



*Guiding You Through the Legal Maze.<sup>SM</sup>*

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## **HOW TO AVOID HAVING YOUR CREDITORS PIERCE THE COMPANY VEIL**

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## **HOW TO AVOID HAVING YOUR CREDITORS PIERCE THE COMPANY VEIL**

One of the principal reasons you form a corporation or a limited liability company (“LLC”) to own and operate your business is to insulate your personal assets from the claims of business creditors in case your business is not successful. Generally, your personal exposure is limited to the amount of capital you have contributed to the company. However, if you fail to follow the requisite business formalities, your attempt to insulate yourself from the claims of business creditors may be futile.

Today, to save money, many business people don’t use an attorney to form their own corporation or LLC. You can create a corporation or LLC over the Internet including Florida by completing and electronically filing the Articles of Incorporation or the Articles of Organization. But many people then do nothing further. However, this is only step 1 of many steps to properly incorporate a corporation or organize a LLC. They fail to order a company minute book, stock certificate book, company seal and stock ledger. They fail to adopt bylaws or an operating agreement. They fail to prepare organizational minutes. They fail to issue stock or membership certificates. I’ve also seen accountants and even lawyers do the same thing. This can be “penny wise and pound foolish” as they used to say.

A business creditor who is not paid when the business fails may seek to go after the personal assets of the owners of the business to satisfy their claim. This is called “piercing the corporate veil.” This is done by filing a lawsuit against the owners. Florida courts have adopted a 3-part test in order to pierce the corporation or LLC veil: (1) the business entity is a mere instrumentality or “alter ego” of another entity or person; (2) the corporate entity is engaged in improper conduct; and (3) there has been an unjust loss or injury to the plaintiff. If a creditor can prove these 3 elements, then your personal assets can be used to satisfy the claims of business creditors.

To avoid this happening to you, particularly in these bad economic times, you need to treat your business as a separate entity by, among other things:

- Complete the incorporation/organization process by: (i) having a company minute book, stock certificate book, company seal and stock ledger; (ii) adopting bylaws or an operating agreement; (iii) preparing organizational minutes; and (iv) issuing stock or membership certificates.
- Have annual meetings of the shareholders and Board of Directors/members and Management Committee even if only signed written Consents, as permitted by law, rather than formal meetings.
- Maintain a separate bank account for the business.
- Do not commingle personal assets with the business assets.
- Have business assets titled in the name of the business.
- Not use business assets for personal use.
- Use the business name (or fictitious name) on all stationary, business cards and contracts.
- Sign all contracts as an officer/manager of the business and not individually.
- Avoid signing a personal guaranty of a business obligation.
- Timely file your annual report and paying the annual fee to avoid having the company be administratively dissolved by the state

If you loan money to the business in addition to your capital contribution, you should make sure that the loan is reflected on the company's balance sheet, the loan is evidenced by a written promissory note and the loan is secured by a first priority security interest in the assets of the business. You do this usually by signing a security agreement and recording a UCC Financing

Statement. This way, if the business fails, you will have priority as a secured creditor over the claims of unsecured creditors.

As the FRAM oil filter commercial used to say “Either pay me now [oil filter and change] or pay me later [engine job].” The costs of retaining a business attorney and accountant at the inception of getting into business will save you time and money in the long run. The cost of defending a claim by a creditor attempting to pierce the company veil will far exceed these initial costs. No one plans to fail in business but you have to prepare for that contingency and minimize your exposure.

*Keith J. Kanouse, Esq.*