

# *Piercing the Limited Liability Company Veil: An Excess of Judicial Power*

by: Thomas F. Cavalier

In recent years, courts have assumed that the judge-made doctrine of “piercing the corporate veil” applies to limited liability companies (“LLC”), whose members, like corporate shareholders, enjoy immunity from the liabilities of the entity. An LLC member’s immunity was created by the Limited Liability Company Act (“LLC Act”).<sup>1</sup> Except where the LLC’s operating agreement imposes member liability, an LLC member has absolute immunity “[u]nless otherwise provided by law[.]”<sup>2</sup> That qualification raises an important question for courts considering piercing the LLC veil: By using the term “law,” did the Legislature reserve for itself, to the exclusion of the courts, the power to create exceptions to otherwise absolute member immunity?

The courts that have considered piercing the LLC veil have rarely addressed this question. Instead, they have extended to the LLC the veil-piercing criteria developed for corporations, without acknowledging the extension;<sup>3</sup> acknowledged the extension without justifying it,<sup>4</sup> or explained that equity can modify an LLC member’s immunity, without analyzing the limits of that power.<sup>5</sup>

One circuit court, however, has looked closely at the statutory provision granting immunity. It concluded that the statute does not grant courts the power to extend the veil-piercing theory to an LLC.<sup>6</sup> As this article explains, that court’s ruling was justified – courts lack the power to carve out an equitable “veil piercing” exception to what is an otherwise absolute statutory immunity.

## **A Veil-Piercing Overview**

Michigan’s courts have pierced corporate veils since the early 20<sup>th</sup> century.<sup>7</sup> There is no single test for

disregarding the corporate form.<sup>8</sup> It will be ignored where one corporation is the “mere instrumentality” of the other,<sup>9</sup> where it is intended for “an improper use such as to avoid legal obligations,”<sup>10</sup> where one corporation so dominates and controls the other that “unjust loss or injury will be suffered” unless the controlling corporation is held liable,<sup>11</sup> or where there is a “community of interest” between the corporations.<sup>12</sup> Whatever the test, piercing the veil is an exercise of the court’s equitable power.<sup>13</sup>

For generations, the veil-piercing doctrine was largely confined to the “veil” of a corporation. In the early 1990s, the Michigan Legislature, along with its counterparts in other states, created the limited liability company, which, like a corporation, shielded its owners – the LLC’s members – from personal liability for the conduct of the entity. With the quick proliferation of LLCs came their inevitable involvement in litigation. Soon Michigan’s state appellate and federal district courts started to apply the veil-piercing doctrine to LLCs.<sup>14</sup>

## **“Law” Is an Act of the Legislature**

An LLC member’s immunity from liability was created by section 501(4) of the LLC Act: “Unless otherwise provided by law or in an operating agreement, a person that is a member or manager, or both, of a limited liability company is not liable for the acts, debts, or obligations of the limited liability company.”<sup>15</sup>

Here, the Legislature clothed LLC members with immunity from liability for the acts, debts, or obligations of the company “unless otherwise provided by law[.]” If “provided by law” means a statute, the judiciary may not fashion an exception, based on a

veil-piercing theory or otherwise, to an LLC member's statutory immunity. On the other hand, if the phrase refers to a court-made exception based on equity, then the courts may pierce the LLC veil using their equitable power. The court's power to pierce the LLC veil, therefore, turns on the proper interpretation of "law."

For over 125 years, the courts have understood the term "law" as used in a statute or the constitution to refer to an act of the Legislature. The specific language appearing in Section 501(4) – "provided by law" – has been construed as "provided by the Legislature." In the state constitution, where it appears in several places, "the phrase 'provided by law' permits action by the Legislature only."<sup>16</sup> The phrase, used in a statute, has been held to have the same meaning.<sup>17</sup>

The term "law," used in other statutory phrases, has long been interpreted to mean a legislative enactment. An early case held that "penal laws of this state" referred to state statutes. The court explained: "The term 'law,' as defined by the elementary writers, emanates from the sovereignty and not from its creatures. The legislative power of the state is vested in the state legislature, and their enactments are the only instruments that can in any proper sense be called laws."<sup>18</sup>

Similarly, the phrases "state law" and "laws of this state" have been viewed as referring to actions that emanate from the Legislature.<sup>19</sup> In *Wikman v. City of Novi*<sup>20</sup>, the Court held that a statute granting the Michigan Tax Tribunal exclusive jurisdiction to review special assessments "under property tax laws" referred to "special assessments levied pursuant to statutes, municipal charters and ordinances." The term extended beyond statutes to municipal ordinances and charters only because municipalities derived their authority to levy special assessments from the Legislature: "[A]ny special assessment levied by a municipal corporation is levied under authority delegated by law from the Legislature. Therefore, such assessments are levied under the property tax laws . . ."<sup>21</sup>

These authorities suggest that "law" refers to a legislative act. So, when the Legislature said an LLC member was immune "unless otherwise provided by law,"

it meant "unless otherwise provided by the Legislature." Thus, an exception to immunity based on a veil-piercing theory may not be grafted onto the statute by the courts. Such judicial action would not be a "law" within the meaning of section 501(3) of the LLC Act.

### **Piercing the LLC Veil Encroaches on the Legislative Domain**

Interpreting "law" in Section 501(4) as a legislative act recognizes that the legislative and judicial branches of government have different functions, a division enshrined in the Michigan constitution's separation of powers clause.<sup>22</sup> The Michigan Supreme Court has explained that "[t]here is a distinction between legislative and judicial acts. The Legislature makes the law - courts apply it."<sup>23</sup> The legislative power to make law is prescriptive, looking to the future; the judicial power is descriptive, ascertaining existing rights. "To declare what the law *shall be* is legislative; to declare *what it is* or has been is judicial. . . . The legislature prescribes rules for the *future*. The judiciary ascertains *existing* rights."<sup>24</sup> The United States Supreme Court put it this way: "A judicial inquiry investigates, declares, and enforces liabilities as they stand on present or past facts and under laws supposed already to exist. . . . Legislation, on the other hand, looks to the future and changes existing conditions by making a new rule, to be applied thereafter to all or some part of those subject to its power."<sup>25</sup> Because "courts cannot make laws"<sup>26</sup>, they may not "usurp the lawmaking function of the Legislature[.]"<sup>27</sup>

When the Legislature said that an LLC member is not liable for the company's acts, debts or obligations unless otherwise "provided by law," it could only be talking about a liability to be created later by the Legislature, not determined to already exist by the courts. Before the LLC Act, there was no LLC member liability – or immunity – because there was no LLC law at all. Thus, when the Legislature conferred immunity on the LLC member with exceptions to be "provided by law," it was speaking about some "new rule" that "changes existing condi-

tions,”<sup>28</sup> that is, the existing condition of member non-liability. Fashioning new rules is what the Legislature does. It is not what the courts do. The judiciary declares “existing” rights; it determines what the law “is”. Courts do not create liability otherwise barred by statute; rather they declare “liabilities . . . under laws supposed already to exist.”<sup>29</sup>

### Equity Is Not The Solution

An LLC member’s statutory immunity cannot be overridden by equity. “Equity as a rule will follow the law[.]”<sup>30</sup> Thus, “[c]ourts of equity as well as of law, must apply legislative enactments in accord with the plain intent of the legislature.”<sup>31</sup> Equity must be restrained even if the statute is unjustly harsh. “[C]ourts must be careful not to usurp the legislative role under the guise of equity because a statutory penalty is excessively punitive.”<sup>32</sup>

There are no such concerns when equity is used to disregard the form of a corporation. Shareholder immunity is also created by statute, but that statute has an important exception. The Business Corporation Act states that, “unless otherwise provided in the articles of incorporation, a shareholder of a corporation is not personally liable for the acts or debts of the corporation except that he or she may become personally liable by reason of his or her own acts or conduct.”<sup>33</sup> Allowing shareholder liability “by reason of his or her own acts or conduct” opens the door to the veil-piercing doctrine, which is based on the shareholder’s own use – and misuse – of the corporate form. The LLC Act contains no such immunity exception based on an LLC member’s own behavior.

An LLC member’s immunity from liability was created by statute, and only the Legislature may carve out exceptions. Until the Legislature acts, courts should refrain from piercing the LLC veil.

#### ENDNOTES

1. Michigan Limited Liability Company Act, Mich. Comp. Laws §450.4101 (1993) *et seq.*
2. Mich. Comp. Laws §450.4501(4) (2010).
3. *See, e.g., RDM Holdings Ltd. v. Continental Plastics Co.*, 281 Mich. App. 678, 714-717, 762 N.W.2d 529 (2008).
4. *Travelers Indemnity Co. v. Employers Co., Inc.*, No. 04-cv-71494, 2006 U.S. Dist. Lexis 59461, \*22-23 (E.D. Mich. August 23, 2006) (“The theory of piercing the corporate veil should apply to LLCs in the same way it applies to corporations.”).
5. *See, e.g., Trinc, Inc. v. Radial Wheel, LLC*, 2009 WL 606453, \*4 (E.D. Mich., Feb. 25, 2009) (“[T]here is an exception to this rule [that LLC members are not liable for the debts or obligations of the LLC] where the owners of a corporation (or LLC) have been guilty of fraud or other inequitable conduct so as to allow a court to pierce the corporate existence[.]”) *Dietrich v. Stephens*, No. 05-cv-72113, 2010 U.S. Dist. Lexis 31464, \*17-18 (E.D. Mich., March 30, 2010) (“The corporate [i.e., LLC] veil should be pierced because no other meaningful remedy exists for Plaintiff. Ignoring a business structure is appropriate where the plaintiff has suffered an unjust loss.”).
6. *Glen Meadows Condominium Association v. Westminster & Abbey Homes*, (Genesee County Circuit Court Case No. 07-087324-CH.).
7. *See, e.g., People v. Michigan Bell Telephone Co.*, 246 Mich. 198, 204, 224 N.W. 438 (1929) (“[W]here a corporation is so organized and controlled and its affairs are so conducted as to make it a mere instrumentality or agent or adjunct of another corporation, its separate existence as a distinct corporate entity will be ignored and the two corporations will be regarded in legal contemplation as one unit.”).
8. *Foodland Distributors v. Al-Naimi*, 220 Mich. App. 453, 456, 559 N.W.2d 379 (1996) (“There is no single rule delineating when the corporate entity may be disregarded.”).
9. *People v. Michigan Bell Telephone Co.*, 269 Mich. at 204.
10. *CMS Energy v. Attorney General*, 190 Mich. App. 220, 232, 475 N.W.2d 451 (1991).
11. *Gledhill v. Fisher & Co.*, 272 Mich. 353, 357-358, 262 N.W. 371 (1935).

12. *LA Walden & Co. v. Consolidated Underwriters*, 316 Mich. 341, 346, 25 N.W.2d 248 (1946). See also *Williams v. American Title Co.*, 83 Mich. App. 686, 698, 269 N.W.2d 481 (1978)(“complete identity of interest”), *Allstate Ins. Co. v. Citizens Ins. Co. of America*, 118 Mich. App. 594, 600, 325 N.W.2d 505 (1982)(“unity of interest”).
13. *United Armenian Brethren Evangelical Church v. Kazanjian*, 322 Mich. 651, 658, 34 N.W.2d 510 (1948) (“[E]quity will look through and behind the legal entity of corporate existence whenever necessary to prevent injustice or right a wrong.”).
14. See, e.g., *Brentwood Golf Club, LLC v. Brentwood Tavern, LLC*, 329 B.R. 802 (Bankr. E.D. Mich. 2005), *New Era Enterprises, Inc. v. Edward Kacos*, No. 03-cv-873, 2006 U.S. Dist. Lexis 24370 (W.D. Mich. March 24, 2006), *Theresita Dietrich v. Stephens*, No. 05-cv-72113, 2010 U.S. Dist. Lexis 31464 (E.D. Mich. March 10, 2006), *TCF National Bank v. Adobe Liquidations, LLC*, No. 286335, 2009 WL 4143818 (Mich. App., November 24, 2009), *RDM Holdings, Ltd.*, 281 Mich. App. 678, 762 N.W. 2d 529 (2008).
15. Mich. Comp. Laws §450.4501(4).
16. *People v. Bulger*, 462 Mich. 495, 510, 614 N.W.2d 103 (2000).
17. *Michigan Humane Society v. National Resources Commission*, 158 Mich. App. 393, 403, 404 N.W.2d 757 (1987)(“The apparent limitation of the NRC’s control over open seasons to those ‘provided by law’, that is, by the Legislature, suggests the omission of further authority [to establish open seasons] was intentional.”).
18. *Fennell v. Common Council of Bay City*, 36 Mich. 186, 190 (1887). See also *Delta County v. City of Gladstone*, 305 Mich. 50, 53-54, 8 N.W.2d 908 (1943), *People v. Crucible Steel Co. of America*, 151 Mich. 618, 621, 115 N.W. 705 (1908).
19. See *Durant v. State Board of Education*, 424 Mich. 364, 387, 381 N.W.2d 662 (1985)(“the term ‘state law’ as used in Const 1963, art 9, §29 means state statutes and agency rules.”), *Lobaido v. Dept of Corrections*, 37 Mich. App. 171, 173-174, 194 N.W.2d 444 (1971)(state statute applied only to a conviction “of ‘a felony or misdemeanor under the laws of this state.’ This phrase refers only to violations of state statutes[.]”).
20. *Wikman v. City of Novi*, 413 Mich. 617, 637, 322 N.W.2d 103 (1982).
21. *Wikman*, 413 Mich. at 636.
22. Mich. Const. art. 3, §2.
23. *In re Manufacturer’s Freight Forwarding Co.*, 294 Mich. 57, 63, 292 N.W. 678 (1940) quoting *In re Application of Consolidated Freight Co.*, 265 Mich. 340, 343, 251 N.W. 431 (1933). See also *People v. Piasecki*, 333 Mich. 122, 145, 52 N.W.2d 626 (1952)(“Under our system of state government, the Legislature makes the law, the governor executes it, and the courts construe and enforce it.”), *Sutherland v. Governor*, 29 Mich. 320, 324 (1874)(“Our government is one whose powers have been carefully apportioned between three distinct departments . . . . One makes the laws, another applies the laws in contested cases, while the third must see that the laws are executed.”).
24. *In re Manufacturer’s Freight Forwarding Co.*, 294 Mich. at 63 quoting *In re Application of Consolidated Freight Co.*, 265 Mich. at 343 (emphasis added.).
25. *Prentis v. Atlantic Coast Line Co.*, 211 U.S. 210, 226 (1908). See also *Johnson v. Kramer Bros. Freight Lines, Inc.*, 357 Mich. 254, 258, 98 N.W.2d 586 (1959)(“The primary functions of the judiciary are to declare *what the law is* and to determine the rights of the parties conformably thereto.”)(quoting 16 C.J.S. Constitutional Law §144, p. 687)(emphasis added.).
26. *People v. Detroit, GH&M Ry Co.*, 228 Mich. 596, 612, 200 N.W. 536 (1924).
27. *Lakehead Pipe Line Co. v. Dehn*, 340 Mich. 25, 35, 64 N.W.2d 903 (1954).
28. *Prentis*, 211 U.S. at 226.
29. *Id.*
30. *Daley v. City of Melvindale*, 271 Mich. 431, 436, 260 N.W. 898 (1935).
31. *City of Lansing v. Twp. of Lansing*, 356 Mich. 641, 650, 97 N.W.2d 804 (1959).
32. *Stokes v. Millen Roofing Co.*, 466 Mich. 660, 671, 649 N.W.2d 371 (2002).
33. Mich. Comp. Laws §450.1317(4).

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