

Tips for Enforcement of Judgments

PIERCING VEILS, CHASING MEMBERS, CHARGING ORDERS AND BLOOD FROM TURNIPS

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Entities are created for many purposes but the first which comes to mind is always the limitation of liability. The “veil” protecting the individuals owning or operating these entities from the creditors of the entity is just as often used as a device to shield assets from creditors of the individual members inside the veil of the LLC.

I. THE HISTORY OF THE LLC

1. *DELECTUS PERSONAE*

“The selection of a person satisfactory to oneself for a position as a partner involving trust and confidence in the other’s character, capacities or responsibility.”

Merriam-Webster

The history of the LLC has its roots all the way back in 1914 when the Conference Commissioners on Uniform State Laws (the “Commissioners”) approved the Uniform Partnership Act (“UPA”). UPA was largely the result of the undesirable process in which a creditor would obtain a judgment against a debtor-partner and then attempt to satisfy the judgment with the partner’s interest in partnership assets. This process was problematic because the creditor could satisfy the judgment by having the sheriff seize the partnership assets, sell the debtor-partner’s interest in those assets, and thereby indirectly cause the “compulsory dissolution and winding up” of the partnership.

Such a result seemed hardly an equitable one for the “innocent” partners who had managed to keep their personal financial affairs from interfering with their partnership activities. Furthermore, the ability of a creditor to step into the shoes of a debtor-partner and cause the dissolution of the partnership essentially granted any such creditor unintended managerial rights and control over the partnership entity. In theory, a creditor could refrain from dissolving and winding-up the partnership and, instead, compel the remaining partners to participate in an involuntary ongoing partnership with him. The resulting entity would be a forced partnership, the very notion of which is at odds with the principle of *delectus personae*. *Delectus personae* is the idea that partnerships, as well as LLCs, “are at their core . . . relationships of trust between partners” and that “when personal relationships are important, a person cannot be compelled to associate with another person.”

To prevent creditors from compelling the dissolution of a partnership, UPA limited creditors’ remedies to the charging order. UPA specifically states that “partnership property is not subject to attachment or execution.” UPA further states that upon application to a competent court, the court “may charge the interest of the debtor partner with payment of the unsatisfied amount of such judgment debt with the interest thereon.” The Court can then “appoint a receiver” for the partner-debtor’s share of the profits “and any other money due” to the partner so that the debtor-partner’s share of any distributions of such profits or money would go towards satisfying the partner’s unpaid debt. Thus, UPA eliminated the possibility that a creditor could

cause the involuntary dissolution of a partnership by limiting the remedies available to that of the debtor's interest in the partnership's distribution of profits rather than allowing the creditor to usurp the debtor's position as a partner.

2. THE ULLCA

The Uniform Limited Liability Company Act ("ULLCA") was conceived in 1992 and first adopted by the Conference in 1994. By that time, nearly every state, including Illinois, had adopted an LLC statute, and those statutes varied considerably in both form and substance. Many of those early statutes were based on the first version of the ABA Model Prototype LLC Act.

ULLCA's drafting relied substantially on the then recently adopted Revised Uniform Partnership Act ("RUPA"), and this reliance was especially heavy with regard to member-managed LLCs. ULLCA's provisions for manager-managed LLCs comprised an amalgam fashioned from the 1985 Revised Uniform Limited Partnership Act ("RULPA") and the Model Business Corporation Act ("MBCA"). ULLCA's provisions were also significantly influenced by the then-applicable federal tax classification regulations, which classified an unincorporated organization as a corporation if the organization more nearly resembled a corporation than a partnership. Those same regulations also made the tax classification of single-member LLCs problematic.

Much has changed. All states and the District of Columbia have adopted LLC statutes, and many LLC statutes have been substantially amended several times. LLC filings are significant in every U.S. jurisdiction, and in many states new LLC filings approach or even outnumber new corporate filings on an annual basis. Manager-managed LLCs have become a significant factor in non-publicly traded capital markets, and increasing numbers of states provide for mergers and conversions involving LLCs and other unincorporated entities.

In 1997 the tax classification context changed radically, when the IRS' "check-the-box" regulations became effective. Under these regulations, an "unincorporated" business entity is taxed either as a partnership or disregarded entity (depending upon the number of owners) unless it elects to be taxed as a corporation. Exceptions exist (e.g., entities whose interests are publicly traded), but, in general, tax classification concerns no longer constrain the structure of LLCs and the content of LLC statutes. Single-member LLCs, once suspect because of novel and uncertain tax status, are now popular both for sole proprietorships and as corporate subsidiaries.

In 1995 the Conference amended RUPA to add "full-shield" LLP provisions, and today every state has some form of LLP legislation (either through a RUPA adoption or shield-related revisions to a UPA-based statute). While some states still provide only a "partial shield" for LLPs, many states have adopted "full shield" LLP provisions. In full-shield jurisdictions, LLPs and member-managed LLCs offer entrepreneurs very similar attributes and, in the case of professional service organizations, LLPs may dominate the field.

ULLCA was revised in 1996 in anticipation of the "check-the-box" regulations and has been adopted in a number of states, including Illinois. In many non-ULLCA states, the LLC

statute includes RUPA-like provisions. However, state LLC laws are far from uniform. Further uniform amendments were promulgated in 2006 and 2013.

3. THE ILLINOIS LLC ACT

Illinois' original Limited Liability Company Act was approved September 11, 1992, PA 87-1062, effective 1994. It later adopted the Uniform Limited Liability Company Act, effective January 1, 1998. Most recently it adopted most of the Revised Uniform Limited Liability Company Act, a 112-page bill (HB 4361) P.A. 99-637 effective July 1, 2017. While the recent amendments materially change many aspects of LLCs, the section titled "Liability of members and managers," 805 ILCS 180/10-10 remain unchanged.

The 1998 Act change to Section 10-10 and 35-7 was construed to eliminate all individual liability of a member for entity debts after the LLC was dissolved purely by virtue of the dissolution. See *Puleo v. Topel*, 368 Ill.App.3d 63, 856 N.E.2d 1152, 306 Ill.Dec. 57 (1st Dist. 2006).

In *Puleo*, the trial court ruled that 10-10(a) of the Limited Liability Company Act controlled and that a member of an LLC could not be liable for debts incurred after an involuntary dissolution. Plaintiffs appealed and Defendant Topel filed no brief.

The Court first noted that corporations were treated different from LLCs, because case law held that since under the Illinois Business Corporation Act an officer or director has no authority to exercise corporation powers after a dissolution, there is personal liability for debts incurred on behalf of the corporation after its dissolution.

In the *Puleo* decision – Philip Puleo and other defendants sued Thinktank LLC, an Illinois Company in Dissolution, and Michael Topel, d/b/a Thinktank LLC. Thinktank was involuntarily dissolved by the Secretary of State on May 30, 2002. In December of 2002, the Plaintiffs filed a complaint for breach of contract, unjust enrichment and account stated.

In August 2002, the sole member/manager had informed Plaintiffs he was ceasing operations.

Topel, the sole member of Thinktank, LLC, answered the complaint. Plaintiffs filed a Motion for Summary Judgment which was denied as to Mr. Topel. *Illinois Bar Journal* articles criticized the decision (March 2008) as simply wrong and argued for a legislative fix (September 2011).

Since the *Puleo* decision, most courts have adopted or distinguished its ruling, depending on the facts and the theory plead by the plaintiff.

In *Westmeyer v. Flynn*, 382 Ill.App.3d 952, 889 N.E.2d 671, 321 Ill.Dec. 406 (1st Dist. 2008), the Court held *Puleo* does not prevent all veil piercing, only actions based on failure to observe corporate formalities.

A year after *Westmeyer*, Federal District Judge Guzman in Chicago in *Aqua Thick, Inc. v. Wild Flavors*, 2009 WL 454469 (N.Dis.Ill. 2009), dismissed a complaint by an Iowa corporation against the sole member of an LLC. However, in *Aqua Thick*, the defendant LLC had not been dissolved. Instead, the plaintiff argued that a member who participates in a tortious act (in this case negligence), was just as liable as a corporate officer who participated in a corporation's tortious act. Judge Guzman cited by *Puleo* and Section 10-10 of the LLC Act. However, it was critical in *Aqua Thick* that the pleadings did not allege that the member personally committed the tortious acts.

Puleo was even extended to a situation where an individual purporting to act as a member of an LLC signed an agreement before the LLC was formed. In *Carollo v. Irwin*, 959 N.E.2d 77, 355 Ill.Dec. 49 (1st Dist. 2011), the court wrote: "There is an important statutory distinction between LLCs and corporations that provides members or managers of unformed LLCs with more protection from personal liabilities than officers of corporations," citing Section 3.20 of the Business Corporation Act and comparing it to 10-10 of the Limited Liability Company Act.

Here is the key provision in the LLC Act protecting members:

(805) ILCS 180/10-10)

Sec. 10-10. Liability of members and managers.

(a) Except as otherwise provided in subsection (d) of this Section, the debts, obligations, and liabilities of a limited liability company, whether arising in contract, tort, or otherwise, are solely the debts, obligations, and liabilities of the company. A member or manager is not personally liable for a debt, obligation, or liability of the company solely by reason of being or acting as a member or manager.

(b) (Blank).

(c) The failure of a limited liability company to observe the usual company formalities or requirements relating to the exercise of its company powers or management of its business is not a ground for imposing personal liability on the members or managers for liabilities of the company.

(d) All or specified members of a limited liability company are liable in their capacity as members for all or specific debts, obligations, or liabilities of the company if:

(1) a provision to that effect is contained in the articles of organization; and

(2) a member so liable has consented in writing to the adoption of the provision or to be bound by the provision.

Puleo was also cited in *Wachovia vs. Neuhauser*, 528 F.Supp.2d 834 (N.D.Ill. 2007), to insulate an agent from individual liability who had signed a contract after the LLC had been dissolved.

The impenetrable cloak which seemingly insulated members and managers from individual liability after an LLC was dissolved was lifted materially by the analysis of Bankruptcy Judge Mary Gorman in *In re Suhadolnik*, 2009 WL 2591338 (BktyCt. C.D.Ill. 2009), when she distinguished the ruling in *Puleo* and illuminated the meaning and interpretation of 10-10 of the Limited Liability Company Act.

In *Suhadolnik*, the issue was the dischargeability of a claim which asserted a veil piercing theory against a member of a dissolved corporation. Judge Gorman pointed out that *Puleo* never addressed the issue of piercing the veil – only the issue of the direct liability of a member for claims against a dissolved LLC. Reading *Puleo* in the context of both *Westmeyer v. Flynn* and the legislative history and comments of the true drafters of the Illinois Act – the Commissioners of the Uniform Acts, the Court ruled that the only difference between the veil piercing theories against corporate shareholders and LLC members is that, in the case of LLC members, it cannot be based upon a failure to comply with statutory formalities.

While in the dissolution of a corporation, shareholders, officers and directors can all be protected by a claims shortening protocol, the comparable limitation under the LLC Act – Section 25-45 does not extend to members and only limits claims against the dissolved limited liability company. The notice to be sent to notify claimants to file claims is not limited to within 60 days of the effective date of dissolution, but does have a two-step limitation provision.

Section 25-45. Known claims against dissolved limited liability company.

(a) A dissolved limited liability company may dispose of the known claims against it by following the procedure described in this Section.

(b) A dissolved limited liability company shall notify its known claimants in writing of the dissolution. The notice must:

(1) specify the information required to be included in a claim;

(2) provide a mailing address where the claim is to be sent;

(3) state the deadline for receipt of the claim, which may not be less than 120 days after the date the written notice is received by the claimant; and

(4) state that the claim will be barred if not received by the deadline.

(c) A claim against a dissolved limited liability company is barred if the requirements of subsection (b) of this Section are met, and:

(1) the claim is not received by the specified deadline; or

(2) in the case of a claim that is timely received but rejected by the dissolved company, the claimant does not commence a proceeding to enforce the claim within 90 days after the receipt of the notice of the rejection.

(d) For purposes of this Section, the term “claim” does not include a contingent liability or a claim based on an event occurring after the effective date of dissolution.

We know that the broad impact of *Puleo* was rejected by the Supreme Court of South Carolina in *16 Jade Street, LLC v. R Design Construction Co.*, 398 S.C.338, 728 S.E.2d 448 (2012), where the pleadings expressly included allegations that the member had personally, individually committed the tortious act of negligence, quoting from Judge Posner’s opinion in a 2004 case: “You don’t buy immunity from your torts by being a member of a business corporation” 728 S.E.2d at 453.

At least one Illinois decision has held a member of an LLC personally liable; although, it was predicated on a violation of the Environmental Protection Act. *Gonzalez v. Pollution Control Board*, 2011 Ill.App. 093021, 960 N.E.2d 772, 355 Ill.Dec. 890 (1st Dis., 2011).

In the context of this history, so colored by the 2006 *Puleo* case, interpreting a provision with its genesis in the then current version of the Uniform LLC Act, consider the Committee Comments to the most recent revision:

4. UNIFORM COMMISSION COMMITTEE COMMENTS.
(in referent to the Uniform Section incorporated into the Illinois Statute as Section 10-10)

Subsection (a) – This subsection provides a corporate-like liability shield to members and managers, protecting them against (and only against) the debts, obligations and liabilities of the limited liability company – *i.e.*, against a member’s or manager’s alleged vicarious liability for the obligations of the entity. The shield “applies regardless of the dissolution of the company” and thus continues in effect through the completion of winding up (*i.e.*, termination). The shield applies regardless of the law giving rise to a claim against a limited liability company.

Shield Applicable Regardless of the Identity of the Plaintiff

What makes the shield relevant is the nature of the claim. If the complaint seeks to hold a member vicariously liable for the LLC’s obligations, the shield applies. If not, not. Thus, there is no distinction between a claim arising from an LLC’s debt to a commercial creditor, a member’s claim that the LLC has failed to return a contribution as required by the operating agreement, and a claim by a former member that the LLC has failed to follow through on a buy-out agreement. See *Rappaport v. Gelfand*, 197 Cal.App.4th 1213, 1230-1232, 129 Cal. Rptr. 3d 670, 682-84 (Cal.App.2 Dist. 2011) (involving a claim by a former partner). Accord *Ederer v. Gursky*, 9 N.Y.3d 514, 526, 881 N.E.2d 204, 212-213 (N.Y. 2007) (Smith, J., dissenting).

Shield Inapposite for Claims Arising from a Member’s or Manager’s Own Conduct

Because the member or manager liability at issue is solely vicarious, the shield is irrelevant to claims seeking to hold a member or manager directly liable on account of the member’s or manager’s own conduct. Put another way, “[t]here is no question” that “the member-manager of a limited liability company who causes his business to breach common law and statutory duties may be held independently liable for his personal torts.” *Dep’t of Agric. v. Appletree Mktg., L.L.C.*, 485 Mich. 1, 4, 18, 779 N.W.2d 237, 239, 247 (2010).

A few judges have failed to understand this point. See *Puleo v. Topel*, 368 Ill.App.3d 63, 68-69, 856 N.E.2d 1152, 1157 (Ill.App.Ct. 2006) (basing its holding on a legislative amendment that “removed . . . language which explicitly provided that a member or manager of an LLC would be held personally liable for his or her own actions or for the actions of the LLC to the same extent as a shareholder or director of a corporation could be held personally liable”).

This mistaken view: (i) ignores the actual words of LLC shield provisions (which protect members and managers only against liability for obligations of an LLC and make no reference to direct obligations of a member or manager); and (ii) flouts public policy (which recoils from the idea of immunizing a person’s misconduct solely because the person acts on behalf of an organization). Moreover, the mistaken view is contrary to the overwhelming weight of the case law. See, *e.g.*, *Mbahaba v. Morgan*, 163 N.H. 561, 565, 44 A.3d 472, 476 (2012) (“When . . . a member or manager commits or participates in the commission of a tort, whether or not he acts on behalf of his LLC, he is liable to third persons injured thereby.”); *Sturm v. Harb Dev., LLC*, 298 Conn. 124, 138, 2 A.3d 859, 870 (2010) (holding that the liability shield of an LLC is subject to “the common-law tort exception . . . [for] individual claims against LLC members”); *Allen v. Dackman*, 413 Md. 132, 154, 991 A.2d 1216, 1229 (2010) (“An LLC member is liable for torts he

or she personally commits, inspires, or participates in because he or she personally committed a wrong, not ‘solely’ because he or she is a member of the LLC.”); *Weber v. U.S. Sterling Sec., Inc.*, 282 Conn. 722, 732-34, 924 A.2d 816, 824-25 (2007) (stating that the Delaware LLC Act “does not preclude individual liability for members of a limited liability company if that liability is not based simply on the member’s affiliation with the company” and holding, in particular, that the Act “does not bar the defendants’ liability for tortious conduct”).

EXAMPLE: A manager personally guarantees a debt of a limited liability company. Subsection (a) is irrelevant to the manager’s liability as guarantor.

EXAMPLE: A member purports to bind a limited liability company while lacking any agency law power to do so. The limited liability company is not bound, but the member is liable for having breached the “warranty of authority” (an agency law doctrine). Subsection (a) does not apply. The liability is not *for* a debt, obligation, or other liability of the [limited liability] company, but rather is the member’s own, direct liability. Indeed, the liability exists because the limited liability company is *not* indebted, obligated or liable. RESTATEMENT (THIRD) OF AGENCY § 6.10 (2006).

EXAMPLE: A manager of a limited liability company defames a third party in circumstances that render the limited liability company vicariously liable under agency law. Under Subsection (a), the third party cannot hold the manager accountable for the *company’s* liability, but that protection is immaterial. The manager is the tortfeasor and in that role is directly liable to the third party.

EXAMPLE: A limited liability company provides professional services, and one of its members commits malpractice. The liability shield is irrelevant to the member’s direct liability in tort. However, if the member’s malpractice liability is attributed to the LLC under agency law principles, the liability shield will protect the other members of the LLC against a claim that they must make good on the LLC’s liability.

EXAMPLE: A single member limited liability company enters into a contract to build a home, and the member performs substantial amounts of the work. The homeowner sues both the LLC and the member for allegedly defective work, but the complaint sounds in contract rather than in tort. The LLC may be liable, but the member is not. See *Ogea v. Merritt*, __So.3d__, 2013 WL 6439355 at 24-25 (La. 2013).

Subsection (a) pertains only to claims based on the LLC’s liability and is irrelevant to claims by a limited liability company against a member or manager and *vice versa*. E.g., Sections 408 (pertaining to a limited liability company’s obligation to indemnify a member or manager), 409 (pertaining to management duties) and 801 (pertaining to a member’s rights to bring a direct claim against a limited liability company).

Shield Inapposite to Role Liability Claims

Provisions of regulatory law may impose liability on a member or manager due to a role the person plays in the LLC. See *e.g.*, *Food Team Intern, Ltd. v. Unilink, LLC*, 872 F.Supp.2d 405, 424 (E.D. Pa. 2012) (holding several individuals “subject to secondary individual liability under PACA [Perishable Agricultural Commodities Act]” because their roles within the LLC enabled them to control the relevant assets) (citing *Bear Mountain Orchards, Inc. v. Mich-Kim, Inc.*, 623 F.3d 163, 172 (3d Cir. 2010)).

5. CHARGING ORDERS

The charging order: The remedial instrument meant to bestow upon creditors the right to collect on a partner’s or a Limited Liability Company (“LLC”) member’s unpaid personal debts by way of that debtor-partner or member’s interest in his respective entity. Traditionally, a decent amount of mystery and uncertainty has surrounded the charging order because of the lack of statutory guidance relating to its scope and application. Generally, the charging order grants a creditor rights in a debtor-partner or LLC member’s interest in his respective entity. However, those rights are limited to the debtor-partner or member’s right to receive distributions from the respective entity. In other words, these “transferee rights” do not grant creditors any control or ability to participate in the management of the company. As such, creditors have no say as to when, and in what amount, distributions can be made. Thus, a creditor with a charging order is often left with limited options for recovering a partner’s or member’s unpaid debts in the event a partnership or LLC decides not to distribute to its partners or members.

Because creditors can be viewed as helpless under the scenario described above, the charging order is often considered an ineffective remedy. However, sound policy reasons and the history of the charging order support the need for this unique remedy in spite of its alleged shortcomings. Consider the right of a creditor to collect on the unpaid debts of a debtor-partner or LLC member. Most, if not all, see this as a valid right and worthy of enforcement. On the other hand, the ability of a given entity’s non-debtor partners or members to be able to continue their collective business with the partners of their choosing (and without the fear of being held hostage by the personal debts of another partner/member and his creditors) is at least equally important in terms of legal rights and protections. Thus, a legal quandary is created as partners, LLC members, creditors and debtors are all left wondering whose rights are supreme.

As a result, the charging order’s ineffectiveness as an equitable remedy lessens the value of the right it is meant to restore (debt repayment). Certainly, the right to collect on the debts of a debtor-partner or LLC member’s interest in his or her entity will never be considered a “great” right so long as the charging order remains an impotent remedy. Rather, charging order protected entities, such as some partnerships and LLCs, will continue to be seen as legitimate wealth preservation vehicles for one’s business or investment assets.

6. STATUTORY BASIS – Section 30-20 of the Illinois LLC Act (805 ILCS 180/30-20) is titled “Rights of Creditor” and provides:

(a) On application by a judgment creditor of a member or transferee, a Court may enter a charging order against the distributional interest of the judgment debtor for the unsatisfied amount of the judgment. A charging order constitutes a lien on a judgment debtor’s distributional interest and requires the limited liability company to pay over to the person to which the charging order was issued any distribution that would otherwise be paid to the judgment debtor. A charging order grants no other rights with respect to the assets or affairs of the company.

(b) To the extent necessary to effectuate the collection of distributions pursuant to a charging order in effect under subsection (a), the Court may:

(i) appoint a receiver of the distributions subject to the charging order, with the power to make all inquiries the judgment debtor might have made; and

(ii) make all other orders necessary to give effect to the charging order.

(c) At any time the Court may foreclose the lien and order the sale of the distributional interest. The purchaser at the foreclosure sale obtains only the distributional interest, does not thereby become a member, and is subject to Section 30-10.

(d) At any time before foreclosure under subsection (c), the member or transferee whose distributional interest is subject to a charging order under subsection (a) may extinguish the charging order by satisfying the judgment and filing a certified copy of the satisfaction with the Court that issued the charging order.

(e) At any time before foreclosure under subsection (c), a limited liability company or one or more members whose distributional interests are not subject to the charging order may satisfy the judgment and thereby succeed to the rights of the judgment creditor, including the charging order.

(f) This Act does not deprive any member or transferee of the benefit of any exemption laws applicable to the member’s or transferee’s distributional interest.

(g) This section provides the exclusive remedy by which a person seeking to enforce a judgment against a member or transferee may, in the capacity of judgment creditor, satisfy the judgment from the judgment debtor’s distributional interest. If and to the extent that other law permits a judgment creditor to obtain a lien against the distributional interest or other rights of a member or transferee of a member, the lien shall be treated as a charging order subject to all the provisions of this Section.

7. PROCEDURE

Obtaining and Applying a Charging Order

Generally, to obtain a charging order, a creditor must first receive a judgment against the debtor to proceed as a judgment creditor. A judgment creditor then submits an application to a court of competent jurisdiction for a charging order against the judgment debtor's interest in the LLC to satisfy the unpaid debt. Once issued, the charging order remains in place until the debt is fully paid. The ULLCA provides that a charging order "constitutes a lien on the judgment debtor's transferable interest" meaning that, as a lien, the Court can order foreclosure on the transferable interest. In jurisdictions adopting the ULLCA or allowing foreclosure on the transferable interest, LLC members may be forced to purchase the interest at a judicial sale. However, in jurisdictions that limit a creditor's remedies to a charging order, and thus, exclude the possibility of foreclosure, the creditor is not able to force the LLC to make distributions or cause the involuntary dissolution of the entity.

Charging Orders as the Exclusive Remedy

How a charging order is obtained and applied depends on whether the jurisdiction in which the charging order is sought treats the charging order as the exclusive remedy for creditors seeking to recover unpaid debts through an LLC member's interest in the entity. The ULLCA makes the charging order and judicial foreclosure of the charging order the exclusive remedies for persons seeking to enforce a judgment against a member or partner. Some states, but not Illinois, do not follow the ULLCA and provide the charging order alone as the exclusive remedy for creditors of LLC members. However, other states, both implicitly and explicitly, do not limit a judgment creditor's remedy against LLC members to charging orders. Illinois added, effective in 2012, 735 ILCS 5/12-112.5 stating that if a statute requires a charging order, that "said remedy may be brought and obtained by serving any of the various enforcement procedures set forth within this Article XII or by serving a citation pursuant to Section 2-1402". It could be argued that 12-112.5 has the effect of elevating the service of a citation alone, without a corresponding charging order, to the attachment of the judgment lien. In the absence of 12-112.5, case law concludes that the charging order is the exclusive option for attaching the judgment lien. See *In re LaHood*, 437 BR 330 (C.D. Ill 2010) and *First Mid-Illinois Bank v Parker*, 342 Ill.Dec. 922 (5th Dis. 2010). It is clear that no new suit or summons needs to be served on the LLC for the court issuing the judgment and the citation to have jurisdiction to enter a charging order. See *Bank of America v. Freed*, 2012 Ill.App. (1st) 110749.

Typically, in jurisdictions where charging orders are the exclusive remedy, a creditor is only entitled to the debtor's distributional interest in his LLC membership interest. In other words, the creditor can essentially use the charging order as a garnishment on distributions from the LLC to the judgment debtor, but cannot participate in managerial decisions. Due to a judgment creditor's inability to participate in management, creditors are unable to force the other LLC members to make distributions for the purpose of satisfying the judgment debtor's outstanding debt. Furthermore, the LLC is not obligated to make distributions and, thus, can retain its earnings for reinvestment. Accordingly, so long as the LLC allows accumulation of earnings, its

members can decide to withhold distributions from the debtor member and possibly leave the judgment creditor helplessly waiting for an indefinite period of time.

Unfortunately, withholding distributions from a judgment creditor acting as an assignee of the judgment debtor's distributional interest usually means the other LLC members do not receive their share of the LLC profits. Until the debtor-member is willing to satisfy the original debt or otherwise negotiate and pay a settlement amount, the charging order can potentially remain in place forever, meaning neither the LLC members, nor the creditor, receive anything from the LLC. However, as discussed in more detail below, planning opportunities exist that help to prevent the "freezing" of the assets held in the LLC without sacrificing the charging order protection the LLC offers. Still, the ability to keep LLC assets from falling into the hands of creditors by withholding the debtor's distributions is a strategy that weakens the value of a charging order and provides the debtor significant leverage in negotiating a discounted settlement amount of the unsatisfied debt. The Illinois version of the statute authorizing charging orders, Section 30-20 provides in subsection (b) for further remedies beyond the charging order including the appointment of a receiver "with the power to make all inquiries the judgment debtor might have made." Since the judgment debtor, as a member, has the right to compel the entity to disclose books or records under Section 10-15, this power of the Trustee is critical in the context of scrutinizing the wherewithal of the entity to make distribution and in determining whether distributions are being cloaked as salary or other payments.

8. FORECLOSURE

In about one-third of the states, a creditor who obtains a charging order but is not paid by the LLC can have the Court order that the debtor-owner's LLC membership interest be foreclosed upon. If this occurs, the creditor becomes the permanent owner of all the debtor-member's financial rights, including the right to receive money from the LLC. However, the creditor cannot participate in the management of the LLC. Thus, it cannot force the LLC to pay money to it or anyone else.

Before any such foreclosure occurred, it is likely that the LLC and its members would settle the debt with the creditor. A creditor's ability to foreclose upon an LLC membership interest puts LLC owners' personal creditors in a stronger bargaining position than they have under the LLC laws of states that do not permit LLC foreclosures.

EXAMPLE: The collection agency's charging order against John's LLC interest proves useless because the LLC does not make any distributions. So the agency obtains a court order for the foreclosure on John's interest in the LLC. To avoid this, the LLC settles John's personal debt with the agency for \$30,000.

Dissolution

A handful of states permit personal creditors of LLC owners to obtain a court order that the LLC be dissolved. In this event, the LLC would have to cease doing business and sell all of its assets. This is the most extreme remedy allowed for personal creditors of LLC owners.

Single-member LLCs

The reason personal creditors of individual LLC owners are limited to a charging order or foreclosure is to protect the other members (owners) of the LLC. It does not seem fair that they should suffer because a member incurred personal debts that had nothing to do with their LLC. Thus, personal creditors are not permitted to take over the debtor-member's LLC interest and join in the management of the LLC or have the LLC dissolved and its assets sold without the other members' consent. However, this rationale disappears when the LLC has only a single member (owner) because there are no other LLC owner/members to protect. Because of this difference with SMLLCs, some Courts have applied different rules for SMLLC protection from creditors and in many states, it remains unclear what type of protection they would receive.

Courts in a few states have found that the charging order protection that exists for LLCs does not apply with SMLLCs because there are no co-owners to protect. These cases created a great deal of uncertainty in other states with similar charging order protection laws. In response, several states amended their LLC laws to make it clear that SMLLCs are entitled to the same protection from creditors as multi-member LLCs. These include Delaware, Nevada and Wyoming – states that want to encourage businesses to form entities in their jurisdictions, because they can earn money from the fees they charge and because they want to be considered business-friendly. Their laws now specifically state that charging orders are the exclusive remedy for creditors of both multi- and single-member LLCs.

A few states, including Florida and New Hampshire, have gone the other way and changed their LLC laws to make it clear that a charging order is not the only remedy that can be used against an SMLLC. In these states, the SMLLC does not provide nearly as much liability protection as a multi-member LLC. Many states have still not addressed this issue either in the courts or by adopting laws specifically addressing SMLLC protection, so in those states, it is unclear what type of protection an SMLLC would provide against an owner's personal creditors.

Impact of Bankruptcy

If an LLC owner files for personal bankruptcy, all bets are off. The federal bankruptcy law says nothing about how LLCs should be treated. As a result, the bankruptcy courts are in the process of making up the rules as they go along. Several bankruptcy courts have held that when the owner of a SMLLC files for Chapter 7 bankruptcy, the trustee appointed by the bankruptcy court becomes a substituted member of the LLC and can exercise all the owner's rights. This includes the right to manage the LLC and sell its assets (such as real estate) to pay off creditors. The protection afforded by the LLC form can simply be ignored by the bankruptcy court where there is only one LLC owner. It is possible that other bankruptcy courts would reach a different conclusion, but no one knows for sure.

It is also possible that the ownership interest of a member of a multi-member LLC could be taken over by a bankruptcy trustee. This is a rapidly evolving and unclear area of the law.

Should an LLC have at Least Two Members?

A simple way to avoid the potential creditor and bankruptcy problems with SMLLCs is not to have one. Instead, make sure your LLC has at least two members. The second member could be your spouse or another relative. However, the spouse, relative or any other second member must be a legitimate co-owner of the LLC. If the second person is a member only on paper, it is likely that a Court would disregard his or her interest and find that you have a single-member LLC. To avoid this, the co-owner must pay fair market value for the interest acquired and otherwise be treated as a “real” LLC member – that is, receive financial statements, participate in decision-making and receive a share of the LLC profits equal to the membership percentage owned.

Should You Form Your LLC Outside Your Home State?

You do not have to form your LLC in your home state, even if it is the state where you live or do business. Thus, if your home state’s LLC law does not provide all the protection from creditors you would like, you could form your LLC in a more debtor-friendly state. For example, even though your business is in California, you could form an LLC in Nevada, because it has a very debtor-friendly LLC law. As a general rule, the formation state’s LLC law will govern your LLC. Thus, forming an LLC in a state with a favorable LLC law could provide you with more limited liability. However, doing so will increase your costs, because you will have to pay the fees to form your LLC in the other state plus the fees to register to do business in your home state.

So should you shop around for the state that provides the most limited liability to LLC owners? If limiting liability is extremely important to you, you may want to form your LLC in a state like Nevada, Delaware or Wyoming that has very debtor-friendly LLC laws. But there is no guaranty that courts in your home state or courts in other states will always apply the law of the state where you formed your LLC, rather than the less favorable LLC law of your home state. This is a complex legal issue with no definitive answer. Consult an experienced business lawyer for more information.

Importance of an LLC Operating Agreement

It is very important for all LLC owners to draft and implement an operating agreement that takes into account the impact of a member filing bankruptcy or having a court judgment entered against him or her. For example, the LLC members may wish to include a provision in their operating agreement allowing for the expulsion of any member who files for bankruptcy, or allowing them to purchase the interest of any member who becomes subject to a charging order. A comprehensive operating agreement is particularly important for multi-member LLCs, since disputes may develop among the members.

9. PIERCING THE CORPORATE VEIL

(a) Introduction

Illinois Courts have recognized veil piercing since the 1800's. Traditionally, veil piercing has been applied as an equitable remedy to impose personal liability upon a corporation's shareholders. Illinois Courts have also reverse-pierced corporate entities to hold a corporation liable for the obligations of its shareholders. While veil piercing is rooted in Illinois law and has been consistently applied to shareholders and corporations, the rise and popularity of Limited Liability Companies ("LLC") in Illinois leaves questions as to the applicability of veil piercing to other corporate forms.

(b) Piercing the Corporate Veil

Veil piercing issues arise when a party seeks to have a corporate entity disregarded and impose personal liability on the corporation's shareholders. Generally, a corporation and its shareholders are regarded as separate legal entities and accordingly, shareholders are not liable for the corporation's obligations. However, in some situations, a Court will use its equitable powers to pierce the corporate veil and impose personal liability on shareholders. Illinois courts have long held that the corporate entity will not be regarded when doing so would result in fraud or injustice. In *Van Dorn v. Future Chem. & Oil Corp.*, the Seventh Circuit, citing the Northern District of Illinois, explained that a corporation's veil of limited liability will be pierced only when (1) "there is such unity of interest and ownership that the separate personalities of the corporation and the individual or other corporation no longer exist," and (2) "when adherence to the fiction of separate corporate existence would sanction a fraud or injustice."

In *Main Bank of Chicago v. Baker*, the Illinois Supreme Court rephrased the first prong such that the corporation must be "so controlled and its affairs so conducted that it is a mere instrumentality of another." A corporation is a mere instrumentality when it is merely the alter ego or business conduit of another person or entity. Thus, an entity or individual who uses a corporation as a method of conducting his or her business may be liable for using the corporation as his or her alter ego. In *People v. Pintozzi*, the Court explained that an individual is an alter ego of a corporation where "there is such unity of interest and ownership that the separateness of the individual and the corporation has ceased to exist." Moreover, the existence of an alter ego relationship is a question of fact dependent on the circumstances of each case. In *Ampex Corp. v. Office Electronics, Inc.*, the Court found that two corporations were mere instrumentalities of one another when the "affairs of the two corporations were so managed and controlled by the same interlocking officers, directors, and single stockholder, as to constitute one corporate entity in its dealings with creditors."

Case Discussion: Fontana and Wachovia

(a) The Fontana Rule

In 2005, in *Fontana v. TLD Builders*, the Appellate Court of Illinois for the Second District delineated eleven factors, generally known as the badges of fraud, to be considered in establishing the “mere instrumentality” or “unity of interest” prong. However, practically speaking, Courts look to the badges of fraud to determine whether the second prong has been established as well. Accordingly, these factors tend to serve a dual purpose in the veil piercing two-step analysis. The badges of fraud are as follows:

- (i) inadequate capitalization;
- (ii) failure to issue stock;
- (iii) failure to observe corporate formalities;
- (iv) nonpayment of dividends;
- (v) insolvency of the debtor corporation;
- (vi) nonfunctioning of officers or directors;
- (vii) absence of corporate records;
- (viii) commingling of funds;
- (ix) diversion of assets from the corporation by or to a stockholder, or other person or entity to the detriment of creditors;
- (x) failure to maintain arms’ length relationships among related entities; and
- (xi) whether the corporation was merely a façade for the operation of the dominant stockholders.

In *Fontana*, the Court explained that to disregard the entity and pierce the corporate veil, the two-pronged test mentioned *supra* must be satisfied. In making that determination, the Court will look to the badges of fraud. The Court further noted that it will not base its decision on a single factor, but examine several factors and the totality of the circumstances. In this case, home purchasers brought an action against TLD Builders, a construction company, and the company’s president for breach of contract. The home purchasers sought to pierce the corporate veil and hold the president personally liable. Ultimately, the Court found that veil piercing was warranted for several reasons. TLD Builders’ actions implicated numerous badges of fraud including undercapitalization, commingling of funds, failure to follow corporate formalities, absence of corporate records, and the nonfunctioning of officers and directors.

(b) *Wachovia Securities, LLC v. Banco Panamerico*

In *Wachovia*, a brokerage firm obtained a multimillion dollar judgment against a corporation for failing to pay margin debt. The firm sued to collect the judgment and sought to hold the corporation’s insiders personally liable for the judgment. The Northern District of Illinois pierced the corporate veil finding that the corporation was inadequately capitalized, diverted assets to insiders and related entities, failed to observe corporate formalities, officers were nonfunctioning, failed to maintain arms’ length relationships among related entities, and that adherence to the separate identities of the corporation and its insiders would sanction fraud or injustice. The Seventh Circuit affirmed these findings and imposed personal liability on the corporation’s insiders.

Just as in *Van Dorn*, the Court in *Wachovia*, explained that veil will be pierced only when (1) there is such unity of interest and ownership that the separate personalities of the corporation and the individual no longer exist, and (2) circumstances are such that adherence to the fiction of separate corporate existence would sanction a fraud or injustice. In making this determination, the Court relied upon the badges of fraud. The Court reasoned that, in support of the unity or interest prong, the corporation diverted assets to business insiders and related entities after incurring the margin debt to the brokerage firm. The corporation paid almost \$1.2 million to insiders and related entities after the stock purchased on margin collapsed, and it also paid suspect, “off-the-books” compensation to officers. The corporation also failed to observe corporate formalities by failing to conform to its bylaws or keep corporate records. These failures enabled the insiders to dominate the corporation’s decision-making and its failure to maintain arms’ length transactions with related entities. Moreover, the corporation’s lack of corporate records related to the entity’s capitalization allowed insiders to control loans from the corporation and transfers to related entities. The Court continued that the entity’s officers were nonfunctioning as they had a 50% stake in the corporation, but the corporate secretary, who owned the remaining 50%, was the entity’s dominant shareholder and controlled the entity that financed the corporation’s operations. The secretary refused to allow the corporation to pay the brokerage firm with loans from an entity that he controlled, and at the secretary’s discretion, the corporation’s accountant falsely held himself out to be the corporation’s vice president. Furthermore, with respect to capitalization, which is discussed in more detail in the following section, the entity’s assets were encumbered by a loan from the shareholder-controlled entity. Ultimately, the Court found that these facts supported the District Court’s ruling to pierce the corporate veil.

Undercapitalization

As mentioned *supra*, Courts look to several factors to determine whether the two-prong test has been satisfied. One highly litigated factor is whether the corporation had inadequate capitalization to conduct its affairs. In *Fontana*, the Court explained that to determine whether a corporation is inadequately capitalized for purposes of piercing the corporate veil, the Court must compare the amount of capital to the amount of business to be conducted and the obligations to be fulfilled. The Court found that a corporation was undercapitalized when the president and a shareholder made loans to the corporation, and where there were no corporate resolutions authorizing repayment notes to be made from the corporation to the president and shareholder. The Court stated that the shareholder loans and line of credit issued by a bank did “not demonstrate adequate capitalization but, rather show[ed] the inadequacy of TLD’s capitalization and indicate[d] that the initial capitalization, if any, was insufficient to conduct TLD’s business of building homes.” The Court reasoned that it is “inequitable to allow shareholders to set up a flimsy organization just to escape personal liability,” and whether a corporation is adequately capitalized “is based on the policy that shareholders in good faith put at the risk of the business unencumbered capital reasonably adequate for the corporation’s prospective liabilities.”

Similarly, in *Wachovia Securities, LLC v. Banco Panamerico*, the Court explained that the undercapitalization factor compares the amount of capital to the amount of obligations to be

fulfilled. The Court further explained that without adequate capitalization, a corporation is merely a liability shield instead of an independent entity capable of conducting its own business. The Court went on to explain that adequate capitalization exists when a corporation has sufficient equity without considering loaned funds or encumbered assets. In this case, the Court held that, in Illinois, a secured insider loan is not wrongful per se; however, the corporation failed to pay its margin debt and received a loan from an insider-controlled entity. The insider structured the loan to avoid the entity's creditors by ensuring that its assets were encumbered by a blanket lien, which favored the insider. Thus, although the corporation had assets in addition to its initial \$1,000.00 paid-in-capital, those assets were encumbered by a line of credit, and the corporation held itself out to others as "thinly capitalized," supporting a finding of undercapitalization.

Likewise, in *Laborers' Pension Fund v. Lay-Com, Inc.*, the Seventh Circuit held that adequate capitalization exists when a corporation has insufficient equity without taking loaned funds or encumbered assets into account. In *Gallagher v. Recono Builders, Inc.*, the Appellate Court of Illinois for the First District found that a corporation was undercapitalized when the amount paid into the corporation at its formation was merely the former statutory minimum of \$1,000, and there were no assets such as equipment, real estate or other resources to rely upon in the event something went wrong considering the "nature and magnitude of the corporate undertaking." The Court found that the statutory minimum was not maintained for creditors and explained that no reduction of stated capital or paid-in-surplus can be made, even if the purpose is to pay creditors, if the withdrawal or reduction will reduce the stated capital (or paid-in-surplus) to an amount below the \$1,000 statutory minimum. In another case, the Appellate Court for the First District found that a corporation was "grossly undercapitalized" because its tax returns showed consistent negative retained earnings and virtually no cash on hand.

With respect to shareholder loans, the Illinois Supreme Court has held that as long as a corporation remains solvent, directors can, with the shareholders' knowledge, "deal with the corporation, loan it money, take security or buy property of it, the same as a stranger." The Court noted that the instant the corporation becomes insolvent, the relationship between the entity and its directors and shareholders is materially changed. In the event of insolvency the corporation's assets then become a trust fund to repay its creditors and directors cannot deal with the entity in a manner that would afford him or her priority over the corporation's creditors. In *Plumbers' Pension Fund v. A-Best*, the Court held that regardless of whether the shareholders intended to "siphon money" from the corporation to place themselves in a better position than the company's creditors, that is precisely what repayment of the loan accomplished and accordingly, constituted sufficient injustice to pierce the corporation veil.

However, note that undercapitalization cannot be the sole factor and is insufficient on its own to render a corporation pierceable. There must also be some element of unfairness, or something akin to fraud or deception to provide a basis for piercing the corporate veil. For example, in *CM Corp. v. Oberer Development Co.*, the Court declined to pierce the corporate veil merely because the entity was insolvent at the time the suit was filed. The Court explained that the claim must be supported with some evidence showing why the corporation was rendered

insolvent; for example, some fraud perpetrated to make the corporation insolvent. The Court held that without such evidence, an action to pierce the corporate veil cannot be justified.

Failure to Observe Corporate Formalities

An entity's failure to observe corporate formalities is often determinative in veil piercing cases. Pursuant to the Limited Liability Company Act, in Illinois, a failure to observe corporate formalities is not a ground for imposing personal liability on a member or manager of an LLC. However, a failure to observe corporate formalities remains a factor for consideration in corporate piercing cases. In an analysis of a corporation's failure to follow corporate formalities, several of the badges of fraud become intertwined. Courts often consider commingling of funds, the absence of corporate records, nonfunctioning of officers or directors, failure to pay dividends, and failure to issue stock evidence of a failure to follow corporate formalities.

(a) Commingling of Funds

Commingling of assets and funds tends to be a heavily weighed factor in a Court's veil piercing analysis, and is generally viewed in the context of a failure to follow corporate formalities. In *Sea-Land Services, Inc. v. Pepper Source*, the Seventh Circuit held that funds were commingled when a shareholder and owner of several corporations borrowed substantial amounts of money from those corporations, interest free, and where the corporations borrowed money from each other. In this case, the shareholder also used the bank accounts of all of these corporations to pay personal expenses, including alimony, child support, educational expenses for his children, automobile maintenance, and healthcare for his pet. In *Wikelund Wholesale Company Inc. v. Tile World Factory*, the Appellate Court for the First District upheld the trial court's finding that funds were commingled when a shareholder used the accounts of various corporations in which he had an interest to pay the debts of any one corporation, and where money received by one corporation might "come to rest" in the accounts of his other corporations. Additionally, in a Second District case, the Court held that money paid into an officer's account that was not a salary, wage, dividend, or distribution demonstrated commingling between the officer and the corporation.

On the contrary, in *Jay Steinberg v. Helen Buczynski*, the Seventh Circuit citing the Northern District of Illinois held that funds were not commingled where shareholders paid some of their personal expenses with checks issued by the corporation. The Court explained that the shareholders "took no more than what would have been a reasonable amount in salary, merely omitting the formality of having salary checks issued to them and paying the personal expenses in question by personal check." In this case, the entity was a Subchapter S corporation and the shareholders properly reported the payments of their personal expenses as personal income. In *National Soffitt & Escutheons v. Superior Systems*, another Seventh Circuit case, the Court declined to pierce the veil holding that assets were not commingled between related corporations when one entity purchased assets of the other at fair market value.

(b) Absence of Corporate Records

The absence of corporate records is also viewed as evidence of a failure to observe corporate formalities. This is particularly so in “one-man” corporations where one person is the sole shareholder, director and manager. In *Jay Steinberg v. Helen Buczynski*, mentioned *supra*, the Seventh Circuit held that there was not a failure to follow corporate formalities despite the fact that the entity never held formal shareholder meetings or kept corporate minutes, and paid some of their personal expenses with checks issued by the corporation. As mentioned above, the shareholders “took no more than what would have been a reasonable amount in salary, merely omitting the formality of having salary checks issued to them and paying the personal expenses in question by personal check.” Additionally, Illinois courts have consistently held that merely missing one annual meeting is not a sufficient showing of failure to observe corporate formalities.

On the other hand, the Seventh Circuit did find a failure to observe corporate formalities between two related corporations where: one corporation used the other’s stationery, where one corporation used a bank wire transfer account to assist in the exercise of options by the other’s customers, and where both corporations conducted business from the same suite of offices. These corporations also made undocumented asset transfers to one another and failed to notify creditors of the transfers. In *Gallagher v. Recon Builders*, the Appellate Court for the First District held that a corporate defendant failed to follow corporate formalities because there were no corporate resolutions, meetings were undocumented, and the defendant failed to produce any corporate books. The Court concluded that, in the absence of any evidence to support the corporation’s claims that it maintained these records, no meetings occurred and no corporate books existed, or alternatively that corporate books contained information adverse to the corporation’s claim.

(c) Corporate Formalities and Other Badges of Fraud

Other badges of fraud that go towards proving or disproving a failure to observe corporate formalities, include nonfunctioning of officers or directors, failure to issue stock, and nonpayment of dividends. These issues are litigated significantly less than commingling and absence of corporate records.

Reverse Pierce

The concept of reverse veil piercing is a variation of the traditional veil piercing remedy. A reverse pierce subjects the corporation to liability for the acts of its shareholders. Generally, reverse pierce issues arise when a shareholder’s creditors try to reach the assets of the corporation. In *Scholes v. Lehmann*, the Court explained that reverse piercing is ordinarily possible only in one-man corporations, since if there is more than one shareholder, seizing the corporation’s assets to pay a shareholder’s debts would be a wrong to the other shareholders.” In *Boatmen’s Nat’l Bank of St. Louis v. Smith*, the Northern District of Illinois, the Court granted a judgment creditor’s request to reverse pierce the veil of a corporation whose sole shareholder, director and president was liable for the judgment.

In 2007, the First District Appellate Court in *Trossman v. Philipsborn* outlined a test for reverse piercing. The Court explained that reverse piercing of the corporate veil is appropriate

when (1) an insider owns all, or substantially all, of the stock, (2) the insider treats the property as his or her own, and (3) no shareholder or creditor would be adversely affected.

In *Trossman*, a corporation was the general partner in a limited partnership. The partnership was engaged in real estate development, and the corporation and plaintiff guaranteed a loan to the limited partnership. The parties agreed that if either guarantor made a payment over their pro rata obligation, each could recover the excess payment from the other guarantor. When the loan was in default, the corporation made payments, which the shareholders claimed should be credited to them under the reverse pierce doctrine. The Court suggested that while each element for reverse piercing appears to be satisfied, it is bound by the Illinois Supreme Court's holding's in *Centaur* that a corporation may not assert an alter ego action against its own shareholders, as well as the affirmation of *Centaur* in *Forsythe* where the Court refused to allow a corporation to pierce its own veil noting "direct participant liability does not rest on piercing the corporate veil such that the liability of the subsidiary is the liability of the parent. On the contrary, "this form of liability is asserted, as its name suggests, for a parent's direct participation, superseding the discretion and interest of the subsidiary, and creating conditions leading to the activity complained of." Accordingly, the Court held that the shareholders did not have the right to contribution from the payments advanced by the corporation.

In *Crum v. Krol*, the First District held that "the same equitable considerations of preventing injustice should apply when it is a third party, rather than a shareholder or officer, who attempts to use the corporate entity as a shield." However, as the Illinois Supreme Court explained in *Centaur*, a subsidiary corporation cannot bring an action against its parent corporation seeking to reverse pierce, thereby piercing its own veil in the process. The Illinois Supreme Court, citing the Northern District of Illinois in *In re Dakota Drilling, Inc.*, explained that "[T]he general law mandates that the piercing of a corporate veil must never be made for the benefit of the corporation or its shareholders. It is troublesome, in this court's view, to allow a corporation, through its trustee, to pierce its own veil since it would have the effect of denying the corporation of its own corporate existence."

In *Main Bank of Chicago v. Baker*, the Illinois Supreme Court did not reverse-pierce the corporate veil at the request of the defendant-shareholder. Main Bank was a subsidiary of Main Corporation. Another corporation was created, for which Main Bank held 80% of the stock and the defendants owned the remaining 20%. The defendants leased services to the corporation and when the corporation defaulted on its lease payments, the defendants could no longer make payments on their note to Main Bank. Main Bank sued on the note and the defendant-shareholders sought to hold Main Bank liable via reverse pierce. The defendants requested that the court disregard the corporation in addition to disregarding Main Bank's corporate existence to hold Main Bank liable on the note, which would cover the defendant's liability. The court declined to reverse pierce holding that a party "cannot assert the equitable doctrine of piercing the corporate veil to disregard the separate corporation existence of a corporation he himself created to gain an advantage which would be lost under his present contention."

In an unusual situation, a corporation's director sought to reverse pierce to bring a claim against the corporation's primary shareholder. The plaintiff obtained a judgment against Heartland Pottery Company. The Defendant, Estes was a shareholder and providing the financing, while the Plaintiff was the other shareholder, president, and director. The plaintiff obtained a judgment against Heartland and filed a citation to discover assets. When no assets were discovered, the plaintiff sought to reverse pierce the corporate veil. The Court explained that while there is no Illinois authority expressly prohibiting directors from piercing the corporate veil for their benefit, to do so would "improperly allow them to hide behind the corporate veil when it benefits them and then discard it when it is no longer useful." The Court explained that the plaintiff "had an obligation to obtain information about the company that he served."

While reverse piercing has not been litigated heavily in Illinois, based on the foregoing, it appears difficult to pierce in a context other than the "one-man" corporation discussed *supra*.

IN THE CIRCUIT COURT OF THE FOURTEENTH JUDICIAL CIRCUIT
WHITESIDE COUNTY, ILLINOIS

GINORMOUS BANK,

Plaintiff,

vs.

JOE DEBTOR,

Defendant.

2011 L 11

MOTION FOR CHARGING ORDER

Now comes Plaintiff and Judgment Creditor, Ginormous Bank and for its Motion pursuant to 735 ILCS 5/2-1402, Supreme Court Rule 277, 735 ILCS 5/12-112.5 and 805 ILCS 180/30-20 states as follows:

1. A judgment was entered herein on January 4, 2012 in favor of Plaintiff and against Defendant in the amount of \$1,201,211.62.
2. Defendant was served with a Citation to Discover Assets on January 30, 2012 commanding him to appear on February 7, 2012.
3. On February 7, 2012, Defendant appeared and was examined. The Citation was continued until March 28, 2012, at 1:00 p.m.
4. Defendant's testimony at the Citation was that he owned:
 - A. Membership interest in Asset Shell, LLC, an Illinois Limited Liability Company.

WHEREFORE, Plaintiff prays for a Charging Order as follows:

1. Requiring Defendant to turnover his membership interest in Asset Shell, LLC to Plaintiff if there are certificates representing title to such entity; and
2. For a Charging Order transferring the Defendant's distributional interest in Asset Shell, LLC to Plaintiff; and
3. For such Order to reserve the right to appoint a receiver of the distributions, with the power to make the inquiries the judgment debtor might have made under 805 ILCS 180/10-15; and
4. For such Order to reserve the right to foreclose the lien of the Charging Order and to order the sale of the distributional interest and/or of the certificate; and
5. Continuing the Citation until compliance with all Orders.

GINORMOUS BANK, Plaintiff,

By WARD, MURRAY, PACE & JOHNSON, P.C.,
Its Attorneys,

By: _____
Paul A. Osborn

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IN THE CIRCUIT COURT OF THE FOURTEENTH JUDICIAL CIRCUIT
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2011 L 11

CHARGING ORDER

This matter comes before the Court upon the Plaintiff's Motion for Charging Order, and the Court having considered the arguments of counsel and authorities cited, finds:

A. That Plaintiff is entitled to a Charging Order requiring Defendant to turn over all his distributional interest in Asset Shell, LLC.

WHEREFORE, IT IS ORDERED:

1. That Defendant shall execute all assignments, endorse all member certificates and sign and deliver all documents reasonably required and requested by Plaintiff to effect a turnover of all his distributional interest in Asset Shell, LLC.

2. This Charging Order is effective until satisfaction of the judgment previously entered in this cause against Defendant in favor of Plaintiff.

3. This Charging Order constitutes a valid lien pursuant to 805 ILCS 180/30-20 on the Defendant's distributional interest in Asset Shell, LLC which shall be binding on the LLC upon delivery by first class mail upon said entity's manager, managing member or registered agent

and said Limited Liability Company shall pay over to Plaintiff any distributions that would otherwise be paid to Defendant.

4. Upon Motion of Plaintiff, this Court may appoint a receiver of the distributions with the power to make all inquiries the Defendant may have made and further, Plaintiff may foreclose the lien and order the sale of the distributional interest.

5. That if, after liquidating the distributional interest or otherwise disposing of the value in said members interest, incident to any foreclosure, Plaintiff realizes a net recovery after satisfying the judgment against the Defendant, Plaintiff shall file a report both to establish Defendant's credit against the judgment and Defendant's equity interest, if any.

6. This is a final Order and there is no reason to delay enforcement or appeal.

7. The pending Citation is continued to _____, 2018.

Dated: _____

JUDGE

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