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ASSET PROTECTION

GreenHunter Energy, Inc.: The Rare Case When the Limited Liability Veil will be Pierced in Wyoming (And Probably in Every Other Jurisdiction)

WYOMING IS HOME TO SOME OF LIFE'S FINER PLEASURES... SKI SLOPES DUSTED WITH CHAMPAGNE POWDER, NATIONALLY RECOGNIZED FLY FISHING RIVERS, AND THE ENACTMENT OF THE FIRST LIMITED LIABILITY COMPANY STATUTE. RECENTLY THE LIMITED LIABILITY PROTECTION AFFORDED TO MEMBERS PURSUANT TO THE 2010 WYOMING LIMITED LIABILITY COMPANY ACT WAS CHALLENGED. ON NOVEMBER 7, 2014, THE WYOMING SUPREME COURT PIERCED THE LIMITED LIABILITY VEIL AND HELD THE SINGLE MEMBER LIABLE FOR THE JUDGMENTS PREVIOUSLY ENTERED AGAINST THE LLC IN GREENHUNTER ENERGY, INC. V. WESTERN ECOSYSTEMS TECHNOLOGY, INC., 337 P.3D 454 (WYO. 2014). WHILE THE COURT ULTIMATELY PIERCED THE LIMITED LIABILITY VEIL IN GREENHUNTER, WYOMING REMAINS A FRONTRUNNER JURISDICTION WHEN SELECTING THE VENUE IN WHICH TO FORM A LIMITED LIABILITY COMPANY. FURTHERMORE, GREENHUNTER PROVIDES PRACTITIONERS WITH EXCELLENT PLANNING OPPORTUNITIES TO CREATE ONGOING RELATIONSHIPS WITH THEIR BUSINESS CLIENTS AND THE RESPECTIVE ADVISORS.



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BRIEF OVERVIEW

In 2009, GreenHunter Wind Energy, LLC ("GreenHunter LLC") entered into a contract with Western Ecosystems Technology ("Western") for consulting services concerning the potential development of a wind turbine farm in Platte County, Wyoming. Between March of 2009 and July of 2010, Western performed the requested services pursuant to the terms of the contract and billed GreenHunter LLC \$43,646.10 for those services. GreenHunter LLC never made any payments toward the outstanding balance, so Western pursued legal action. The trial court entered judgment against GreenHunter LLC in the amount of \$43,646.10 for the unpaid bill plus \$2,161.84 for attorney's fees incurred by Western in its effort to compel discovery. Western quickly realized that GreenHunter LLC had no assets with which to pay the judgments. Accordingly, Western sought to pierce GreenHunter LLC's limited liability veil and hold GreenHunter Energy Inc. ("Member"), the sole member of GreenHunter LLC, liable for the amount of the judgment and discovery sanctions. The trial court found in favor of Western and the Wyoming Supreme Court affirmed its decision.

VEIL PIERCING

The protections from liability offered to shareholders/members by corporations and limited liability companies are routinely scrutinized by courts across the country. In the matter of GreenHunter Energy, Inc., the Court repeatedly stated in incontrovertible terms that "limited liability is the rule, and piercing is the rare exception to be applied only in cases involving excep-

tional circumstances," that are determined on a case-by-case basis. *Id.* at 465. The court in *GreenHunter* outlined a two-prong test and the respective factors that will be considered when determining whether or not to pierce the limited liability veil. According to the *GreenHunter* Court:

The veil of a limited liability company may be pierced under exceptional circumstances when: 1) the limited liability company is not only owned, influenced and governed by its members, but the required separateness has ceased to exist due to misuse of the limited liability company; and 2) the facts are such that an adherence to the fiction of its separate existence would, under the particular circumstances, lead to injustice, fundamental unfairness, or inequity.

Id. at 462. The court further found that the two-prong test is fact driven and "focuses on whether the limited liability company has been operated as a separate entity as contemplated by statute, or whether the member has instead misused the entity in an inequitable manner to injure the plaintiff." *Id.* at 463.

Furthermore, it should be noted that the Wyoming Limited Liability Company Act provides limitations on a court's ability to pierce the limited liability veil. According to Wyo. Stat. Ann. § 17-29-304 (2010):

(a) The debts, obligations or other liabilities of a limited liability company, whether arising in contract, tort or otherwise:

(i) Are solely the debts, obligations or other liabilities of the company; and

(ii) Do not become the debts, obligations or

other liabilities of a member or manager solely by reason of the member acting as a member or manager acting as a manager.

(b) The failure of a limited liability company to observe any particular formalities relating to the exercise of its powers or management of its activities is not a ground for imposing liability on the members or managers for the debts, obligations or other liabilities of the company.

The court in *GreenHunter* analyzed several factors that may be applied when determining whether both prongs of the veil piercing test have been satisfied. Three factors analyzed by the court include inadequate capitalization, intermingling of business and finances, and fraud (actual and constructive).

FACTOR NO. 1:

INADEQUATE CAPITALIZATION

A court may consider evidence of inadequate capitalization because basic business practices and “societal policy” dictate that when a limited liability company incurs potential expenses, the company attempts to arrange for capital remuneration of its financial obligations. When

determining whether a company is undercapitalized, a court will “compare the amount of capital to the amount of business to be conducted and the obligations which must be satisfied.” *Id.* at 463.

The court in *GreenHunter* conspicuously failed to create a bright line rule regarding the amount of business a company must conduct in relation to its financial obligations, to avoid being deemed undercapitalized. The Court did recognize, however, that undercapitalization alone is insufficient to pierce the limited liability veil because “some businesses need a great deal of capital, others need very little, and of course there are the in-betweens.” *Id.* at 463 – 64.

In *GreenHunter*, the court found that undercapitalization was a proper factor to consider, in the totality of circumstances, when determining whether or not

to pierce GreenHunter LLC’s limited liability veil. The court based its finding on the following facts:

On June 8, 2009, Western submitted its first invoice to GreenHunter LLC in the amount of \$5,022.85, for services provided. Beginning in June 2009 through the end of July 2009, Member transferred approximately \$16,500 to GreenHunter LLC’s operating account to pay some of the financial obligations owed by GreenHunter LLC. However, GreenHunter LLC did not pay any part of Western’s invoice.

On August 31, 2009, when Western submitted a second invoice for services rendered in the amount of \$14,916.51, GreenHunter LLC had \$0.00 in its operating account. During September of 2009, Member transferred \$2,397.79 to GreenHunter LLC’s operating account to pay some of GreenHunter LLC’s financial obligations. Yet again, GreenHunter LLC did not pay any part of Western’s invoice.

On November 6, 2009, Western submitted its third invoice in the amount of \$7,175.82. On November 23, 2009, Member transferred \$4,978.86 to GreenHunter LLC’s operating account to pay some of the financial obligations owed by GreenHunter LLC. Once again, GreenHunter LLC did not pay any part of Western’s invoice.

Credulously, Western continued to provide consulting services under the terms of the contract with GreenHunter LLC. From December of 2009 through July of 2010, Western submitted four additional invoices totaling \$10,740.37. During that time, Member transferred funds to GreenHunter LLC’s operating account to pay some of the financial obligations owed by GreenHunter LLC. Predictably, GreenHunter LLC did not pay any amount owed to Western.

The Court also noted that GreenHunter LLC often carried a \$0.00 balance in its operating account prior to receiving the monetary transfer from Member and immediately thereafter. The court was sensitive to the fact that “start-up companies, new business ventures, and early stage companies sometimes may not have initial capital or income sufficient to cover their expenses, and that they do in fact require periodic capital infusions from members to meet their financial obligations.” *Id.* at 466. The court, however, was unwilling to accept this premise for GreenHunter LLC because Member continuously manipulated Green-

Hunter LLC’s operating account to ensure it would remain undercapitalized and serve as a judgment-proof shell.

FACTOR NO. 2:

INTERMINGLING OF BUSINESS AND FINANCES

When considering whether GreenHunter LLC and Member intermingled their businesses and finances, the Court noted that GreenHunter LLC and the Member did in fact maintain separate accounting and business records. The Court did not end its analysis there when considering this factor in the context of piercing the limited li-

ability veil. The specific facts that the Court found to be persuasive that GreenHunter LLC and Member intermingled their businesses and finances included:

The overlap between GreenHunter LLC’s and Member’s ownership and management was considerable and difficult to understand where one entity ended and the other began. Member and GreenHunter LLC used Member’s accounting department and that the same accountants managed the finances of both entities.

The entities used the same business address and creditors of GreenHunter LLC mailed their invoices to Member’s address for processing.

GreenHunter LLC consolidated its tax returns with the tax returns of Member.

GreenHunter LLC did not have any employees who were independent of Member; rather, all of GreenHunter LLC’s functions were carried out by employees of Member. Employees of Member negotiated and entered into contracts on behalf of GreenHunter LLC, and these same individuals decided which of GreenHunter LLC’s creditors to pay through contributions from Member.

Member assigned its own employees to perform work of GreenHunter LLC, and although Member “charged” GreenHunter LLC for the labor performed by Member’s personnel, Member directly paid its employees for that work.

GreenHunter LLC had no source of revenue aside from the contributions received from Member.

The funds were commingled in the sense that GreenHunter LLC’s bills that Member wanted paid were settled with Member’s funds which were “passed through” to GreenHunter LLC by periodic transfers. A particular bill was paid only if and when Member decided to transfer funds to pay it.

GreenHunter LLC entered into an agreement with Western to procure services for the purpose of supporting and benefitting Member’s business. Member claimed a deduction in the amount of \$884,092.00 attributable to the Platte County wind energy project and a loss on its corporate tax return in the amount of \$61,047.00 attributable to the same project on its 2009 tax return. Member manipulated the assets and liabilities in a manner such that Member improperly reaped all of the rewards and benefits of GreenHunter LLC’s activities, while simultaneously saddling GreenHunter LLC with all of the liabilities, including the unpaid bills for services rendered by Western. Member had enjoyed significant tax breaks attributable to GreenHunter LLC’s losses, without bearing any responsibility for GreenHunter LLC’s debt and obligations that contributed to such losses. Such a disparity in the risks and rewards resulting from this manipulation would lead to injustice.

Id. at 467.

The Court tempered its findings by acknowledging that a single-member limited liability company may properly be taxed as a disregarded entity. The Court specifically decided not to create a scenario “in which a single-member limited liability company would be confronted with a catch 22: either follow federal tax law and risk losing limited liability, or forego advantages available under federal tax law to assure limited liability.” *Id.* at 468. Accordingly, the Court considered the tax filings because Member directed the benefits from GreenHunter LLC’s wind farm project to itself, while deciding which debts associated with the project would not be paid, while attributing responsibility for those decisions and debts to GreenHunter LLC.

The Court further extenuated its holdings by acknowledging that a single-member limited liability company is permitted pursuant to the express language of

Wyoming's Limited Liability Company Act. Moreover the Court reasoned that a single-member limited liability company is likely to use the member's home address as its business address, and the single-member will likely manage the company's finances, as well as conduct business and negotiate contracts on behalf of the company. The Court was mindful of the fact that single-member limited liability companies are not only valid in Wyoming but also appropriate when created to engage in legitimate business purposes.

FACTOR NO. 3:

FRAUD

Finally, the Court recognized that fraud, both actual and constructive, is sufficient to pierce the limited liability company's veil, but not a necessary prerequisite. Furthermore, fraud is the only factor that may stand

alone to justify a decision to disregard the veil of limited liability because "[i]t is in the public interest to disregard the legal fiction of a separate entity, whether that be a corporation or LLC, when those benefiting from that fiction commit fraudulent conduct." *Id.* at 469. In the *GreenHunter* matter, the Court found that Western did not specifically allege fraud against Member. In Wyoming, a party must assert allegations of fraud with particularity and prove the existence thereof by clear and convincing evidence.

ASSET PROTECTION

Wyoming continues to serve businesses, single member or publicly traded, with innovative limited liability protection. Just a few examples of the progressive provisions that practitioners may utilize, under the Wyoming's Limited Liability Company Act, include: 1. Increased privacy concerning the names of members and managers and their respective capital contributions; 2. Increased flexibility when operating and managing the company; 3. Allowing the enforcement of oral operating agreements; 4. Certain fiduciary duties of the members and managers may be waived;

5. A creditor's sole remedy against an limited liability company is the charging order; 6. A dissociating member only retains a non-voting economic interest and is unable to participate in management or obtain information; and 7. "[A] member is not an agent solely by reason of being a member." Wyo. Stat. Ann. § 17-29-301.

Like all jurisdictions, Wyoming is intolerant of companies that serve as judgment-proof shells and is unwilling to allow injustice to prevail. Notwithstanding *GreenHunter* LLC's blatant disregard for basic business practices, the Court struggled with piercing its limited liability veil and stated that its decision was a "close call." While any other decision by the Court in *GreenHunter* would have been an affront to justice, certain facts considered by the Court when piercing the limited liability veil cause us discomfort as practitioners. Nevertheless, the *GreenHunter* Court has created an excellent opportunity for us to alleviate the trepidation of the potential veil piercing scenarios our clients may face. (Yet another reason we are set apart from LegalZoom and its "online legal solution.") While we all initially counsel our business clients not to commingle assets, to avoid defrauding creditors, and to ensure the company exists for a legitimate business purpose, it is now prudent for attorneys to encourage their clients to participate in subsequent meetings with their advisors to discuss their normal course of business and receive advice on best practices.

About the Author

A Wyoming native, Marty L. Oblasser attended the University of Wyoming to obtain both her undergraduate and juris doctor degrees. Marty began her career as an associate attorney in the Legacy Planning Department with a law firm in Casper, Wyoming. During that time, she not only focused on building an estate planning and business law practice but she also engaged in trust litigation matters and successfully argued to the Wyoming Supreme Court. Marty is a partner with Wyoming's oldest law firm, Corthell and King, P.C. and is licensed to practice law in the State of Wyoming as well as the United States District Court for the District of Wyoming.

Marty enjoys educating the public about various estate planning and business law matters as well as teaching legal seminars for her local community and presenting continuing legal education courses to her peers for the Wyoming State Bar and the National Business Institute.

Marty, her husband, Erik, and their two dogs reside in Laramie, Wyoming. 