



NRAI WHITEPAPER

Protecting Your Legal Entity Status

Corporate Governance Policies Shield Your Company from Losing
Essential Legal Protections



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Since the inception of corporation statuses more than 125 years ago, business owners have sought asset protection according to applicable state laws via legal entities such as “C” Corporations, “S” Corporations, Limited Liability Corporations (LLC), or Limited Liability Partnerships (LLP).

Legal entities exist to shield the personal assets of the owners/shareholders from personal liability for the debts or actions of the corporation. Each type of legal entity features its own array of benefits and protections based on their governing statutes and case law. The type of entity designation is often based on the business, tax, and asset objectives of the founding owner(s).

The Importance of Corporate Governance

Corporate Governance is the set of processes, customs, policies, laws, and institutions affecting the way a corporation (or company) is directed, administered or controlled. Corporate governance also includes the relationships among the stakeholders and the goals for which the corporation is governed. The principal stakeholders are the shareholders, the board of directors, employees, customers, creditors, suppliers, and the community at large.

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To maintain its legal benefits and protections, the most common Corporate Governance policies and procedures require a company to:

- Adopt corporate bylaws
- Maintain corporate records and minute books
- Conduct business under a company name
- Open and maintain a corporate bank account separate from individual bank accounts
- Maintain an arm’s-length relationship with related entities (no comingling of owner and business assets)
- Schedule and conduct regularly scheduled board of director and shareholder meetings
- Document board of director and shareholder votes
- Maintain sufficient business capitalization

Courts Can Strip Companies of Their Legal Entity Protections

When business owners/shareholders do not adhere to **Corporate Governance** processes, they leave themselves open to the possibility of losing their legal entity protections. It's called "**piercing the corporate veil**," and it's the judicial term coined for the doctrine of taking away the personal liability and asset protection features provided by the company's legal entity, thereby making the owners/shareholders liable for the corporation's actions and debts.

Piercing the corporate veil means that a company loses the personal liability and asset protection granted by an entity type, such as a Limited Liability Company. If this happens, the owners and shareholders become liable for the company's actions and debts.

When a court looks to determine whether a company's corporate veil should be pierced, not all of previously listed Corporate Governance policies and procedures need be practiced. However, some courts may find that neglecting even one of the items is sufficient grounds to find owners/shareholders liable. See *Piercing the Corporate Veil, TechInsurance Small Business Center*, June 25, 2010 by John Alsterada and Christine Polk.

In another example, *The Stone v. Frederick Hobby Associates, II, LLC*, 2001 Conn. Super. LEXIS 1853, Superior Court docket no. CV000181620S (July 10, 2001), the court found that "instrumentality and identity rules" could be applied to pierce the corporate veil of an LLC and hold individuals personally liable. See also *Piercing the Corporate Veil of a Limited Liability Company* by John C. Murray, First American Title.

Piercing the Corporate Veil: An Empirical Study

Corporate veil piercing is the most litigated issue in U.S. corporate law and most often applies in cases of fraud, inadequate capitalization, failure to adhere to corporate formalities, and/or abuse of the corporate entity that results in complete dominance by shareholders.

As found by Robert B. Thompson, the author of *Piercing the Corporate Veil: An Empirical Study*, Cornell Law Review 76: 1036 – 1074, when legal action is sought to pierce a company's corporate veil, the burden falls on the plaintiff to prove the company did not adhere to corporate governance policies, or the corporation formation was a sham.

The study indicated:

- Courts pierced the corporate veil in about **40% of reported cases**
- There were **no significant differences between state and federal court rulings**
- Courts were **more willing to pierce the corporate veil in contract rather than tort cases**
- Piercing the veil **occurred most often in private corporations and in groups of 10 or less shareholders**
- **Smaller companies are at increased risk of corporate veil piercing because they are less likely to have Corporate Governance procedures in place**

Company Guard[®] – the Corporate Compliance and Governance Solution for Small Business

Company Guard is our proprietary, secure web-based platform that helps reduce risk and **keep entities in compliance**. It provides real-time alerts around key corporate compliance events such as annual report filings and other important tax notifications.

It also provides the tools necessary to efficiently manage all aspects of **corporate governance** and **records management**.

As the findings in this paper prove, Corporate Governance processes are critical to the legal protections afforded to a company. Whether you're a business owner or a shareholder, you should review your current Corporate Governance policies and ensure they are adhered to and up-to-date. Being on the wrong side of a contract dispute could endanger your corporate status and leave shareholders responsible for all corporate liabilities.

For more information on Corporate Governance, call **1-800-550-6724** today.

About NRAI

National Registered Agents, Inc. ("NRAI") offers local and personalized service through experienced professionals with the global strength of an industry leading corporate and legal services provider. Founded in 1995 by industry veterans on the conviction that a registered agent should deliver exceptional service and innovative technology at a reasonable price, NRAI has experienced unrivaled market growth. NRAI delivers services that transform the registered agent into a trusted business partner, services that include corporate governance and compliance solutions, corporate transactional and due diligence services, and risk management solutions. By focusing on the client rather than the bottom line and disinterested shareholders, NRAI has become the trusted partner of thousands of companies and law firms of all sizes across the United States and around the world.