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Client Alert

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Virginia LLC Update: Supreme Court of Virginia Clarifies Standard Used to Pierce the Veil of an LLC

On June 2, 2016, the Supreme Court of Virginia issued an opinion clarifying the standard courts should use when determining whether to pierce the veil of a Virginia limited liability company. In *A.G. Dillard, Inc. v. Stonehaus Construction, LLC*,[1] the court confirmed that the same standard applies to piercing the veil of an LLC as applies to piercing the veil of a traditional corporation.

Background

In *A.G. Dillard, Inc. v. Stonehaus Construction, LLC*, A.G. Dillard, the plaintiff, sought to collect a judgment against Stonehaus Construction, LLC (Stonehaus). Stonehaus was legally insolvent; so A.G. Dillard sought to have the court pierce Stonehaus' veil to reach the assets of its owners, Robert and Kendra Hauser, and various entities affiliated with them (collectively, the defendants). Piercing the veil would set aside the limited liability of the owners of Stonehaus and make the defendants jointly and severally liable for its debts.[2] A.G. Dillard also claimed that Stonehaus had fraudulently conveyed its assets to the defendants in a scheme to avoid liability for breaches of contract and failure to pay.

The defendants filed a demurrer, arguing that A.G. Dillard failed to state claims on which relief could be granted. The circuit court sustained the demurrer, and the Supreme Court of Virginia reviewed the decision.

Court's Decision

The court first reviewed A.G. Dillard's claim to pierce Stonehaus' veil. The court noted that, in determining whether to pierce the veil of a traditional corporation, the Supreme Court of Virginia has previously held that there is no single rule or standard and the determination is fact specific. Piercing the corporate veil is appropriate when the unity between the corporation and its shareholders is such that separation between them no longer exists, or if the corporate entity is merely a device or sham used to conceal wrongs, fraud or crime, and adhering the separateness of the entity and the shareholders would work an injustice. The court stated that this same standard applies to piercing the veil of an LLC.

The court held that, viewing the facts in the light most favorable to A.G. Dillard, the plaintiff's complaint adequately stated a claim to pierce Stonehaus' veil and reach the assets of Robert Hauser, but not the assets of Kendra Hauser, as she had only an indirect relationship to Stonehaus through her husband. The complaint alleged that Stonehaus and Robert Hauser were not separate personalities; Stonehaus

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[1] *A.G. Dillard, Inc. v. Stonehaus Constr., LLC*, No. 151182, 2016 BL 178651 (Va. June 2, 2016).

[2] Generally, a plaintiff with a claim against an LLC may only pursue a claim against the LLC itself and not its members. Va. Code § 13.1-1019 provides, "no member, manager, organizer or other agent of a limited liability company shall have any personal obligation for any liabilities of a limited liability company, whether such liabilities arise in contract, tort or otherwise, solely by reason of being a member, manager, organizer or agent of a limited liability company."

was legally insolvent; it had no bank account or assets; its funds had been siphoned off by Robert Hauser; and Stonehaus made no effort to collect money Robert Hauser owed it. The court further held that A.G Dillard also adequately stated a claim to reverse pierce the veils of the related entity defendants through Robert Hauser.[3] The complaint alleged that Robert Hauser was the controlling member of Stonehaus and each of the related entity defendants, and that Stonehaus and the related entities did not operate as separate personalities and were each other's "corporate alter egos." All related entity defendants presented themselves to the public under a single name, and each entity's assets and employees were used by the other entities as if they were the assets and employees of the other entities.

Finally, the court found that A.G. Dillard adequately stated a claim for fraudulent conveyance through its allegations that conveyances from Stonehaus to the defendants were not made for valuable consideration. Among other things, the complaint alleged that Stonehaus had fraudulently conveyed its assets to the Hausers and their related entities in order to avoid paying the judgment owed to A.G. Dillard.

The court remanded the case for further proceedings.

Key Observations and Takeaways

Virginia courts are reluctant to order veil piercing and will do so only in extraordinary circumstances. However, now that the Supreme Court of Virginia has allowed such a claim against an LLC and its members and affiliated entities to proceed, LLCs and their members should be familiar with the criteria Virginia courts will apply in determining whether to pierce the veil of an LLC. The Supreme Court of Virginia has held that whether to pierce the veil is determined on a case-by-case basis and that there is no single rule or criterion for making a piercing determination. The Supreme Court of Virginia has also set forth the following principles for piercing the veil of an entity:[4]

- ***Lack of Separateness Between the Entity and its Owners***: The veil may be pierced in circumstances where the separate personalities of the entity and its owners do not practically exist, and adhering to the formal separation between them would allow an injustice to occur. This is sometimes referred to as the "alter ego" or "instrumentality" theory of veil piercing. As legal formalities associated with LLCs are less stringent than those associated with corporations, it is unclear how Virginia courts will apply the "alter ego" theory in the LLC context. However, as in *Stonehaus Construction*, courts may focus their analysis on the financial and operational independence of the LLC from its owners and affiliates.

- ***Improper Use of the Entity by its Owners***: The veil may be pierced when the owners controlled or used the entity to evade personal obligations, perpetrate a fraud or a crime, commit an injustice or gain an unfair advantage.

- ***Deliberate Undercapitalization of the Entity***: Courts may pierce the veil when the inability of the entity to satisfy its debts and obligations is a result of deliberate undercapitalization. This applies when the entity is unable to pay its costs of doing business because its owners have intentionally underfunded it or siphoned money from it. This does not apply when the entity cannot pay because of bad business decisions, mismanagement or unexpected liabilities.

[3] In traditional veil piercing, a shareholder is held personally liable for a corporation's liabilities, while in reverse veil piercing, a corporation is held liable for its shareholder's personal liabilities. Courts consider the same standard in determining whether to apply either doctrine.

[4] *See Dana v. 313 Freemason, A Condo. Ass'n*, 266 Va. 491 (Va. 2003).

- ***Special Considerations in Reverse Veil Piercing***: Reverse veil piercing occurs when an entity is held liable for an owner's personal liabilities. In *Stonehaus Construction*, the court stated that, in addition to the traditional factors outlined above, a court considering reverse veil piercing must weigh the impact it will have on the entity's innocent owners and creditors. The court must also consider the availability of other remedies the creditors may pursue.

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