

New Single Member LLC Veil Piercing Case Is a Wakeup Call to Attorneys and Spells Opportunity

By Mason D. Salisbury, J.D.

The case in point is the Wyoming Supreme Court's Greenhunter Energy, Inc. v. Western, 2014 WY 144, 2014 WL 5794332 (WY S.C., Nov. 7, 2014).

First and foremost, Greenhunter reminds us that single member LLCs ("SMLLCs") really do get pierced! But contrary to some initial reactions, Greenhunter is not the death knell for SMLLCs as asset protectors, far from it! The better take on Greenhunter with its emphasis on the multipart State court analysis of SMLLC piercing "factors" is twofold. One, Greenhunter is most certainly a wakeup call to drafting attorneys that SMLLC organization and operation must be taken seriously if asset protection is the goal (and when isn't it with SMLLCs?). And two, there is opportunity for attorneys who do not yet do SMLLCs to "get into the business" by developing their own asset protection SMLLC Package and opportunity for attorneys already organizing SMLLCs to modify their existing SMLLC organization to include and enhance asset protection and anti-piercing features. Consider one such opportunity, every time an estate planning attorney "funds" a client's SMLLCs or funds assets that should be in SMLLCs, why not be able to convincingly offer your client the benefit of an upgrade to an asset protection SMLLC? Not the overriding reason to do so but interestingly, one of the asset protection features in an asset protection SMLLC is the tying of an SMLLC operating agreement to certain provisions in the Living Trust, should the client have one.

Greenhunter Case Synopsis: The SMLLC owner (a publicly traded Texas corporation) had its newly organized non-asset owning, non-revenue generating Wyoming solar energy SMLLC contract with a Wyoming energy consulting firm. Contract services were provided and the SMLLC did not pay the consulting firm any part of the \$43,000 billed. Of great importance, the SMLLC owner significantly benefited from the SMLLC by lowering its own taxes using a \$880,000 pass-through tax deduction from the SMLLC



and a \$62,000 pass-through loss.

The Wyoming Supreme Court upheld the lower court's piercing decision holding the SMLLC owner liable for the SMLLC's debt. The Court said the SMLLC owner kept the SMLLC "continually undercapitalized by choice", "used its position to control the amount of money transferred to the LLC, and decided which bills of the LLC would be paid", "enjoyed significant tax breaks attributed to the LLC's loss, without bearing any responsibility for the LLC's debt and obligation that contributed to such losses", and "[s]uch a disparity in the risks and rewards resulting from this manipulation would lead to injustice". Greenhunter at ¶143.

SMLLC Piercing Law: SMLLC piercing law in all 50 states uses basically the same piercing "factors" and follows the same logic as Greenhunter. Piercing "factors" will be analyzed based on the facts of each case and the operation of

each SMLLC with “no rigid formula”. Then two questions (“prongs”) of this analysis need to be answered in the affirmative to pierce. The first question is about “separateness”. Has the “separateness” between the SMLLC and its owner been eroded to the point a Court is no longer compelled to respect the SMLLC as a separate and distinct legal entity. The second question is about “fairness”. Has the SMLLC been used by its owner (Greenhunter says “manipulated”) to commit a wrong, unfair, unjust, or fraudulent act against the creditor (or the accident victim if a tort case). The unfair act needs to be more than simply not paying a creditor, but it does not need to rise to a crime or outright fraud. However, if it does rise to the level of a crime or fraud often courts will pierce on that alone.

Message to Attorneys – Proactive SMLLC Organization and Opportunity: Greenhunter highlights the importance of piercing “factors” in SMLLC piercing cases, actually mentioning “factors” 21 different times in the opinion. And we know because Courts like Greenhunter will examine a set of piercing “factors” and analyze them in terms of the “separateness” and “fairness” questions, Attorneys too will examine, calculate, and argue these same “factors” and questions before bringing an action, while in discovery, during settlement negotiations, and at trial if it goes that far. We know from Greenhunter that creditor attorneys will take a SMLLC piercing case to court for a relatively small judgment - \$47,000 – if they think they will win the piercing battle. Thus Greenhunter is telling us if asset protection is the goal, SMLLCs should be proactively organized to resist piercing claims and hopefully overwhelm creditor attorneys with anti-pricing “factors” well before a law suit is filed.

Finally, Greenhunter is telling us we have a business opportunity in providing client’s better asset protection SMLLCs. We have an opportunity to educate clients about what they need for SMLLC asset protection, why they need it, that they very likely do not have it in their current SMLLCs, and then to provide it.

Separate and Distinct Legal Entities: I was a creditor’s attorney (“commercial litigator”) for the first 15 years of my practice and then I switched sides. I have spent the last 15 years as an asset protector and estate planner. We tell our clients not to use their SMLLCs wrongly, unfairly, or unjustly, and certainly not to use them for fraudulent purposes (the second prong), but realistically, it is with the first question, the “separateness” analysis and its “factors”, that we can best prepare and best protect them. We do so by structuring SMLLC organization and providing the tools for future SMLLC operation that will support the conclusion the SMLLC is and always has been a separate and distinct legal entity apart from its owner.

Asset Protection SMLLC Package: Start with a written SMLLC

Questionnaire that asks for everything you will need to file the SMLLC with the State, draft the SMLLC operating agreement, and obtain its federal EIN#. I email the questionnaire to my clients after our initial contact. Once client’s answers are received, fill out your State’s SMLLC organizational document and file it for the client. If you leave it to your clients, odds are they will mess up something of asset protection significance – SMLLC manager information, LLC term information, something.

Absolutely key and next is the SMLLC asset protection operating agreement, the heart and soul of the SMLLC! My SMLLC operating agreements are about 25 pages long to include all the asset protection provisions I believe they should have. Almost all my SMLLCs are “term” LLCs, “manager managed” with the client as Manager, and have a “Potential” manager section because I recommend these provisions for asset protection. A short generic operating agreement will not just obviously be missing asset protection provisions; it will shout lack of planning and opportunity to creditor attorneys.

A cardinal rule for asset protection SMLLC operating agreements, never require anything your client might not do! If it is required and not done creditor attorneys will argue that fact as evidence your client does not respect the SMLLC as a separate and distinct legal entity and thus the Court should not either. It is a big reason why creditor attorneys want to review the operating agreement in discovery (the only thing worse is no operating agreement at all). Every State’s LLC Act removes the requirement of keeping “corporate formalities” in an LLC; do not put “formalities” back into the piercing equation by requiring them in the operating agreement.

Make the operating agreement user friendly. Use Word commands that tie section headings automatically into an inserted table of contents with page numbers because it helps clients ease into the operating agreement and you really want them to read it! Use a definition section and everywhere a defined term appears, have it appear in *italics* so clients know it has a definition.

I have never reviewed a SMLLC operating agreement for a client or in a law suit that in my opinion was not missing some asset protection feature and/or simply had something wrong.

A SMLLC should not operate paperless but how often do attorneys – do you - provide common but important collateral documents to help with “safe” SMLLCs operation?

LegalZoom does – or will for an extra fee. The assets that end up being owned by the SMLLC, is there a paper trail? There should be. Money often moves back and forth between owners and their SMLLCs and when questioned owners often say it's a loan. When I heard this as a creditor's attorney my next request was to see the promissory notes. Inevitably there weren't any which is exactly what I wanted to hear.

Explain everything in a SMLLC "Attorney Letter". You cannot hold the client's hand in the future but you can give them SMLLC operational advice with their SMLLC. I put everything I hope my clients will remember on "safe" SMLLC operation in the Letter. You will be pleasantly surprised at how many clients actually read the Letter.

IRS Employee Identification Number ("EIN"): Even if the SMLLC is taxed as a "Disregarded Entity" and thus will pay taxes under the owner's social security number, it should still have its own federal EIN# for asset protection purposes – more evidence of a separate and distinct legal entity. Plus the SMLLC will need an EIN# to open its own ("separate") bank account. If the SMLLC elects Sub S tax status it will need its own EIN# for asset protection purposes, banking purposes, and tax purposes. Either you get the LLC's EIN#, client gets it, or client's tax pro gets it. I get them on-line at the IRS website after getting permission to do so from the client in the SMLLC Questionnaire. Clients love it as part of the SMLLC Package and more importantly for asset protection; it is the only way you know they will actually get one! No fear, you do not need to be a tax attorney to obtain an EIN# on-line.

Practically Speaking, How Does It Work? Once you have drafted or procured everything you will use in your SMLLC Package, you will use the same documents over and over again basically changing only the names, addresses, SMLLC purpose, sometimes your fee, and SMLLC tax election. You will have one set of SMLLC documents for "Disregarded Entity" tax status and one set for Sub-S tax status. You will not do "at-will" LLCs nor "member managed" LLCs because they may be inferior asset protectors. And importantly, you will keep a small notebook listing each SMLLC you do by name, date, and tax status and you will note every substantive change you make in your documents going forward which is how you always know where to find the latest version of the particular SMLLC Package.

Conclusion - Technology - HotDocs: If you want to reduce errors, cut preparation time, allow staff to be more involved, sell an excellent asset protection SMLLC at an amazingly competitive price (or for a lot, price is up to you), as well as move your entire legal practice into the 21st Century, get and learn HotDocs document software. You use HotDocs Developer 11 (about \$800) to create your own HotDocs templates and HotDocs User 11 (about

\$300) if you are going to license other people's HotDocs templates. If you get HotDocs Developer 11, you wouldn't just use it for SMLLC documents, you would use it for all the documents you regularly use in your practice.

I used just Word to do my SMLLC Packages for 10 years and it worked great but HotDocs type software is the future. I now input approximately 35 pieces of information, once, which is all the information I need for my SMLLC Package, names, addresses, my fee, filing fees, nothing more than the length of an address. It takes about 15 minutes and every SMLLC document I use is customized to my SMLLC client and ready to print in final form! That is, the preliminary SMLLC Questionnaire, the asset protection Operating Agreement, Attorney Letter on "safe" SMLLC operation, SMLLC Package Instruction Letter, Tax Document Letter (if Sub S taxed), Sample Documents, Fee Statement, and any other extra document(s) I/you want to contrive to make the SMLLC Package a better value for clients. Adding extra documents is easy because once you have a template for them, HotDocs will pick up the info you have inputted for the client's other SMLLC docs and populate the extra docs making them immediately ready to print. That is, once set up any extra docs you want to add won't take any more of your time than it takes to print them! I do it with mediation and arbitration rules I have drafted specifically for LLC use.

Once the templates are done or licensed, the Hot Docs documents you will work with are Word documents with HotDocs coding running through them. The coding appears in color while the text of the document is normal black which allows you to easily change your substantive language (the black font) at any time just like a regular Word document without screwing up the coding. This means if you license a HotDocs template SMLLC operating agreement for example, you can easily change the substantive text in the operating agreement without screwing up the HotDocs coding which means you can update it, customize it, whatever you want, and it will continue to work just fine.

I did it, the big firms are doing it, it is the future, and I highly recommend you do it too!

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