

## **Preserving Corporate Protection – How to Ensure Your “Corporate Veil” Is Not Pierced**

Many business owners believe that once they incorporate, they automatically protect themselves from personal liability for debts owed by the corporation. A corporation is recognized as a separate and distinct legal entity from its shareholders and officers. Consequently, the assets and liabilities are owned by the corporation itself, not individual shareholders. This means that a creditor cannot go after an individual shareholder to satisfy a judgment if all of the corporation’s assets are exhausted.

Simply incorporating your business, however, is not enough to protect your personal assets from the corporation’s creditors. In order to protect your personal assets, business owners must implement a series of corporate formalities to ensure that the corporation maintains a legal identity separate from its owner or shareholders. Failing to follow such formalities can result in the owner or shareholders losing the corporate liability protection and allow creditors to “pierce the corporate veil” to hold individuals responsible for debts owed by the corporation.

In January 2005, the Circuit Court of Virginia in Fairfax County issued an opinion in *Brooks v. Becker*, piercing the corporate veil of Becker Interiors, Inc. (“BII”). The Court held BII’s sole shareholder, officer, and director, Ronald Becker, personally responsible for a judgment that Stephen Brooks obtained against the corporation. BII hired Brooks as a subcontractor on a home renovation project in McLean, Virginia. Brooks did not receive full payment for his services, so he sued and obtained a judgment against BII for \$54,587.09. When BII was unable to satisfy the judgment, Brooks alleged that Becker and his companion used BII’s assets for their own personal use, leaving the corporation unable to pay the money owed. The Circuit Court agreed with Brooks, finding that Becker used BII’s funds to finance the renovation of his personal home and pay personal credit cards and deposited checks payable to BII into his personal account. In this situation, piercing the corporate veil was justified because “the separate personalization of the corporation and the individual no longer exist and to adhere to that separateness would work an injustice.” Becker was found to have knowingly violated his duties as an officer and shareholder when he treated corporate funds as his “personal piggy bank.”

There is no one circumstance that will lead a court to pierce the corporate veil. There are several factors taken into consideration when determining if a corporation is nothing more than an alter ego for its shareholders or was created to advance an individual’s private interest or commit fraud. These factors include:

- **Lack of Corporate Formalities**  
It is important that a company file annual reports with the state, maintain minutes of shareholder or Board of Directors meetings, and keep adequate corporate financial records and stock ledgers.
- **Commingling of Assets**  
The corporation should have a separate set of books and financial accounts from your personal finances. Owners and shareholders should not use corporate money to pay personal debts such as a credit card or mortgage payments.
- **Inadequate Capitalization/No Corporate Assets**  
If the corporation is undercapitalized at the time of the transaction and when the creditor tries to collect on the judgment, the court may order the corporate veil to be pierced. There

is no threshold level that constitutes undercapitalization, but the courts will look at the debt-to-equity ratio and cash flow requirements.

- **Insufficient Oversight by Officers and Directors**

Having officers and directors who do not take part in the operations of the company may lead a court to conclude that the corporation was controlled entirely by one person. If that person used the corporation to advance his or her own personal interests, the court may conclude that the organization was simply the alter-ego of the individual.

There are numerous benefits in creating a corporation such as the protection of personal assets from corporate creditors. It is critical, however, that once the corporation is formed, you implement a simple system of corporate formalities to ensure that it remains a separate and distinct legal entity. For information on the simple steps that businesses can take to receive corporate protection, please contact legal counsel.