate veil applies to limited liability companies. Citing *d'Elia v. Rice Dev., Inc.*, 2006 UT App 416, ¶¶ 30-34.
- The Court explained that the parties assumed that alter-ego theory applied to the limited liability company.
- Bear Hollow Restoration, L.L.C. was an LLC formed in 2003.



Alter-Ego Theory Applies to LLCs Says the Utah Court of Appeals

Simons v. Park City RV Resort, LLC, 2015 UT App 168 (July 9, 2015)

- Cites *Lodges at Bear Hollow* several times in its in alter-ego analysis.
- Park City RV Resort, L.L.C. was formed in 2004.



Divorce Decree Ordered Liquidation of Investment in Multi-Member LLC and not Land Owned by It.

CFD Payson, LLC v. Christensen, 2015 UT App 251 (Oct. 8, 2015)

- In *Dahl v. Dahl*, 2015 UT 79 in dividing the Dahls' marital estate, the divorce court ordered liquidation of the "Pheasant Run investment".
- Defendants filed liens on property owned in a multi-member LLC .
- Assets in the rightful legal possession of a separate entity generally "are not available for distribution as marital assets." *Endrody v. Endrody*, 914 P.2d 1166, 1169 (Utah Ct.App.1996).
- "Although Kim Dahl was awarded proceeds from the ordered sale of the Pheasant Run investment, she necessarily had no legally cognizable interest in the Pheasant Run land itself, as would support recordation of a lien against the Pheasant Run land."



What about Utah Code § 48-3a-304(2)?

- The statute provides:

The failure of a limited liability company to observe formalities relating to the exercise of its powers or management of its activities and affairs is not a ground for imposing liability on a member or manager of the limited liability company for a debt, obligation, or other liability of the limited liability company.

- General Application of Utah Revised Uniform Limited Liability Company Act (the “New Utah LLC Act”) was effective January 1, 2016 for all LLCs and January 1, 2014 for new LLCs.



What about Utah Code § 48-3a-304(2)?

- But what about the following?

- No separate Employer Identification Number.
- No bank account set up for the business.
- Mingling of funds between individual and business.
 - Using the LLC bank account as their personal bank account.
- Owns real property but has no written operating agreement.
- Intercompany rental agreements not documented.

- More than mere formalities?



2016 Reverse-Piercing Case

MJ v. Wisan, 2016 UT 13 (March 23, 2016)

Reverse Veil-Piercing: “an artificial entity may be viewed as an individual's alter ego, and the entity is thus deemed responsible for the individual's personal acts.”

- The Court concluded that the reverse veil-piercing theory is a viable doctrine in Utah. It declined, however, to extend the doctrine to the present case because another theory (*respondeat superior*) provided the complainant with relief.
- Entity requested to be reverse-pierced was a trust.



2016 Reverse-Piercing Case

- Eighteen states, D.C., and a number of federal courts that have accepted reverse veil-piercing. Kurtis A. Kemper, Annotation, *Acceptance and Application of Reverse Veil-Piercing—Third Party Claimant*, 2 A.L.R.6th 195 § 4 (2016).
- Even in Utah, our courts appear to have employed it without great controversy or difficulty. See *Colman v. Colman*, 743 P.2d 782, 786-87 (Utah Ct. App. 1987).
- Two cases where Utah declined to apply reverse veil piercing and resolved on other grounds: *Messick v. PHD Trucking Serv., Inc.*, 678 P.2d 791, 793 (Utah 1984); *Transamerica Cash Reserve, Inc., v. Dixie Power & Water, Inc.*, 789 P.2d 24, 26-27 (Utah 1990).



What about Utah Code § 48-3a-503(6) regarding LLC Charging Orders?

- The statute provides:
 - If a court orders foreclosure of a charging order lien against the sole member of a limited liability company:
 - (a) the court shall confirm the sale;
 - (b) the purchaser at the sale obtains the member's entire interest, not only the member's transferable interest;
 - (c) the purchaser thereby becomes a member; and
 - (d) the person whose interest was subject to the foreclosed charging order is dissociated as a member.

- This is a collection method, and at the heart of it is an open back door for reverse-piercing single-member LLCs.



What about Utah Code § 48-3a-503(6) regarding LLC Charging Orders?

- Should the back door of single-member LLCs have the same piercing requirements as for multi-member LLCs?

- Remember beginning purposes of separate entity:
 - (1) protect investors from the liabilities of the business,
 - (2) protect the investors of the business from the creditors of the other investors, and
 - (3) protect the business itself from the creditors of the investors.

- What percentage of Utah businesses are single-member limited liability companies?



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