

## Is Your Company Your “Alter Ego”?

One of the most popular legal theories used by plaintiffs when trying to pierce the veil of a privately held corporation, or LLC, is "alter ego." Under this theory, the corporate veil is disregarded and the liabilities of the company become the liabilities of its owners. Nationally, if alter ego can be proven, the business owner will lose in court 96% of the time.

Veil piercing cases using alter ego vary somewhat from state to state, but there appears to be a common test:

- (1) If it can be determined the separate personalities of the company and its owner(s) no longer exist, and
- (2) If the veil is NOT pierced then an inequitable or unjust result will follow.

In addition, there is no clear method the jury can use to determine whether to pierce or not, making it an entirely subjective decision. *Associated Vendors, Inc. v. Oakland Heat Co.*, 210 Cal. App. 2d 828, 838 (1962). Therefore, keeping the rules is critical.

The key to preventing or overcoming alter ego is knowledge and action:

- (1) knowledge of what you should be concerned about,
- (2) knowledge of how to remedy and avoid alter ego practices in the future, and
- (3) implementing this knowledge, thereby creating a stronger corporate veil.

## COMMINGLING

Commingling is defined as the sharing or pooling of personal and business assets. This can occur in multiple ways between the owner and his/her company, or between multiple companies owned by the same individual(s). Although many business owners claim they never participate in commingling practices, we know otherwise. For example, it may be convenient for you to take a "loan" from the company, with the intent to pay it back. But you may have never bothered to formalize the loan with proper documentation creating an arms-length transaction. Take a hard look at your own company practices and procedures as you review this list of commingling activities:

1. Depositing corporate monies into personal rather than corporate accounts (or vice versa).
2. Payment of personal obligations with company funds.
3. Payment of company obligations with personal funds.
4. Failure to set up separate company bank accounts.
5. Depositing and withdrawing company monies in and from another business's bank account.
6. Failure to make payments to the company for its services.
7. Failure of the company to pay for goods or services it receives from you or related companies.
8. Moving assets between companies or between a company and its owner(s) for the main purpose of generating or accessing cash.
9. Payments for company services or goods being made to the business owner individually, rather than to the company.

10. Failure to maintain separate bank accounts for each company division or subsidiary.
11. Failure to properly document loans made to or by any company divisions, subsidiaries, shareholders, officers or directors.
12. Failure to subordinate loans to or from shareholders, directors, officers or subsidiaries to loans from third parties.
13. Failure of loan documents to identify terms that demonstrate the loans were made in an arms-length fashion.
14. Failure of the parties to the loans to comply with the terms of the loan.
15. Failure to pay for use of assets that are shared by more than one company or any subsidiaries.
16. Failure of one related company to reimburse another for services or materials received.
17. Failure to fairly calculate reimbursement charges between companies which share assets, employees and related costs.
18. Failure to timely pay reimbursement charges or to charge interest.
19. Failure to properly account for costs shared between companies, and for those companies to pay their proportionate share of such costs from their own bank accounts.

While researching the issue of commingling, we noticed a significant pattern in the cases: in virtually every case where the courts identified the factors leading to veil piercing, commingling of funds was mentioned first. This does not necessarily mean the courts weighed this factor more than others. However, it does imply that commingling is one of the most common errors practiced by business owners.

Our advice: If you loan money to another entity or to a company director, officer or shareholder do it properly. Don't commingle company assets with personal assets. Don't commingle one company's assets with those of another in which you have ownership. Review your business practices to ensure you are not engaging in any of the conduct on the list. If you are doing some of these things, STOP. The strength of your company's corporate veil may depend on it.

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*Mr. Graham is an Attorney specializing in Business Litigation, Entity Structuring, Business Compliance & Contract Law. Material discussed is meant for general illustration and/or informational purposes only and it is not to be construed as tax or legal advice. Although the information has been gathered from sources believed to be reliable, please note that individual situations can vary.*