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## ASK A LAWYER

# Abusing LLC will erode its protection

**Q. As a member of a limited liability company, can I be individually liable for the acts of the company?**

New Jersey's Limited Liability Company Act protects an LLC member from liability for the acts of the LLC under most circumstances. In general an LLC member will not be liable for debts, obligations or liabilities of the LLC. The courts, however, will not tolerate an LLC member's abuse of the LLC structure and will "pierce the veil" of the LLC to hold an individual liable under certain circumstances.

Courts have traditionally employed veil-piercing as a tool to remedy an individual's unfair abuse of the corporate form. Compared with a corporation, New Jersey statutory law permits LLCs to operate more flexibly. For this reason the courts are more reluctant to extend veil-piercing to LLCs, but they are beginning to do so. If an LLC member dominates and controls the LLC rendering it a mere instrumentality for the member or the "alter ego" of the member to carry out a fraud or injustice or otherwise circumvent the law, the courts will pierce the LLC veil to hold the LLC member individually liable for the acts of the LLC.

The courts will look at several factors to determine whether the LLC is a mere instrumentality or "alter ego" of an LLC member. The most widely considered factors are: 1) gross undercapitalization of the LLC; 2) failure to observe formalities such as holding regular management meetings and keeping the assets of the LLC distinct from the assets of its members; 3) non-payment

of distributions; 4) insolvency; 5) siphoning of funds from the LLC to an LLC member; and 6) absence of LLC records.

Overall, the courts will look to see if the LLC is merely a facade for the operations of individuals.

Notably, the Limited Liability Company Act authorizes LLC members and managers to transact with the company to lend and borrow money and to assume obligations of the company. Given this LLC flexibility as compared with a corporation, evidence of domination and the failure to adhere to formalities, without other evidence to support veil-piercing, is less likely to expose an LLC member to individual liability in the LLC context than in the corporate context.

For certain, although an LLC member enjoys extensive protection from individual liability, an LLC member must act carefully to ensure continued entitlement to that protection. Ongoing review and monitoring of the LLC's business practices are essential.

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