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## OLR Bill Analysis

sHB 7340 (as amended by House "A")\*

***AN ACT CONCERNING THE USE OF VEIL PIERCING TO DETERMINE THE PERSONAL RESPONSIBILITY OF AN INTEREST HOLDER OF A DOMESTIC ENTITY FOR THE DEBTS, OBLIGATIONS OR OTHER LIABILITIES OF SUCH ENTITY AND THE RESPONSIBILITY OF A DOMESTIC ENTITY FOR THE DEBTS, OBLIGATIONS OR OTHER LIABILITIES OF AN INTEREST HOLDER OF SUCH ENTITY.***

### SUMMARY

“Veil piercing” is a common law doctrine that allows a court to impose personal liability on interest holders of an entity (e.g., a corporation) for the entity’s actions.

This bill sets specific limits on when a veil piercing claim can override statutory limitations on a domestic entity interest holder’s liability in connection with the entity’s transactions. In doing so, the bill generally codifies the “instrumentality test,” one of two methods Connecticut courts currently use to determine whether to grant a veil-piercing claim.

Under the bill, a court can override statutory limitations on an interest holder’s liability for an entity’s debt, obligation, or other liability only if the court makes certain findings. These findings include, among other things, that the interest holder used his or her domination or control over the entity to commit fraud or another violation of the law or his or her duties, which proximately caused injury or loss to the claimant. The statutory limitations above include laws that generally provide corporate shareholders and limited liability company (LLC) members and managers with immunity from liability for the corporation’s or LLC’s actions, respectively.

Under the bill, the court must make a decision on a veil piercing claim regarding statutory limitations on liability in accordance with

the bill's provisions.

The bill also specifies that a domestic entity's failure to observe formalities relating to exercising its powers or managing its activities and affairs is not grounds to impose personal liability on an interest holder for the entity's debt, obligation, or other liability based on a veil piercing claim.

The bill additionally prohibits "reverse veil piercing," in which a domestic entity is held responsible for an interest holder's debt, obligation, or other liability.

\*House Amendment "A" lowers the evidentiary standard, from clear and convincing evidence to a preponderance of the evidence, that must be met for the court to find that a statutory limitation on interest holder liability may be disregarded on the basis of a veil piercing claim (see BACKGROUND).

EFFECTIVE DATE: Upon passage and applicable to civil actions filed on or after that date.

### **ENTITIES, AFFILIATES, AND INTEREST HOLDERS**

Under the bill, an "entity" is:

1. a business or nonstock corporation;
2. a limited partnership, including a limited liability limited partnership;
3. an LLC or limited liability partnership; or
4. any other person that (a) has a separate legal existence and (b) is subject to the law's provisions that grant its interest holders immunity from personal liability for its debt, obligation, or other liability solely for being or acting as an interest holder.

An "affiliate" means, with respect to a specified person, any other person directly or indirectly controlling, controlled by, or under common control with that person.

An “interest holder” is the direct holder of a (1) governance interest in an unincorporated entity, (2) a transferable interest in an unincorporated entity, or (3) a share or membership in a corporation.

### **COURT FINDINGS**

Under the bill, in order to find that a statutory limitation on interest holder liability may be disregarded on the basis of a veil piercing claim as described above, the court must find by a preponderance of the evidence the following:

1. the interest holder exerted complete domination and control over the entity’s management, finances, policies, and activities with respect to the transaction;
2. the interest holder used the domination and control to (a) commit fraud or other intentional wrong-doing against the person asserting the veil piercing claim, (b) intentionally violate a statutory or common law duty to that person, or (c) commit a deceitful or other unlawful act against that person; and
3. the domination and control and the breach of duty or other act proximately caused injury or loss to the person asserting the veil piercing claim.

Under the bill, the person seeking to hold the interest holder responsible for the domestic entity’s liabilities has the burden of proof.

### **CONSIDERATIONS**

When making the above determination, the court must consider certain factors, including whether:

1. the entity was adequately capitalized;
2. the entity distributed or otherwise transferred assets to the interest holder without any lawful business purpose;
3. there were overlapping interest holders, governors, or other management personnel between the entity and the interest holder;

4. the interest holder shared office spaces, addresses, and telephone numbers with the entity without paying fair consideration;
5. transactions involving the entity and the interest holder were at arm's length and for fair consideration;
6. the entity's funds were commingled with the interest holder's funds;
7. the entity was treated as a separate legal entity for financial and other business purposes as evidenced by having its own contractual relationships, bank accounts, account books, and financial statements;
8. the entity was insolvent or rendered insolvent by the interest holder's acts; and
9. the interest holder used the entity's property without paying fair consideration.

These provisions also apply to such actions involving the interest holder's affiliates.

## **BACKGROUND**

### ***Evidentiary Standard***

A "preponderance of the evidence" means that it is more likely than not that the facts asserted are true. It is the burden of proof in most civil trials. "Clear and convincing" means that it is highly probable or reasonably certain that the facts asserted are true. Clear and convincing is a greater burden of proof than a preponderance of the evidence, but less than evidence "beyond a reasonable doubt," which is the standard in criminal trials (Black's Law Dictionary, 10<sup>th</sup> ed.).

## **COMMITTEE ACTION**

Judiciary Committee

Joint Favorable Substitute

Yea 38 Nay 0 (04/08/2019)