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CORPORATE ADVISORY

If you are a small business owner, your attorney (and accountant) probably told you to be sure to follow the appropriate corporate formalities in running your business. What does this mean? It means treating your company¹ as a distinct, separate person. It means not commingling your assets or debts. It means holding annual meetings and complying with all the procedural requirements associated with such meetings. Have you followed the advice of your attorney or did you merely shrug it off as inconsequential? All too often, small business owners ignore the need to follow the appropriate corporate formalities. For instance, it's much easier to deposit a check made out to the company directly into your personal bank account, rather than deposit it into the company bank account and then have the company distribute those funds to you as the sole shareholder of the company. After all, the money is going to you anyway, isn't it? Why not skip the extra step?

The answer is that taking the easy approach could prove to be costly. Failure to follow appropriate corporate formalities could give a company creditor the opportunity to argue that, as the company's shareholder, *you should be personally liable for the company's debts*. The creditor could argue that the company is simply your alter ego, has no separate existence of its own, and is merely a conduit through which you conduct personal business. In other words, the creditor could ask the court to pierce the corporate veil.

In Florida, a creditor is only able to pierce the corporate veil and hold the shareholder personally liable when the creditor can prove two things. First, the creditor must establish that the shareholder dominated and controlled the company to such an extent that the company effectively did not have an independent existence (*i.e.*, it was the shareholder's alter ego). Second, the creditor must prove the shareholder used the company for some illegal, fraudulent or other unjust purpose.² Although the typical piercing-the-corporate-veil case involves a creditor going after the assets of the owner of the debtor-company, Florida courts also recognize "reverse piercing," which is where the company's creditor goes after the assets of the company's subsidiary. A recent example of a reverse piercing case is a 2010 decision by the Third District

¹ This Corporate Advisory applies generally to both corporations (including S corporations) and limited liability companies.

² The seminal case in Florida on piercing the corporate veil is Dania Jai-Alai Palace, Inc. v. Sykes, 450 So. 2d 1114 (Fla. 1984).

Court of Appeal of Florida, *17315 Collins Avenue, LLC v. Fortune Dev. Sales Corp.*³ In that case, the issue was whether the lower court properly allowed a judgment against the parent company to operate as a lien against real estate owned by its subsidiary.

Applying the veil piercing test, the court in *17315 Collins Avenue* first had to determine whether the parent company and its subsidiary operated as alter egos. The court took into account the following factors: (1) the subsidiary was the actual owner, developer and operating entity of the real estate project; (2) the parent company owned 100% of the subsidiary and was its sole manager; (3) the parent company did not conduct any operations, have any employees or payroll, or have any bank accounts; and (4) both companies were single-purpose entities that existed solely for the development of the real estate project. Based on these facts, the court found that the companies were alter egos, thereby satisfying the first prong of the veil piercing test.

Next, the court had to determine whether the parent company used the subsidiary for an improper purpose. The court concluded that it was improper for the parent company, as the sole manager of the subsidiary, to have the subsidiary divert funds that had been earmarked to pay a specific creditor of the parent company, so that those funds were out of that creditor's reach. Consequently, the court confirmed the lower court's decision.

The *17315 Collins Avenue* case emphasizes the importance of following appropriate corporate formalities. If the company is treated as a distinct and completely separate person, then a creditor will have a much more difficult time trying to hold the shareholder (or a subsidiary) personally liable for such company's debts. As discussed above, the veil piercing test has two prongs, and both must be satisfied to pierce the corporate veil. Therefore, the next time you think about depositing the company check directly into your personal checking account, think again.

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If you would like to discuss the *17315 Collins Avenue* case or any other business legal issue, please contact Mark Hobson, Esq. or John Devine, Esq. at DEVINE GOODMAN RASCO & WELLS, P.A.

³ *17315 Collins Avenue, LLC v. Fortune Dev. Sales Corp.*, 34 So. 3d 166 (Fla. 3d DCA 2010).