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## the corporate veil can easily slip, even after a judgment

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MSK Client Alert

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On December 31, 2013, the California Court of Appeal, Second Appellate District, issued an opinion making it easier to find business owners personally liable for a judgment entered against their limited liability entity – such as a limited liability company (LLC), a limited partnership, or a corporation.

In *Relentless Air Racing, LLC v. Airborne Turbine Ltd. Partnership*, 2013 Cal. App. LEXIS 1058 (Dec. 31, 2013), a plaintiff in a contract dispute obtained a money judgment against defendant limited partnership (the "Entity"). Unable to collect on the judgment from the Entity, the plaintiff sought to amend the judgment to add the Entity's owners, two natural persons and two corporations (the "Owners"), as judgment debtors.

The Entity was essentially a family business engaged in the importing and selling of aircraft, and its individual Owners – husband and wife – were its limited partners. The corporate Owners were owned and controlled by the individual Owners and were former and current general partners of the Entity. Under corporate law, limited partners, similarly to members of an LLC, are not personally liable for the obligations of the limited partnership. The court in *Relentless*, however, found that the relationship of the Owners with the Entity was such that the Owners, including the individuals, were *alter egos* of the Entity and thus could be added as judgment debtors that are personally responsible for the judgment.

In arriving at this conclusion, the court applied three factors initially used in the LLC context in *Greenspan v. LADT LLC*, 191 Cal. App. 4th 486, 517 (Cal. App. 2010). Specifically, to add the owners of an entity as judgment debtors, plaintiff must show that:

1. the owners had control of the underlying litigation and were virtually represented in that proceeding (which will usually be the case);

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2. there is such a unity of interest and ownership that the separate personalities of the entity and its owners no longer exist; and
3. an inequitable result will follow if the acts giving rise to the judgment are treated as those of the entity alone.

All three factors were satisfied in *Relentless*.

Most significant was the court's finding that the Entity's insolvency and plaintiff's inability to collect on the judgment in and of itself amounted to an "*inequitable result as a matter of law*", thus satisfying the third factor. The court expressly held that the Owners' *intent* – wrongful or not – was irrelevant in determining whether an "*inequitable result*" has occurred.

The court also found that the Owners and the Entity were not separate, and thus the second factor was satisfied, relying on the following facts:

- the individual Owners used funds of the Entity to pay their personal bills on an as-needed basis;
- no meetings were held nor other formalities observed to make a decision to take a draw, and there was generally "some disregard for the legal formalities," although minutes from annual meetings were maintained;
- the individual Owners were the sole officers, directors, members, shareholders, owners, and operators of all business entities, including of the corporate Owners;
- the individual Owners switched general partners (the corporate Owners) at the end of trial on the underlying action without a rational business reason;
- the Partnership's business was operated from the individual Owners' personal residence; and
- intercompany agreements were only oral and generally not documented in any manner.

Finally, the court held it was not necessary to litigate the *alter ego* status of the Owners in the underlying action before the judgment was entered, even if the plaintiff had been reasonably aware all along of the nature of the relationship between and among the Owners and the Entity.

After *Relentness*, business owners should be vigilant, more than ever, in following legal formalities, maintaining adequate capitalization, and preserving separateness of their entities – whether corporations, partnerships, or limited liability companies. Separate books and records are essential, as are written resolutions/consents created as contemporaneously as possible when any actions involving the relationship between the owners and their entity are taken, especially if those actions involve taking funds out of the entity in question. In fact, following *Relentless*, maintaining legal separateness of the entity may be the least burdensome and most certain way to strengthen its limited liability shield.