Business Law Update:
Piercing the Veil of Iowa Entities
and Related Issues

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Relevant Iowa Practice—Business Organizations Excerpts

Iowa Practice—Business Organizations is a two-volume practitioner treatise published by West Publishing. I am the author of most of the chapters. Chapter 15 covers the Corporation as a Separate Entity, and Sections 15:3 – 15:6 of that Chapter cover the topics of limited liability and exceptions to that principle, including the topic of piercing the corporate veil in Iowa. Chapter 13 covers the Limited Liability Company, and Section 13:22 of that Chapter covers similar subjects as they relate to Iowa limited liability companies.

The following pages re-print author page proofs of those Sections, as prepared for the forthcoming 2017-2018 edition of the Iowa Practice Business Organizations books. (The black lines in the margins of the proof pages indicate where new material was added this year.) Thomson Reuters generously permitted me to re-print those pages here.

The discussion in the re-printed sections below is organized as follows:

Section 15:3 covers the general rule of limited liability for corporate shareholders and related limited liability protections that extend to corporate directors, officers and employees who act on the corporation’s behalf. Section 15:3 also discusses important conduct-based exceptions to the limited liability rule.

Section 15:4 discusses the doctrine of piercing the corporate veil as applied by the Iowa courts, with separate explanatory discussions of each of the factors Iowa courts have identified as relevant to piercing analysis.

Section 15:5 discusses special topics relating to piercing the corporate veil, including choice of law, reverse piercing, piercing and statutory interpretation, and piercing for procedural purposes in litigation.

Section 15:6 discusses planning advice that may help protecting against veil-piercing.

Section 13:22 covers the above-listed issues as applied to limited liability companies.

Section 13:29 covers creditor’s rights against members of limited liability companies.

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majority of courts. The narrower approach may have little practical impact, however, given that unprivileged documents prepared in anticipation of litigation may still qualify for work product protection. Moreover, even under Upjohn, employee witnesses or experts may still be deposed by an opposing party concerning their knowledge of relevant facts or expert opinions. 19

§ 15:3 Liability rules generally applicable to corporate shareholders, directors, officers, employees, and other agents

Research References
West’s Key Number Digest, Corporations ☞=1.3

(1) General Rule of Limited Liability for Corporate Shareholders. While limited liability for shareholders provides an incentive for people to conduct business in the corporate form, such limited liability is not, strictly speaking, an essential corporate attribute. 1 Nonetheless, the two closest common law prototypes for modern business corporations, the joint stock companies and overseas trading companies chartered by royal decrees in the 16th and 17th centuries, typically provided limited liability for their owners. 2 Modern corporate law continues this tradition.

Section 490.622(2) of the IBCA states: “Unless otherwise provided in the articles of incorporation, a shareholder of a corporation is not personally liable for the acts or debts of the corporation.” 3 At least two important results follow from this broad statutory directive. First, limited liability for corporate shareholders is the general rule, not the exception. 4 Second, “[t]he burden is on the party seeking to pierce the corporate veil to

197 Doré, Iowa Practice-Evidence § 5.504:10 (Thomson West 2010) (citing Sisk and Cady, Iowa Practice-Lawyer and Judicial Ethics, § 5.13(g) (Thomson West 2008) (footnotes omitted)).

[Section 15:3]

1 For example, Blackstone does not include limited liability an essential corporate attribute. Neither does Professor Dewing, a famous corporate commentator. See generally Hayes, Extent of the Legislature’s Reserve Power to Change Common Law Attributes of Corporations, 13 Vand.L.Rev. 2261 (1959). One can draw the same conclusion from modern partnership law, which treats the partnership as an entity separate from the partners in all respects, but which also, as a general rule, makes partners liable for partnership obligations. See, e.g., I.C.A. §§ 486A.201, 486A.306 (partnership is an entity distinct from its partners; all partners are jointly and severally liable for partnership obligations).


3 I.C.A. § 490.622(2).

4 See, e.g., Schnoor v. Deitchler, 482 N.W.2d 913, 915 (Iowa 1992) (“Exceptions to the general rule of limited stockholder liability do exist which allow piercing of the corporate veil . . . .”) (emphasis supplied). Des Moines & C.I. Ry. Co. v. Iowa State Tax Commission, 253 Iowa 994, 115 N.W.2d

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show the exceptional circumstances required to impose personal liability on shareholders.

(2) General Rule of Limited Liability for Corporate Directors, Officers, Employees, and Other Agents. Nothing in the IBCA expressly provides that corporate directors, officers, employees, and other agents are not personally liable for corporate debts. However, given the corporation’s status as a separate legal “person” from those who act on its behalf, this result ordinarily follows as a matter of agency law. As discussed in the following paragraphs, for liability purposes the corporation is distinct not only from its shareholders, but also from its directors, officers, employees, and other agents. Absent a statutory exception, these agency law rules ordinarily control.

For example, if a corporate officer signs a contract with a third party on behalf of the corporation, so long as the corporation’s status as principal is properly disclosed in the formation of the contract, the corporate officer will have no liability in the event the corporation breaches. A corporate officer’s inclusion of his title following his name may not alone be sufficient to invoke this


5In re Marriage of Ballstaedt, 606 N.W.2d 345, 349 (Iowa 2000). See also HOK Sport, Inc. v. FC Des Moines, L.C., 495 F.3d 927, 935 (8th Cir. 2007) (“[The] party seeking to [pierce the corporate veil] bears the burden of proof. . . .”); C. Mac Chambers Co., Inc. v. Iowa Tae Kwon Do Academy, Inc., 412 N.W.2d 593, 598 (Iowa 1987) (“Plaintiffs bear the burden of proving that exceptional circumstances exist which warrant piercing the corporate veil.”).

6See, e.g., Wyatt v. Crimmings, 277 N.W.2d 615 (Iowa 1979).

A key exception is that corporate officers who are responsible for a corporation’s withholding and payment of federal payroll and other taxes may be liable if such tax payments are not made. See, e.g., Colosimo v. U.S., 630 F.3d 749, Unempl. Ins. Rep. (CCH) P 14896C, 2011-1 U.S. Tax Cas. (CCH) P 50178, 107 A.F.T.R.2d 2011-622 (8th Cir. 2011) (holding that defendant, who was a 50% shareholder and who also served as an officer of an Iowa corporation, was a “responsible person” under a federal statute requiring withheld payroll taxes to be paid over to the federal government and that defendant was liable for willfully failing to pay over the corporation’s payroll taxes).

rule.9 A similar result obtains under the doctrine of respondeat superior when corporate employees commit a tort. The corporation is the employer and principal of such persons. Thus, the corporation may be held vicariously liable for its employees’ torts, but the corporation’s directors, officers, and employees (other than those employees who committed the tort) will not face any exposure.10

There is an important exception to the general rules of limited liability for corporate obligations described in the preceding paragraphs. A corporate agent, like any other person, is always personally liable for his own actionable conduct.11 For example, an agent who enters a contract on the corporation’s behalf is not liable to the other party on the contract if he properly discloses the corporation’s status as principal. The agent may nonetheless face liability on other theories, such as lack of authority to enter the contract or for misrepresentations the agent makes in connection with contract formation.12 Similarly, no immunity arises for a tortfeasor who commits a tort in the course of his employment by a corporation (or any other person).13 The tortfeasor’s employment may trigger vicarious liability for his employer, but such liability does not negate his own exposure. Thus, the Iowa Supreme Court has held "corporate officers . . . individually liable to third parties for their torts, even when occurring while the [officers] act in their official corporate capacity."14

It is improper, of course, to recast contract or other transac-

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9 See Builders Kitchen and Supply Co. v. Moyer, 776 N.W.2d 112 (Iowa Ct. App. 2009).

10 This result follows from the principal and agent concept: an agent works on behalf of a principal, and subject to the principal’s control. See Restatement (Third) of Agency § 1.01 (2006). While corporate employees might work subject to the control of corporate directors, officers, or supervisory personnel, the employees do not work on such persons’ behalf.


12 See, e.g., All Energy Corp. v. Energetix, LLC, 985 F. Supp. 2d 974 (S.D. Iowa 2012) (individual member of limited liability company who executed nondisclosure agreement without clearly indicating his agency status, and who personally benefitted from the agreement, was bound by the agreement and the forum selection clause contained therein). See generally Restatement (Third) of Agency §§ 6.10, 6.11 (2006).

13 See generally Restatement (Third) of Agency § 7.01 (2006). This common law rule can be modified by statute, of course. For example, Iowa worker’s compensation laws permit employee suits against co-employees only where the co-employee’s gross negligence amounts to a wanton disregard for the safety of another. I.C.A. § 85.20(2).

14 Haupt v. Miller, 514 N.W.2d 905, 907 (Iowa 1994). Accord Grefe v. Ross, 231 N.W.2d 863 (Iowa 1975); Luther v. National Inv. Co., 222 Iowa 305, 268 N.W. 589 (1936); Stambaugh v. Haffa, 217 Iowa 1161, 253 N.W. 137 (1934). Corporate officers and other corporate agents have been held liable
tional claims as tort claims solely for the purpose of asserting personal liability claims against a corporate officer. In Barnhill v. Iowa District Court,\textsuperscript{15} the plaintiff's attorney brought a class action lawsuit against a shingle manufacturer on a breach of warranty and related theories. The attorney included personal liability claims against the manufacturer’s president, arguing, \textit{inter alia}, that breach of warranty was a tort for which the officer could be personally liable. The Iowa Supreme Court disagreed: “While it is true a corporate officer is individually liable for the torts he commits in his official capacity . . . it is not true that a breach of warranty claim is founded in tort law.”\textsuperscript{16}

And even in the case of conduct that is undoubtedly tortious, there are some situations where personal liability rules may be less than clear. For example, the Iowa Supreme Court held in Jasper v. H. Nizam, Inc.,\textsuperscript{17} that a corporate officer who wrongfully discharges an employee is personally liable for the tort of wrongful discharge.\textsuperscript{18} In so holding the court rejected the view adopted in some jurisdictions that the tort of wrongful discharge may be committed only by the person or legal entity that employs the terminated employee.

(3) Role of Limited Liability for Corporate Participants. Considering the foregoing, one can begin to appreciate that the limited liability protections that flow from a corporation’s separate “person” status are most important in limiting the liability exposure of a corporate shareholder, director, officer, or other agent in two broad situations: (i) where the corporate obligation arises as a result of contractual or similar relations between the corporation and a third party, and the third party has not insisted on a personal guaranty from the individual sought to be held liable to third parties under this theory for wrongful acts ranging from negligence to fraud and conversion. Haupt v. Miller, 514 N.W.2d 905 (Iowa 1994) (negligence); Briggs Transp. Co., Inc. v. Starr Sales Co., Inc., 262 N.W.2d 805 (Iowa 1978) (fraud and conversion). See also Midwest Media Group, Inc. v. Fusion Entertainment, Inc., 825 N.W.2d 327 (Iowa Ct. App. 2012) (table, unpublished decision) (affirming judgment holding corporate officer defendants liable for “the fraudulent acts they participated in or committed”).

\textsuperscript{15}Barnhill v. Iowa Dist. Court for Polk County, 765 N.W.2d 267 (Iowa 2009), as corrected, (May 14, 2009). The court similarly rejected the attorney’s other arguments in support of tort claims, such as fraudulent misrepresentation, and affirmed the imposition of sanctions against the attorney for filing the claims.


able on that obligation; and (ii) where the corporate obligation arises as a result of tortious conduct by a corporate agent other than the individual sought to be held personally liable for the tort. Yet, even in these situations, the claimant will sometimes assert that one or more corporate shareholders should be held personally liable for the obligation if the corporation cannot pay. The theory advanced will usually fit in one or more of the categories noted in the following section, which describes Iowa case law analysis pertaining to disregard of the corporate entity.

§ 15:4 Iowa case law involving disregard of the corporate entity

Research References
West's Key Number Digest, Corporations ⇔1.3 to 1.4(5)
C.J.S., Corporations §§ 14 to 16

In Iowa, as elsewhere, it is difficult to make sense of the case law governing disregard of the corporate entity.\(^1\) But some guideposts are clear. For example, disregard of the corporate entity is entirely a phenomenon of closely held corporations, and predominantly one-person corporations.\(^2\) The party who wants the court to ignore the corporation's separate existence bears the burden of proof.\(^3\) The question whether the corporate entity

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\(^3\)Cemen Tech, Inc. v. Three D Industries, L.L.C., 753 N.W.2d 1, 5-6 (Iowa 2008); In re Marriage of Ballstaedt, 606 N.W.2d 345 (Iowa 2000). See also HOK Sport, Inc. v. FC Des Moines, L.C., 495 F.3d 927, 935 (8th Cir. 2007) ("[T]he party seeking to pierce the corporate veil] bears the burden of proof . . ."); C. Mac Chambers Co., Inc. v. Iowa Tae Kwon Do Academy, Inc., 412 N.W.2d 593, 598
should be disregarded is ordinarily an issue of fact for the jury, although at least one Iowa jurist has recently challenged this practice. Incorporation of a one-person business to attain limited liability (or acquisition of all shares of a corporation by one person), even where such person also serves as a director and officer of the corporation, does not of itself destroy the corporate entity. In most cases where the corporate entity is disregarded, all shareholders who actively participate in its affairs or who have positions of responsibility will be held liable for its obligations. Finally, courts may disregard the corporate entity in both the for-profit and non-profit settings.

One procedural issue that the Iowa cases have not discussed is whether veil-piercing is a separate cause of action against persons who are alleged to have abused the corporate form or simply a remedy for a plaintiff who brings a cause of action against the corporation. And if the latter is true, a related question is whether claim preclusion/res judicata principles bar later pursuit of the piercing remedy if plaintiff failed to join individual shareholder defendants in the original corporate action.

As regards the substantive grounds for disregard of the

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4 See, e.g., Team Central, Inc. v. Teamco, Inc., 271 N.W.2d 914 (Iowa 1978); Fazio v. Brotman, 371 N.W.2d 842 (Iowa Ct. App.1985). See also HOK Sport, Inc. v. FC Des Moines, L.C., 495 F.3d 927 (8th Cir. 2007) (applying Iowa law, affirming a jury verdict that imposed liability based on piercing and alter ego theories). Because issues of alter ego and veil piercing are normally equitable questions, many states make the trial court responsible for determining the underlying factual issues as well as for fashioning the equitable remedy. See, e.g., Wandering Trails, LLC v. Big Bite Excavation, Inc., 156 Idaho 586, 591, 329 P.3d 368, 373 (2014).


7 See, e.g., Briggs Transp. Co., Inc. v. Starr Sales Co., Inc., 262 N.W.2d 805, 809 (Iowa 1978) (holding shareholder personally liable when veil was pierced, despite her lack of activity in corporation’s affairs, where she was also corporate officer). See generally Thompson, The Limits of Liability in the New Limited Liability Entities, 32 Wake Forest L.Rev. 1, 10 (1997).

8 See HOK Sport, Inc. v. FC Des Moines, L.C., 495 F.3d 927 (8th Cir. 2007) (applying Iowa law and affirming piercing decision imposing liability on person who was sole organizer, sole director and sole officer of non-profit corporation).

corporate entity, the Iowa courts often metaphorically describe the result in such cases as “piercing the corporate veil.”\textsuperscript{10} They have used other colorful phrases as well, labeling a corporation whose separate existence is disregarded as the “mere shell,” “intermediary,”\textsuperscript{11} “instrumentality,” or “alter ego” of the shareholders,\textsuperscript{12} or as a “sham.”\textsuperscript{13} Cardozo’s admonition concerning this trend remains relevant: “The whole problem of the relation between [shareholder and corporation] is one that is still enveloped in a mist of metaphor. Metaphors in law are to be narrowly watched, for starting as devices to liberate thought, they end often by enslaving it.”\textsuperscript{14}

When one looks beyond the metaphors, at least two different sets of standards for piercing the corporate veil emerge from the Iowa cases. Under the “alter ego” theory, a court will disregard a corporate entity that is “merely an instrumentality or device set up to ensure the avoidance of . . . legal obligations.”\textsuperscript{15} HOK Sport, Inc. v. FC Des Moines, L.C.,\textsuperscript{16} a recent Eighth Circuit case applying Iowa law, stated the elements of this theory as follows:

A corporate entity is the alter ego of a person if (1) the person influences and governs the entity; (2) a unity of interest and ownership exists such that the corporate entity and the person cannot be separated; and (3) giving legal effect to the fictional separation between the corporate entity and the person would “sanction a fraud

\textsuperscript{10}See, e.g., Briggs Transp. Co., Inc. v. Starr Sales Co., Inc., 262 N.W.2d 805, 809 (Iowa 1978) (“piercing the corporate veil”). See also HOK Sport, Inc. v. FC Des Moines, L.C., 495 F.3d 927, 935–936 (8th Cir. 2007) (applying Iowa law, “piercing the corporate veil”).


\textsuperscript{12}Benson v. Richardson, 537 N.W.2d 748, 761 (Iowa 1995) (“instrumentality” or “alter ego”). See also HOK Sport, Inc. v. FC Des Moines, L.C., 495 F.3d 927, 935 (8th Cir. 2007) (applying Iowa law, “alter ego theory”).


\textsuperscript{14}Berkey v. Third Ave. Ry. Co., 244 N.Y. 84, 155 N.E. 58, 61, 50 A.L.R. 599 (1926). Other metaphors the courts have used describe the corporation as the “agent,” “alias,” or “dummy” of its shareholders. Solomon et al., Corporations Law and Policy 300 (4th ed. 1998).

\textsuperscript{15}Benson v. Richardson, 537 N.W.2d 748, 761 (Iowa 1995). See also Moyle v. Elliott Aviation, Inc., 715 N.W.2d 767 (Iowa Ct. App. 2006).

\textsuperscript{16}HOK Sport, Inc. v. FC Des Moines, L.C., 495 F.3d 927 (8th Cir. 2007).
The HOK court affirmed a jury's finding that the owner of a soccer team was the alter ego of a nonprofit corporation the owner organized to build a stadium for his team. The nonprofit corporation contracted with the plaintiff for stadium design services but was unable to pay for the services after construction plans were abandoned. The court summarized the "alter ego" evidence as follows:

When the proprietor of a for-profit business establishes a nonprofit corporation to assume a liability or risk that otherwise, in the ordinary course of business, would have been assumed by a for-profit business, and when the non-profit corporation accrued liabilities without any means to satisfy the liabilities, a reasonable jury may easily decide that allowing the for-profit business (or its owner) to escape the liability would be sanctioning a fraud and promoting an injustice.18

A more commonly applied theory for disregard of the corporate entity is to "pierce the corporate veil" of a corporation that is "a mere shell, serving no legitimate business purpose, and used primarily as an intermediary to perpetuate fraud or promote injustice."19 This standard can be traced to Briggs Transportation Co. v. Starr Sales Co.,20 where the Iowa Supreme Court characterized these three criteria not as a "test" per se for piercing the corporate veil, but rather as an "example" of the "exceptional circumstances" that courts should require before disregarding the corporate entity.21 Nonetheless, many cases in which the corporate veil has been pierced fit these criteria.22

The most helpful set of piercing standards from the Briggs case

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17HOK Sport, Inc. v. FC Des Moines, L.C., 495 F.3d 927, 935 (8th Cir. 2007).
18HOK Sport, Inc. v. FC Des Moines, L.C., 495 F.3d 927, 941 (8th Cir. 2007).
19See, e.g., In re Marriage of Ballstaedt, 606 N.W.2d 345, 349 (Iowa 2000), quoting C. Mac Chambers Co., Inc. v. Iowa Tae Kwon Do Academy, Inc., 412 N.W.2d 593, 597 (Iowa 1987).
22See, e.g., C. Mac Chambers Co., Inc. v. Iowa Tae Kwon Do Academy, Inc., 412 N.W.2d 583 (Iowa 1987) (corporate veil pierced where son formed corporation to carry on the business of an insolvent corporation owned by his father, allowing father to enjoy the benefits of the continued business without any compensation to father's insolvent corporation or its creditors); Murray v. Conrad, 346 N.W.2d 814, 38 U.C.C. Rep. Serv. 1633 (Iowa 1984) (corporate form disregarded to reach corporate assets as if they belonged to controlling individual where corporation was not capitalized, no stock was ever issued, no corporate books were kept and corporate funds were commingled with funds of individual and with funds of his other corporations); Briggs Transp. Co., Inc. v. Starr Sales Co., Inc., 262 N.W.2d 805 (Iowa 1978) (corporate veil pierced where corpora-
requires consideration of six separate factors to determine whether the corporate entity should be disregarded. These criteria, consistently repeated in one form or another by the Iowa courts in piercing cases, are: (1) Was the corporation undercapitalized? (2) Did the corporate participants follow corporate formalities? (3) Did the corporation keep separate books? (4) Were corporate finances kept separate from individual finances, or did the corporation pay individual obligations? (5) Was the corporation used to promote fraud or illegality? (6) Was the corporation a mere sham?

While more than one element is typically present in a given case, and the list of considerations is not necessarily exhaustive, each contributes something useful to piercing analysis.

(1) Undercapitalization. The adequacy of corporate capital, measured by the nature and magnitude of the corporate undertaking, has long been considered relevant to piercing analysis. In Briggs the Iowa Supreme Court offered the following rationale for considering undercapitalization as a piercing factor:

If a corporation is organized and carries on business without substantial capital in such a way that the corporation is likely to have no sufficient assets available to meet its debts, it is inequitable that shareholders should set up such a flimsy organization to escape personal liability. The attempt to do corporate business without providing any sufficient basis of financial responsibility to creditors is an abuse of the separate entity and will be ineffectual to exempt the shareholders from corporate debts. It is coming to be recognized as the policy of the law that shareholders should in good faith put at the risk of the business unencumbered capital reasonably adequate for its prospective liabilities. If capital is illusory or
trifling compared with the business to be done and the risks of loss, this is a ground for denying the separate entity privilege.27

“Capital” typically means shareholder equity, although in an appropriate context, it may also include insurance coverage.28 Inadequate capitalization, by itself, rarely leads to disregard of the corporate entity.29 Nonetheless, a focus on capitalization in piercing cases is consistent with an understanding of the doctrine as rooted in fraudulent conveyance principles.30

The Iowa courts have cited inadequate capitalization as a basis for piercing in a number of cases. These include Briggs, where the Iowa Supreme Court noted testimony from one of the corporation’s shareholders that “‘there wasn’t any money paid in. There wasn’t any assets.’”31 Similarly, in C. Mac Chambers Co. v. Iowa Tae Kwon Do Academy, Inc.,32 the court pierced the corporate veil in part because the sole shareholder “did [not at any time] offer any consideration for his 1,000 shares of stock . . . and by his own admission . . . made no capital contribution to the venture.”33 Affirming a jury’s piercing decision in HOK Sport, Inc. v. FC Des Moines, L.C.,34 the Eighth Circuit stated: “By being in the business of constructing a stadium, TSF needed to be sufficiently capitalized so TSF could pay its debts even if the stadium project failed. TSF never had sufficient capital to pay for the stadium’s design in the event the stadium was not built.”35 Most recently, in Keith Smith Company v. Bushman,36 a limited liability company piercing case, inadequate capitalization was a key basis for the court’s piercing decision.

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28See, e.g., Moyle v. Elliott Aviation, Inc., 715 N.W.2d 767 (Iowa Ct. App. 2006) (while airline company’s $40 million insurance did not prove proper capitalization, the policy helped establish that no exceptional circumstances justified piercing); Radoszewski by Radoszewski v. Telecom Corp., 981 F.2d 305 (8th Cir. 1992) (piercing claim by tort victim).
29Clark, Corporate Law § 2.4.1 at 74 (1986). But see Slottow v. American Cas. Co. of Reading, Pennsylvania, 10 F.3d 1355, 1360 (9th Cir. 1993) (reiterating 9th Circuit’s view that, under California law, undercapitalization alone constitutes an “excellent argument” for piercing the corporate veil).
30Clark, Corporate Law § 2.4 (1986).
32C. Mac Chambers Co., Inc. v. Iowa Tae Kwon Do Academy, Inc., 412 N.W.2d 593 (Iowa 1987).
33C. Mac Chambers Co., Inc. v. Iowa Tae Kwon Do Academy, Inc., 412 N.W.2d 593, 598 (Iowa 1987).
34HOK Sport, Inc. v. FC Des Moines, L.C., 495 F.3d 927 (8th Cir. 2007).
35HOK Sport, Inc. v. FC Des Moines, L.C., 495 F.3d 927, 941 (8th Cir. 2007).
Beck v. Equine Estates Development Co.,\(^ {37}\) in contrast, involved a corporation that was adequately capitalized at the time of the transaction in question. Despite the corporation’s later inability to fulfill its obligation, the court refused to pierce the corporate veil.\(^ {38}\)

(2) Procedural Formalities; (3) Separate Books; and (4) Separate Finances. The courts also consider whether shareholders have observed corporate procedural formalities (e.g., elected directors and appointed officers, issued shares, conducted regular meetings, etc.). A related consideration is whether shareholders have kept the corporation “financially” separate from themselves (e.g., maintained corporate financial records and distinguished between individual and corporate funds and obligations). Along with undercapitalization, shareholders’ failure to follow these procedural and financial formalities appears to be one of the most important elements in a piercing claim.\(^ {39}\)

One may plausibly ask why this is so. In what respect are corporate formalities related to the principle of limited liability? To be sure, when shareholders fail to observe formalities to such an extent that third parties are confused about the corporation’s very existence, piercing might be appropriate. But such confusion is not always present when courts cite deficiencies in corporate formalities as a basis for piercing.\(^ {40}\)

Perhaps the focus on formalities simply reflects equitable principles of estoppel: if the shareholders do not consistently observe the separate existence of the corporation in its operation, why should they be permitted to do so when the corporation’s separate existence prejudices creditors? Moreover, failures of corporate record-keeping and financial commingling may make it more difficult for creditors to trace and recover corporate assets.\(^ {41}\)

Whatever the justification, the Iowa courts have cited shareholders’ failure to observe corporate procedural formalities and/or to preserve the financial separateness of their corporation in a


\(^{39}\) In Briggs for example, the court affirmed a piercing finding by the lower court not only based on the shareholders’ failure to properly capitalize the corporation, but also because there were no corporate books and records, and because corporate funds were not segregated from those of the shareholders. Briggs Transp. Co., Inc. v. Starr Sales Co., Inc., 262 N.W.2d 805, 810–11 (Iowa 1978).


number of cases where piercing claims have been sustained. For example, in Van Oort Construction Co. v. Nuckoll's Concrete Service, Inc.,\(^{42}\) the Iowa Supreme Court affirmed a trial court's finding that a shareholder violated a covenant not to compete by engaging in a competitive business under the auspices of a corporation he had formed. The court observed:

No stock was ever issued. No tax returns were ever filed. The corporation did not collect or pay any employment taxes or social security. Randall [the sole shareholder] did not observe corporate formalities. . . . We conclude that substantial evidence supports the trial court’s finding that the corporation was a sham and that Randall violated his covenant not to compete.\(^{43}\)

In Murray v. Conrad,\(^{44}\) the court cited similar considerations in support of its decision to treat corporate assets as if they belonged to the corporation’s sole shareholder for purposes of a security agreement the shareholder had signed:

The factfinder could find C.D.I. [the corporation] was a mere shell established by Conrad to hold his distributorship license. The corporation was not capitalized, and no stock was ever issued. No corporate books were kept. Corporate funds were commingled with funds of Conrad individually and with funds of other Conrad corporations.\(^ {45}\)

The Eighth Circuit’s recent piercing decision in HOK Sport, Inc. v. FC Des Moines, L.C.,\(^{46}\) similarly cited commingling of finances and failure to follow formalities as evidence supporting a jury’s verdict piercing the corporate veil of an Iowa nonprofit corporation.\(^ {47}\)

The shareholders observed corporate formalities for the corporation at issue in Northwestern National Bank of Sioux City v. Metro Center, Inc.\(^ {48}\) A twenty percent (20\%) shareholder of the corporation then claimed that his mechanic’s lien had priority over a bank mortgage on corporate property. The trial court pierced the corporate veil and held for the bank, but the Iowa


\(^{46}\)HOK Sport, Inc. v. FC Des Moines, L.C., 495 F.3d 927 (8th Cir. 2007).

\(^{47}\)HOK Sport, Inc. v. FC Des Moines, L.C., 495 F.3d 927, 941–942 (8th Cir. 2007).

Supreme Court reversed. The court noted that the shareholders had maintained the corporation as a separate and distinct entity from themselves and had preserved separate financial accounts.49

There is some indication in recent decisions from the Iowa Court of Appeals that where the only basis for piercing is shareholders’ failure to strictly observe corporate formalities, the corporate veil should not be pierced if that failure did not in any way mislead third party creditors. In these situations, one can fairly conclude that the corporate creditor assumed the risk that corporate assets might not be sufficient to satisfy his claim.

In Ross v. Playle,50 for example, the sole shareholder, director, and officer of a corporation failed to follow corporate formalities in connection with the issuance of purchase orders, but the creditor knew that the shareholder was “buying all merchandise for the corporation.”51 The Iowa Court of Appeals affirmed a trial court finding that such evidence was an insufficient basis for piercing the corporate veil.52 Similarly, in Tannahill v. Aunspach,53 the shareholder and president of a corporation failed to adhere to corporate formalities when entering a rental transaction on the corporation’s behalf and did not object when the lessor failed to include references to the corporation in related documentation. The Iowa Court of Appeals reversed the trial court’s decision to pierce the corporate veil, reasoning that the shareholder’s failure to adhere to formalities and the absence of corporate references did not mislead the lessor into believing the transaction was a personal one.54

However, the Iowa Supreme Court’s piercing decisions do not universally impose a requirement that the lack of formalities must cause confusion on the part of corporate creditors, at least where other factors (such as inadequate capitalization) support piercing.55 In any event, creditor confusion should generally be irrelevant when the victim of a corporate tort seeks piercing relief,

49 The court also noted that there was no claim of fraud or undercapitalization. Northwestern Nat. Bank of Sioux City v. Metro Center, Inc., 303 N.W.2d 395, 398–99 (Iowa 1981). See also King v. Wilson, 860 N.W.2d 341 (Iowa Ct. App. 2014) (table, unpublished decision)(affirming directed verdict dismissing piercing claims where plaintiff failed to establish that the defendant “materially failed to follow formalities” and where there was no evidence of financial commingling); Ross v. Playle, 505 N.W.2d 515 (Iowa Ct. App.1993) (refusing to pierce where the only failure to observe corporate formalities occurred in the execution of purchase orders and did not mislead creditor).


55 See, e.g., the piercing decisions
since, typically, the tort victim will not have voluntarily transacted business with the corporation.

(5) Corporation Used to Promote Fraud or Illegality; (6) Corporation a “Mere Sham.” The most common situations in which courts disregard the corporate entity are those where the shareholders have used the corporation to accomplish an end that is in some respect fraudulent, illegal, or unfairly prejudicial to the rights of creditors. In these cases, the courts often label the resulting corporation as a “mere sham” or “instrumentality” of the shareholders and disregard its separate existence.

The decision to pierce the corporate veil in Briggs is a good example. A family-owned corporation purchased merchandise from plaintiff. In the process, one or more of the shareholders falsified the corporation’s credit history, resold the delivered merchandise, and misappropriated the proceeds without payment to the original seller. These events, together with evidence that the corporation had never been properly capitalized and that no formalities had ever been observed, persuaded the Iowa Supreme Court that piercing was a proper remedy.

In Van Oort Construction Co. v. Nuckoll’s Concrete Service, Inc., discussed above, the court applied similar reasoning to strike down an individual’s attempt to circumvent a covenant not to compete by working under the auspices of a corporation he formed for that purpose. The court labeled the resulting corporation a “sham” and pierced the corporate veil in order to find a violation of the covenant not to compete.

The degree of fraud, illegality, or other shareholder misconduct necessary to produce a piercing result will not always rise to the levels present in the foregoing cases. Indeed, one Iowa decision expansively suggests that disregard of the corporate entity is permissible “where limited liability would be inequitable” or where corporate recognition “would work inequitably against one or more groups of creditors of the enterprise.” While such language might be overbroad, it serves as a helpful reminder that piercing analysis is equitable in nature, and that “no hard and fast rule as to the conditions under which the entity may be

\[\text{References:}\]


disregarded can be stated. . . ."\(^{61}\)

(7) An Additional Factor? Contract Creditors and Assumption of the Risk. In a recent Iowa limited liability company piercing case, Keith Smith Company v. Bushman,\(^{62}\) Court of Appeals Judge McDonald argued in dissent that another consideration should be added to Iowa piercing jurisprudence: whether the claimant voluntarily transacted business with the entity without seeking security or personal guarantees and thereby assumed the risk that the entity might be unable to pay the claim.

The facts of the case were unexceptional. Keith Smith Company (Smith) contracted to supply eggs to Farmer Grown Poultry (FGP), a start-up limited liability company owned by the Bushmans. The eggs were to be used in a hatchery and poultry processing business that the Bushmans planned to conduct through FGP and several other Bushman entities. When Smith investigated FGP’s financial condition before entering the egg supply contract, the Bushmans provided financial information on the related entities, as FGP had not yet been formed. As it turned out, FGP was severely undercapitalized upon its formation, operating mainly on borrowed funds from other Bushman companies. FGP closed its doors after only a brief period of operations and without paying approximately $250,000 in egg invoices from Smith. Smith sued FGP for breach of contract and included piercing claims against the Bushmans and the other Bushman companies. The trial court held the Bushmans, but not the related companies, personally liable for FGP’s obligations. A divided Court of Appeals affirmed, emphasizing trial court findings that FGP was severely undercapitalized.

Judge McDonald’s dissenting opinion argued that it should be extremely difficult for a plaintiff who contracts with a limited liability entity—even one that is inadequately capitalized—to pierce the entity’s veil. He wrote:

I would hold personal liability should not be imposed on members of an LLC for the LLC’s obligations on the basis of inadequate capitalization of the LLC where the judgment creditor’s claim arises in contract, where the judgment creditor had the opportunity to obtain financial statements and other credit information prior to entering the contract, where the judgment creditor had the opportunity to price and allocate the risk of loss by requesting personal guaranties or other security, and where the judgment

\(^{61}\) 15A Fletcher, Cyclopedia of the Law of Private Corporations § 41.30 (rev. perm. edition).

\(^{62}\) Keith Smith Co., Inc. v. Bushman, 873 N.W.2d 776 (Iowa Ct. App. 2015) (table, unpublished decision). The case is also covered in Section 13:22, which discusses piercing claims in the limited liability company context.
creditor failed to do so.\textsuperscript{63}

As reflected by the authorities Judge McDonald marshalled in his dissenting opinion, his position—that a voluntary creditor of a limited liability entity should rarely be able to pierce because such a creditor can bargain in advance for security or for a guaranty from the entity’s owners—does have considerable support.\textsuperscript{64} But there is contrary authority,\textsuperscript{65} and it remains to be seen whether the Iowa Supreme Court will adopt Judge McDonald’s position.

\section*{§ 15:5 Disregard of the corporate entity: special situations}

\textbf{Research References}

West’s Key Number Digest, Corporations \textsuperscript{\textbf{\(\Rightarrow\)}}1.4(1)

C.J.S., Corporations §§ 14 to 17

Special considerations apply in certain situations in which courts are asked to disregard the corporate entity. These include: cases where choice of law issues arise; piercing cases designed to reach corporate assets to satisfy claims against shareholders; “reverse piercing” cases; cases where the piercing claim involves interpretation of a statute; and disregard of the corporation for procedural purposes in litigation.

\textbf{(1) Choice of Law Issues.} When an Iowa state or federal court resolves a piercing claim relating to an Iowa corporation, there is little question that Iowa law applies. But what if an Iowa court is asked to pierce the corporate veil of a foreign corporation? Does Iowa piercing law control that issue or should the court instead look to the law of piercing as applied in the corporation’s home jurisdiction? The answer is not clear.

Under the “internal affairs” choice of law rule, the law of a


\textsuperscript{64}Keith Smith Co., Inc. v. Bushman, 873 N.W.2d 776, 2015 WL 8364910 at *12 - *13 (Iowa Ct. App. 2015) (McDonald, J., dissenting, collecting cases) (table, unpublished decision). And as discussed earlier in the text of this Section 15:4, there is also some support for McDonald’s view in a few Iowa corporate piercing cases where courts have declined to impose liability on shareholders who failed to follow corporate formalities. In Tannahill v. Aunspach, 538 N.W.2d 871 (Iowa Ct. App. 1995), for example, the court justified a refusal to pierce the veil on the theory that, despite the problem with formalities, plaintiff was never misled into thinking the transaction was a “personal” rather than a “corporate” one.

\textsuperscript{65}See, e.g., Kinney Shoe Corp. v. Polan, 939 F.2d 209 (4th Cir.1991) (rejecting argument that West Virginia adds an “assumption of the risk” element for piercing claims by contract creditors).
corporation’s organizing jurisdiction generally controls the outcome of *internal* entity governance questions regardless of where they are litigated. But piercing cases have an important external dimension. A third party (typically a corporate creditor) contends that one or more shareholders should be held personally liable for corporate obligations because the corporate form has been abused. In such a case, traditional choice of law theories, like “the most significant relationship” test, might be more appropriate than the internal affairs rule.

To date Iowa’s appellate courts have not addressed this issue. However, an Iowa federal district court, noting that the majority of jurisdictions addressing this question also apply the internal affairs rule in veil-piercing cases, has predicted that Iowa courts will resolve choice of law issues in piercing cases by applying the internal affairs rule. The court therefore used Nebraska law when analyzing piercing claims brought against the owners of a Nebraska limited liability company that allegedly breached a contract to deliver hogs in Iowa.

(2) Reverse Piercing (Piercing to Reach Corporate Assets). Disregard of the corporate entity has traditionally been understood as an equitable remedy to be applied where principles of limited liability would produce an unjust result for corporate creditors. In some situations, however, it is the personal creditors of shareholders who seek disregard of the corporate veil. The goal in such cases—which some describe as “reverse piercing cases”—is to reach corporate assets to satisfy shareholder creditor claims.

Benson v. Richardson, where the court pierced the corporate veil to reach the assets of a professional corporation owned by a physician and his wife, is a good example of this tactic being employed in Iowa, although the court never used the phrase “re-

[Section 15:5]


4For a recent example from the federal courts, see U.S. v. Badger, 818 F.3d 563 (10th Cir. 2016) (government sought declaration that various entities were debtor’s alter egos so that their assets could be pursued to satisfy securities fraud claims; court predicted that Utah law would recognize a reverse-piercing theory of recovery and remanding case for trial on that basis); see also M.J. v. Wisan, 2016 UT 13, 371 P.3d 21, 34-37 (Utah 2016) (holding that Utah allows reverse piercing of the corporate veil, but declining to reverse pierce).

5Benson v. Richardson, 537 N.W.2d 748 (Iowa 1995).
verse piercing.” The evidence strongly suggested that the corporation’s sole purpose was to hide the physician’s earnings from his judgment creditors, and thus, it effectively operated as a fraudulent conveyance on those creditors. The court directed entry of judgment against the corporation for the full amount of the physician’s obligations, stating:

[The shareholders] provided us with no credible purpose for the establishment of Richardson, P.C. other than to maintain the Richardsons’ lavish lifestyle and shield Gary’s substantial earnings from the satisfaction of his obligations. Richardson, P.C. is truly Gary’s alter ego. It stands in his place with regard to his former employment arrangements and serves no independent purpose other than to provide for the day-to-day comfort of himself and his family. Fraudulent concealment of earnings is not a valid purpose for a corporation.7

(3) Reverse Piercing (Piercing to Benefit Shareholders).
Circumstances sometimes also arise where it is to the advantage of corporate shareholders that the corporate entity be disregarded.8 In these situations some courts have applied a “reverse piercing” doctrine to enable shareholders to pierce the corporate veil “from within,”9 but thus far, the Iowa courts have been less than receptive to such attempts.

In Hawkeye Bank and Trust, N.A. v. Baugh,10 the first Iowa Supreme Court decision on this question, the court rejected a shareholder’s attempt to pierce the veil of a small, closely held corporation he owned with several other persons.11 The shareholder asked the court to disregard the corporate entity so that

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7Benson v. Richardson, 537 N.W.2d 748, 762 (Iowa 1995).
11The earliest reported decision of the Iowa Supreme Court concerning reverse piercing, Inn Operations, Inc. v. River Hills Motor Inn Co., 261 Iowa 72, 152 N.W.2d 808 (1967), did not decide the issue. Plaintiff corporation did not qualify to do business in Iowa until after it commenced a lawsuit here, and wanted the court to disregard its status as a corporate entity to avoid questions about its right to maintain the action. The court avoided the question, concluding that the corporation’s subsequent qualification entitled it to maintain the action without piercing its corporate veil.
he could defend the corporation on a pro se basis in a fraudulent conveyance action (pro se representation being a right available to individuals but not to corporations). The court rejected the request, noting that even proponents of the reverse piercing doctrine had recognized its limitations:

We are aware of the danger of a debtor being able to raise or lower his corporate shield, depending on which position best protects his property. Consequently, a reverse pierce should be permitted in only the most carefully limited circumstances.12

The court was not persuaded that the pro se representation doctrine “was one of the ‘limited circumstances’ calling for departure from the general rule.”13

Without citing the reverse piercing doctrine by name, the court also effectively refused to apply it in Sullivan Graphics, Inc. v. Board of Review.14 Sullivan involved the tax treatment of an individual’s acquisition of a corporation that owned machinery and equipment. If the individual had acquired the machinery and equipment directly, he would have qualified for a reduction in their valuation for property tax purposes under Iowa Code Section 427B.17 (providing reductions for certain machinery and equipment acquired after January 1, 1985). The individual argued that he should receive the reduction, despite the form of the transaction, on the theory that buying all of the stock of the corporation that owned the machinery and equipment was the same as buying the machinery and equipment itself. The court disagreed, holding that ownership of the equipment had never changed.15

Similarly, in Krupp Place 1 Co-op, Inc. v. Board of Review,16 the Iowa Supreme Court declined an invitation to “pierce the corporate veil” in order to deny residential cooperative status to two multi-unit apartment buildings based on their actual status as rental units. The court stated that, “the doctrine of piercing the corporate veil is a limited one that is employed only on behalf of creditors to reach the personal assets of shareholders of

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12 Hawkeye Bank and Trust, Nat. Ass’n v. Baugh, 463 N.W.2d 22, 25, 8 A.L.R.5th 991 (Iowa 1990) (quoting Cargill, Inc. v. Hedge, 375 N.W.2d 477, 480 (Minn. 1985)).
16 Krupp Place 1 Co-op, Inc. v. Board of Review of Jasper County, 801 N.W.2d 9 (Iowa 2011).
Another example is Crees v. Chiles,18 where the Iowa Court of Appeals rejected an effort to extend worker’s compensation immunity to persons who might be considered the alter ego of a corporation under a reverse piercing theory. An injured worker sued a co-employee for gross negligence, as permitted under the worker’s compensation laws. The co-employee, who was also a shareholder, director, and officer of the injured worker’s corporate employer, claimed immunity under the worker’s compensation statute on the theory that he was the corporate employer’s “alter ego.” The court rejected the claim, concluding that it was inappropriate to expand the statutory immunity scheme authorized by the legislature.19

While the reverse piercing doctrine was not invoked by name, the Iowa Court of Appeals, in a recent unpublished decision, Rooker v. Flanagan,20 held that a corporate shareholder was not protected by immunity that was otherwise available to his corporation as a licensee or permittee under Iowa’s Dram Shop Act. The court held: “a person who is not a licensee or permittee, regardless of whether that person is a principal of a corporation that actually holds the license or permit, is not protected by the provisions of the dramshop act.”21

(4) Piercing and Statutory Interpretation. The Sullivan Graphics and Crees decisions discussed immediately above deserve special comment for another reason. Both cases illustrate that, for some piercing claims, the court’s decision on disregard of the corporate entity will depend more on the court’s reading of a controlling statute than on traditional piercing criteria. In Sullivan, for example, the court refused to disregard the corporate entity as owner of the property in question not only because corporate law treated the shareholder and his corporation as separate persons, but also because the court understood the tax statute at issue as requiring that result.22 The same was true in Crees, where the statutory immunity scheme of the worker’s compensation laws controlled the outcome as much as traditional

17Krupp Place 1 Co-op, Inc. v. Board of Review of Jasper County, 801 N.W.2d 9, 16 (Iowa 2011). See also Dolphin Residential Cooperative, Inc. v. Iowa City Bd. of Review, 863 N.W.2d 644, 650 (Iowa 2015) (citing Krupp).
corporate law doctrine, and in Rooker v. Flanagan,\textsuperscript{23} where the Iowa Dram Shop Act controlled the outcome.\textsuperscript{24}

Similar statutory interpretation issues have surfaced in a variety of contexts. Whether the statute will support corporate participants’ personal liability or immunity depends upon its interpretation. Certain federal statutes, such as the environmental and employment laws, have long been construed to impose personal liability on corporate participants in certain situations.\textsuperscript{25}

\textbf{(5) Piercing for Procedural Purposes in Litigation.} A final topic that deserves special attention is disregard of the corporate entity for procedural purposes in litigation.\textsuperscript{26} As in ordinary piercing contexts, when a party asks a court to disregard the separate entity status of a corporation for procedural purposes, the court must start from the presumption that the corporation is a separate entity from other parties.\textsuperscript{27} If applicable burdens of proof can be met, however, piercing can be a useful procedural tool.

For example, it has long been the practice of courts to pierce the corporate veil in order to entertain or decline jurisdiction over corporate participants in the interest of fair and orderly judicial procedure. Indeed, the six-factor piercing test endorsed by the Iowa Supreme Court in Briggs Transportation Co. v. Starr Sales Co.\textsuperscript{28} originated from a personal jurisdiction ruling by the Eighth Circuit. In Lakota Girl Scout Council v. Havey Fund-Raising Management, the Eighth Circuit applied these six factors to establish in personam jurisdiction over the chief execu-

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\textsuperscript{24}Crees v. Chiles, 437 N.W.2d 249, 251–53 (Iowa Ct. App. 1988).
\textsuperscript{26}See generally Henn & Alexander, Laws of Corporations § 151 (3d ed. 1983).
tive officer and sole shareholder of a nonresident corporation that conducted corporate activities in Iowa.\textsuperscript{29}

As in cases where disregard of the corporate entity intersects with questions of statutory interpretation, the outcome of such “procedural piercing” decisions will not always depend solely on standard piercing factors. For example, where piercing has been asserted to overcome the “fiduciary shield” defense to personal jurisdiction over nonresident corporate agents,\textsuperscript{30} the Iowa courts have supported a relaxed application of the traditional criteria. As the Iowa Supreme Court noted in a recent decision:

In deciding whether the corporation is a real or a shell entity [for purposes of overcoming a fiduciary shield defense to personal jurisdiction], the appropriate standard should not be the very stringent test normally applied in other contexts for piercing the corporate veil. . . . The fiduciary shield doctrine . . . is not concerned with liability. It is concerned with jurisdiction and specifically with the fairness of asserting jurisdiction over a person who is acting solely in the interests of another. In determining whether a corporation for which an owner-employee acts is really ‘another,’ it is sufficient to inquire whether the corporation is a real or a shell entity. If the corporation is merely a shell, it is equitable, even if the shell may not have been used to perpetrate a fraud, to subject its owner personally to the court’s jurisdiction to defend the acts he has done on behalf of his shell. . . .\textsuperscript{31}

As in all cases where disregard of the corporate entity is asserted, much depends on context.

\textbf{§ 15:6 Protecting a corporation against disregard of its entity}

\textbf{Research References}

West’s Key Number Digest, Corporations \textsuperscript{\textsuperscript{\textsuperscript{1}.3, 1.4(1)}}

C.J.S., Corporations § 27

As noted at the outset of this discussion, it is difficult to make sense of all of the case law pertaining to disregard of the corporate veil. However, the cases teach a few lessons for corporate participants who wish to avoid piercing claims. While the sep-

\textsuperscript{29}Lakota Girl Scout Council, Inc. v. Havey Fund-Raising Management, Inc., 519 F.2d 634 (8th Cir. 1975).

\textsuperscript{30}Under the fiduciary shield doctrine, a nonresident corporate agent is not individually subject to the forum state’s in personam jurisdiction if that individual’s only contact with the state is by virtue of his acts as a fiduciary of the corporation. See generally Note, The Fiduciary Shield and In Personam Jurisdiction, 70 Iowa L.Rev. 1021 (1985).

rate entity of the corporation is the rule and not the exception, abuse of the entity by those who own or control it invites courts to disregard its existence.

Thus, corporate capitalization and insurance should be adequate for foreseeable corporate needs. Where parent and subsidiary corporations (or a dominant sole shareholder and his corporation) are involved, each should have its own bank accounts, and its own accounting records. There should be no commingling of assets of shareholders and the corporation, or, if commingling is necessary, ownership identity should be carefully preserved. Similarity of officers and directors is not of itself a basis for disregard of the entity, but the presumption in favor of a separate entity may be harder to rebut if these are not identical. Corporate formalities should be observed carefully. Stockholders’ and directors’ meetings should be held regularly or reflected in properly kept consent minutes. In short, when the participants treat the corporation as having a factual existence, they cannot guaranty that the entity will not be disregarded, but they substantially increase the likelihood that its existence will be respected.

§ 15:7 Chapter contributions

The material in this Chapter is not entirely original. With the permission of West Group, the author has taken parts of Sections 15:1 and 15:2 from the discussion in 25 Louis & Brown, Missouri Practice—Business Organizations, Ch. 8, §§ 8.1 & 8.2 (1993). In some places within those sections the text and footnote material is taken directly from the original discussion in the Louis & Brown treatise, without quotation or specific attribution. The author gratefully acknowledges the contribution of these authors.
§ 13:22 Member and manager liability for limited liability company obligations—Exceptions to the limited liability shield

Despite the generally prevailing rule of limited liability for members and managers of limited liability companies, there are several important exceptions to the liability protections afforded by the company’s entity status and its statutory liability shield. These include: (i) conduct-based liability to third persons; (ii) personal liability voluntarily assumed by contract; (iii) personal liability that may be imposed by other provisions of Re-ULLCA or by other statutory law; and (iv) veil-piercing and similar equitable exceptions that are commonly applied to participants in limited liability entities. The following paragraphs describe these situations in more detail.

(1) Conduct-Based Liability to Third Persons—Agency Law Exceptions and Personal Liability for Torts. Re-ULLCA’s recognition of the limited liability company’s entity status and Re-ULLCA’s express liability shield protect members and managers from liability for company obligations simply because of their status as members and managers or because they have “acted” as members and managers. This protection does not apply to liability claims against members and managers based on their own conduct, even if the company may also be vicariously liable for such claims. Two easy examples of conduct-based liability that may apply to limited liability company members and managers come from the common law of agency and the law of torts, both of which supplement Re-ULLCA.

Agency Law Exceptions. Under the common law of agency, a person who enters a contract as agent for another may be personally liable on that contract on any of several grounds, such as failure to disclose the identity of the principal on the contract, failure to clearly execute the contract as agent, or for misrepresentation of the scope of agency authority. Courts in Iowa and other jurisdictions have applied these theories to limited liability company members who conduct business on the company’s behalf, and the comments to NCCUSL’s version of Re-ULLCA Sec-

[Section 13:22]

1I.C.A. § 489.107.
2These liability theories are discussed in detail in § 15:3, which describes exceptions to limited liability protections that otherwise protect corporate shareholders and other corporate participants.
3See, e.g., All Energy Corp. v. Energetix, LLC, 985 F. Supp. 2d 974 (S.D. Iowa 2012) (individual member of limited liability company who exe-
Tortious Conduct. The tortious conduct exception is similarly unremarkable. Agency law generally, and Iowa law in particular, has long recognized that if a person commits a tort while acting for another person, the tortfeasor is personally liable for the tort, even if the person for whom he is acting is also vicariously liable for the same wrong. In other words, a person’s status as an agent confers no immunity with respect to the person’s own tort liability. Thus, if a member of a limited liability company injures another person while working in the course of the firm’s business, the member is personally liable for that harm along with the company, just as the member would be if he worked for a firm organized as a corporation, a partnership or any other business form.

The Iowa Supreme Court recently applied the tortious conduct exception in Estate of Counrtyman v. Farmers Cooperative Association. A propane explosion leveled a home, killing seven people and injuring six others. The estates of the decedents and survivors sued Iowa Double Circle, L.C. (the limited liability company that supplied the propane to the home) along with Keota, a farm cooperative that managed and owned ninety-five percent (95%) of Double Circle. Plaintiffs’ theory of liability was that the propane supplier and the farm cooperative failed to provide proper information about the dangers of using the propane. The Iowa Supreme Court held that the tortfeasor is personally liable for the tort, even if the person for whom he is acting is also vicariously liable for the same wrong. In other words, a person’s status as an agent confers no immunity with respect to the person’s own tort liability. Thus, if a member of a limited liability company injures another person while working in the course of the firm’s business, the member is personally liable for that harm along with the company, just as the member would be if he worked for a firm organized as a corporation, a partnership or any other business form.

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8See, e.g., Pepsi-Cola Bot. Co. of Salisbury, Md. v. Handy, 2000 WL 364199 (Del. Ch. 2000) (holding, “if a person makes material representations to induce a purchaser to purchase a parcel of land at a price far above fair market value, and thereafter forms an LLC to purchase and hold the land, can that person later claim that his status as an LLC member protects him from liability to the purchaser . . .? I think not.”). Anthony v. Blum, 1999 WL 259726 (Conn. Super. Ct. 1999) (stating that a member qua actor, rather than qua member, is liable for his own negligent acts or for personal misrepresentations upon which others have relied).
9Estate of Counrtyman v. Farmers Co-op. Ass’n, 679 N.W.2d 598 (Iowa 2004).
against Keota was based on Keota’s alleged tortious conduct while managing Double Circle. Specifically, plaintiffs complained about Keota’s decisions in consumer safety matters for Double Circle, including alleged improper odorization of the propane and its failure to warn users to install gas detectors.

Keota moved for summary judgment, arguing that the ILLCA protected it from liability for any acts taken as a member or manager of Double Circle. The trial court granted the motion, but the Iowa Supreme Court reversed. Citing this Treatise, the Court noted that the ILLCA protects members and managers of limited liability companies from liability that is premised on their mere status as such, but “clearly imposes liability [on limited liability company members and managers] when they participate in tortious conduct.”\(^\text{10}\) The Court rejected the Keota’s claim that a limited liability company manager is exposed to liability only for conduct committed outside its managerial role: “[T]his approach is contrary to the corporate model and agency principles upon which the liability of LLC members and managers is based, and cannot be found in the language of the statute.”\(^\text{11}\) The Court acknowledged that the “participation in tortious conduct” standard:

\[W\]ould not impose tort liability on a manager for merely performing an administrative duty. [citations omitted] There must be some participation. The participation standard is consistent with the principle that members or managers are not liable based only on their status as members or managers. [citations omitted] Instead, liability is derived from individual activities. Yet, a manager who takes part in the commission of a tort is liable even when the manager acts on behalf of a corporation [citing, \textit{inter alia}, Haupt v. Miller, 514 N.W.2d 905, 909 (Iowa 1994)]. . . . Thus, it is not inconsistent to protect a member or manager from vicarious liability, while imposing liability when the member or manager participates in a tort. Liability of members of an LLC is limited, but not to the extent claimed by Keota.\(^\text{12}\)

A recent decision by an Iowa federal district court followed \textit{Countryman’s} logic, but did not cite the case. Broadcast Music, Inc. v. Mooney Hollow Saloon LLC\(^\text{13}\) involved infringement claims (based on unauthorized performances of five copyrighted songs)

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\(^\text{10}\)\textit{Estate of Countryman v. Farmers Co-op. Ass’n}, 679 N.W.2d 598, 603 (Iowa 2004). The Court continued: “This approach is compatible with the longstanding approach to liability in corporate settings, where, under general agency principles, corporate officers and directors can be liable for their torts even when committed in their capacity as an officer.” Id.


against a limited liability company that operated a saloon and against Petesch, an individual member of the company. Petesch also served as company president, and according to BMI’s allegations, had the right to supervise the saloon’s activities. Petesch moved to dismiss the infringement claims against him, citing statutory provisions that shield members and managers from liability for limited liability company obligations. The court denied the motion. BMI’s claim, the court explained, was that Petesch was liable for infringement along with the company because he had the right and ability to direct the activities of the saloon where the infringing activity allegedly occurred, because he had a direct financial interest in the company, and because of his “personal involvement” in the infringing activity. While Petesch’s financial interest as a member of the company should not have subjected him to liability for infringement claims arising out of company operations, the court correctly determined that Petesch’s personal involvement in the company’s infringing activity, if any, *would* be a sufficient basis for liability.

When considering the tortious conduct exception to the limited liability company’s shield, it is important to remember that defenses outside of the shield may still apply. For example, tort law itself may privilege certain conduct by limited liability company participants that might otherwise trigger liability for business torts, like interference with business relations or defamation.\(^{14}\) Special defenses, like the economic loss rule or liability waivers, may apply to tort claims arising out of contractual transactions.\(^{15}\) And to establish tortious conduct based on management decisions by a member or manager plaintiff must distinguish the member’s or manager’s misconduct from ordinary participation in the company’s administrative life.\(^{16}\)

Sykes v. Hengel,\(^{17}\) a recent federal court decision applying Iowa law, is a a good example of the application of defensive theories. The case arose when managers of a limited liability company fired the company’s chief executive officer for financial mismanagement and then communicated that fact by letter to the company’s members. The terminated officer sued the managers alleging: (1) that the letter to members was libelous, and (2) that by ordering his termination the managers had tortiously interfered with his business relations with the limited liability

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company.

The federal district court rejected both claims, concluding, with respect to the libel allegation, that a qualified privilege applied to the managers’ communications to the members. The court reasoned that there was no evidence that the managers were doing anything other than performing their administrative duty to communicate information to members, who had an interest in receiving the information concerning the chief executive officer. The court noted that the qualified privilege would not apply where actual malice (e.g., where a publisher entertains serious doubts about the truth of a libelous statement) was shown, but that no actual malice had been shown here.\(^{18}\) The court applied a similar privilege concept to protect the company’s managers from the tortious interference with business relations claim. The court reasoned that such a privilege should apply where the company’s managers act as agents of the company and terminate a company contract with a third party in a good faith effort to protect the company’s best interests.\(^{19}\)

(2) Liability to Third Persons Based on Contract. An agreement may expressly provide that a member or manager will be personally liable for a company obligation. If so, Re-ULLCA’s general limited liability rules do not override such personal guarantees. A contract may effectively establish a personal obligation of a member or manager that the law will enforce, just as it does any other contract of surety.\(^{20}\)

(3) Liability to Third Persons Based on Statute. Members and managers may also incur personal liability to third parties pursuant to provisions of Re-ULLCA. For example, in certain circumstances creditors of a limited liability may enforce member promises to make contributions to the company.\(^{21}\) General regulatory statutes may also be a source of liability for members and managers when their conduct violates statutory limits.\(^{22}\)

(4) Liability Based on Veil-Piercing Theories. As explained in more detail in Chapter 15, the Iowa courts have long recognized equitable veil-piercing exceptions to the general rule of limited li-


\(^{20}\) For a recent application of this concept, see J.C. Compton Co. v. Brewster, 185 Or. App. 382, 59 P.3d 1288 (2002) (member’s actions and representations held to constitute an agreement to pay limited liability company’s debts).

\(^{21}\) I.C.A. § 489.403(2) (“A creditor of a limited liability company which extends credit or otherwise acts in reliance on [a promised contribution by a member] may enforce the obligation.”).

ability where corporate shareholders push the limits of the corporate form to the extreme. As one commentator has observed, “[Such veil-piercing theories are] based on equitable and common sense grounds that should apply equally to [limited liability companies], including misrepresentation of capitalization or of owners’ responsibility for debts, deliberate undercapitalization in the form of excessive dividends, or commingling of the firms’ and the owners’ assets.”

Veil-Piercing Applies to Iowa Limited Liability Companies. Insofar as Iowa law determines the merits of a limited liability company piercing claim, \[24\] Re-ULLCA implicitly confirms that piercing theory applies to Iowa limited liability companies when it expressly cautions that

[it]he 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

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24Under the “internal affairs” choice of law rule, Iowa law should generally control the outcome of internal entity governance questions for business organizations formed under Iowa law. See Doré, Déjà Vu All Over Again? The Internal Affairs Rule and Entity Law Convergence Patterns in Europe and the United States, 8 Brook. J. Corp. Fin. & Comm. L. 317, 320-22 (2014) (describing the internal affairs choice of law principle as generally applied in the U.S.). Because piercing cases involve claims by third parties that participants in a business entity should be held personally liable for entity obligations, it is not clear whether the internal affairs rule or competing choice of law theories, like “the most significant relationship” test, should control.

An Iowa federal district court, noting that the majority of jurisdictions addressing the question also apply the internal affairs rule in veil-piercing cases, has predicted that Iowa courts will resolve choice of law issues in piercing cases by applying the internal affairs rule. The court therefore used Nebraska law when analyzing piercing claims brought against the owners of a Nebraska limited liability company that allegedly breached a contract to deliver hogs in Iowa. See Tyson Fresh Meats, Inc. v. Lauer Ltd., L.L.C., 918 F. Supp. 2d 835, 849-50 (N.D. Iowa 2013).

Re-ULLCA provides some support for applying the law of a foreign limited liability company’s formation jurisdiction to resolve piercing claims that are litigated in Iowa. Re-ULLCA Section 489.801(1)(b), governing foreign limited liability companies that qualify to do business in Iowa, provides that the laws of the company’s home state continue to govern, among other things, the liability of its members or managers. It is not clear whether that provision encompasses only the company’s liability shield or also extends to the law of piercing.
company.\textsuperscript{25}

The Iowa Supreme Court has also confirmed that piercing theory applies. In Cemen Tech, Inc. v. Three D Industries, L.L.C.,\textsuperscript{26} the Court affirmed a summary judgment in favor of individual defendants who had been sued on a limited liability company piercing theory. Because the Court concluded that no evidence supported the piercing claim, the Cemen opinion offers very little analysis. But the opinion did quote the six-factor piercing test from Briggs Transportation Company v. Starr Sales Company,\textsuperscript{27} the leading Iowa corporate law piercing case, as the relevant legal standard. Each of the Briggs factors are analyzed in detail in Chapter 15.

CCS, Inc. v. K&M Enterprises, L.L.C.,\textsuperscript{28} an unpublished decision by the Iowa Court of Appeals, followed Cemen and affirmed a trial court's summary judgment determination that individual members of K&M, a limited liability company, were not liable for company debts under a veil-piercing theory. The Court of Appeals agreed with the lower court that plaintiffs had not presented sufficient evidence on any of the six factors listed in Briggs and Cemen, including observance of corporate formalities, and therefore held that the individual members of the company were entitled to judgment as a matter of law on plaintiff's piercing and related unjust enrichment claims.\textsuperscript{29}

Keith Smith Company v. Bushman,\textsuperscript{30} another unpublished Iowa Court of Appeals case, is a recent example where the plaintiff successfully pierced an Iowa limited liability company's veil using the Briggs factors. Keith Smith Company (Smith) contracted to supply eggs to Farmer Grown Poultry (FGP), a start-up limited liability company owned by the Bushmans. The eggs were to be used in a hatchery and poultry processing business that the Bushmans planned to conduct through FGP and several other Bushman entities. When Smith investigated FGP's financial condition before entering the egg supply contract, the Bushmans provided financial information on the related entities, as FGP

\textsuperscript{25}I.C.A. § 489.304(2).
\textsuperscript{26}Cemen Tech, Inc. v. Three D Industries, L.L.C., 753 N.W.2d 1 (Iowa 2008).
\textsuperscript{28}CCS, Inc. v. K & M Enterprises, L.L.C., 829 N.W.2d 193 (Iowa Ct. App. 2013) (Table, unpublished decision).
\textsuperscript{29}CCS, Inc. v. K & M Enterprises, L.L.C., 829 N.W.2d 193, at 2013 WL 751284 at *8 (Iowa Ct. App. 2013) (Table, unpublished decision). An earlier unpublished decision by the Iowa Court of Appeals,
\textsuperscript{30}Keith Smith Co., Inc. v. Bushman, 873 N.W.2d 776 (Iowa Ct. App. 2015) (table, unpublished decision).
had not yet been formed. As it turned out, FGP was severely undercapitalized upon its formation, operating mainly on borrowed funds from other Bushman companies. FGP closed its doors after only a brief period of operations and without paying approximately $250,000 in egg invoices from Smith. Smith sued FGP for breach of contract and included piercing claims against the Bushmans and the other Bushman companies. The trial court applied the Cemen factors and held the Bushmans, but not the related companies, personally liable for FGP’s obligations. A divided Court of Appeals affirmed, emphasizing trial court findings that FGP was severely undercapitalized.

In Torstenson v. Birchwood Estate, LLC\(^3\) the Court of Appeals reversed a limited liability company piercing decision. The Torstensons organized Tierra Linda (TL), a limited liability company, for the sole purpose of serving as one of the members of Birchwood, a limited liability company that was engaged in real estate development. Birchwood encountered financial difficulties because of a declining real estate market, and because its members refused to continue injecting needed capital. Nonetheless, the Torstensons and other parties eventually paid Birchwood’s loans pursuant to guaranty arrangements. When the Torstensons later sued Birchwood for reimbursement on the guaranty, Birchwood defended the reimbursement suit on several grounds, including that the Torstensons had failed to adequately capitalize either TL or Birchwood, and that the Tortensens were therefore liable for the consequences of those failures on a piercing theory. The district court agreed with Birchwood, but the Court of Appeals reversed, reasoning that piercing is an equitable remedy for creditors and that Birchwood was not a creditor of TL—which was not a party to the suit in any event.\(^3\) The court also noted that even if piercing theory did apply, the facts did not support piercing on inadequate capitalization grounds, since the Torstensons had provided TL with sufficient initial capital to meet its own initial capital commitment to Birchwood.\(^3\)


\(^{32}\)Torstenson v. Birchwood Estate, L.L.C., 2017 WL 1086222, *8 (Iowa Ct. App. 2017) (“Birchwood is not alleged to be a creditor needing to pierce the corporate veil of TL. In fact, Birchwood is more akin to a disinterested entity holding funds that may face multiple claims for the same monies, similar to a party having the right of interpleader . . . .”).

sens at some point in time discontin-
ued providing capital to TL so TL could continue providing capital to Birchwood in light of the real estate market crash is not significant to the issue of whether TL was initially inade-
quately capitalized.”).
Cases. Although the Iowa Supreme Court did not address the issue in Cemen, the Briggs piercing analysis must be modified slightly in limited liability company cases. As explained in more detail in Section 15:4, under the Briggs test a corporation’s failure to observe “corporate formalities”—like issuing stock, electing directors and officers, conducting annual meetings, and the like—is a factor that supports piercing the corporate veil. Yet former ILLCA Section 490A.603 (in effect when Cemen was decided) expressly provided that “the failure to hold meetings of members or managers or the failure to observe formalities pertaining to the calling or conduct of meetings shall not be considered a factor tending to establish that the members have personal liability for [any company obligation].” Like Re-ULLCA Section 489.304(2) (quoted earlier in the text), Section 490A.603 recognized that limited liability companies may dispense with many of the management formalities that corporations traditionally observe. That provision, and now Re-ULLCA Section 489.304(2), should make a limited liability company’s failure to follow particular management formalities a nonissue in piercing cases.

A very recent Iowa appellate decision applying limited liability company piercing standards—the Iowa Court of Appeals’ unpublished opinion in Northeast Iowa Co-op v. Lindaman\(^{34}\)—expressly acknowledges that Re-ULLCA Section 489.304(2) prohibits courts from considering a limited liability company’s observance of formalities as a piercing factor. The appellate court affirmed the district court’s refusal to pierce the veil of a two-member limited liability company that had been engaged in farming operations. The principal Briggs factor on which there was evidence supporting piercing was the limited liability company’s failure to observe management formalities: the company had held no meetings and had not preserved minutes. The appellate court held that such evidence could not properly support a piercing determination: “Because the statute [Iowa Code Section 489.304(2)] specifically provides the failure to ‘observe any particular formalities is not a ground for imposing liability on the members’ for company debts, we are not persuaded [that piercing is appropriate].”\(^{35}\)

Thus, it appears that Iowa courts will decide piercing claims in

\(^{34}\)Northeast Iowa Co-Op. v. Lindaman, 843 N.W.2d 477 (Iowa Ct. App. 2014) (Table, unpublished decision).

\(^{35}\)Northeast Iowa Co-Op. v. Lindaman, 843 N.W.2d 477, 48 (Iowa Ct. App. 2014) (Table, unpublished decision). See also Burke v. Continental Broadcasting, Inc., 746 N.W.2d 279 (Iowa Ct. App. 2008) (Table, unpublished decision). The court applied Cemen’s piercing factors and affirmed a district court’s decision piercing the veil of an Iowa limited liability company that had failed to perform as purchaser under an asset purchase agreement. The effect of the decision was to hold the company’s sole owner personally liable for the breach. The appellate court affirmed the lower court’s decision under a “substantial
limited liability company cases by considering the same factors (other than formalities) that they have applied in the corporate context.\textsuperscript{36} This is certainly the course that courts have followed in other jurisdictions.\textsuperscript{37}

That said, formalities may not be completely off the table in limited liability company veil piercing cases. For example, some courts have considered a member’s commingling of personal assets with those of the limited liability company—which might be considered a failure to observe formalities—to be a ground supporting piercing.\textsuperscript{38} And a failure to follow formalities that masks the very existence of the limited liability company may also justify piercing.\textsuperscript{39}

**Piercing Across Company Groups.** Courts in other jurisdictions sometimes pierce limited liability company veils across groups of companies to hold the assets of one company liable for claims against a related company.\textsuperscript{40} In Keith Smith Company v. Bush-
a piercing case discussed above, Keith Smith successfully pierced the veil of FGP, a limited liability company. Keith Smith had asked the court to pierce both as to the Bushmans—the couple who organized and controlled FGP—and also to reach the assets of other companies the Bushmans controlled. The trial court refused to pierce as to the related entities, stating: “They were not involved in the creation of [FGP]; they operated separately from [FGP]. These entities had no obligation to provide sufficient capital to [FGP].” The Iowa Court of Appeals affirmed the refusal to pierce based on these findings.42

_Piercing in Contract Cases and the Assumption of the Risk Defense._ Keith Smith Company v. Bushman43 is worthy of special attention for another reason: Judge McDonald’s dissenting opinion argued that it should be extremely difficult for a plaintiff who contracts with a limited liability entity to pierce the entity’s veil. He wrote:

I would hold personal liability should not be imposed on members of an LLC for the LLC’s obligations on the basis of inadequate capitalization of the LLC where the judgment creditor’s claim arises in contract, where the judgment creditor had the opportunity to obtain financial statements and other credit information prior to entering the contract, where the judgment creditor had the opportunity to price and allocate the risk of loss by requesting personal guaranties or other security, and where the judgment creditor failed to do so.44

Judge McDonald’s position could be summarized as follows: unless a voluntary creditor of a limited liability entity bargains for security or a guaranty from the entity’s owners, that creditor assumes the risk that the entity may be undercapitalized, so that piercing the veil in such cases should be quite difficult. McDonald marshalled support for his position from many sources, including

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cases in other states. There is contrary authority, of course, and it will be up to the Iowa Supreme Court to add “assumption of the risk” to Iowa’s piercing factors.

Reverse Piercing Claims. As in corporate piercing cases, courts are often skeptical of a request that a limited liability company be allowed to pierce its own veil (reverse piercing) when disregard of the entity would be advantageous to members. A representative decision is *In re Crowe Rope Industries, LLC* (Turner v. JPB Enterprises, Inc.), where the court concluded that Maine law would not permit a limited liability company to pierce its own veil, based on the Maine Supreme Court’s earlier rejection of “reverse piercing.”

Judge or Jury. One other issue deserves mention. If there are disputed questions of fact, who decides the piercing issue, judge or jury? Since piercing is an equitable remedy, one might assume that courts, rather than juries, should resolve related factual disputes. But in Iowa the courts have made clear in corporate cases that piercing is a question of fact for the jury. One would expect Iowa courts to follow that same approach in limited liability company cases. However, as discussed in more detail in Section 15:4, Iowa Court of Appeals Judge McDonald has recently expressed concerns about allowing juries to decide piercing cases, acknowledging the Iowa precedent but arguing that piercing

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45 *Keith Smith Co., Inc. v. Bushman*, 873 N.W.2d 776, 2015 WL 8364910 at *12 - *13 (Iowa Ct. App. 2015) (McDonald, J., dissenting) (table, unpublished decision). As discussed in Section 15:4, there is some support for McDonald’s view in a few Iowa corporate piercing cases where courts have declined to impose liability on shareholders who failed to follow corporate formalities. In *Tannahill v. Aunspach*, 538 N.W.2d 871 (Iowa Ct. App. 1995), for example, the court have justified a refusal to pierce the veil on the theory that, despite the problem with formalities, plaintiff was never misled into thinking the transaction was a “personal” rather than a “corporate” one.


48 See, e.g., *Wandering Trails, LLC v. Big Bite Excavation, Inc.*, 156 Idaho 586, 329 P.3d 368 (2014) (holding that issues of alter ego and piercing are equitable questions so that the trial court is responsible for determining factual issues that may exist, and for fashioning the equitable remedy, although the court can impanel an advisory jury).

49 *See Team Central, Inc. v. Teamco, Inc.*, 271 N.W.2d 914 (Iowa 1978); *Fazio v. Brotman*, 371 N.W.2d 842 (Iowa Ct. App. 1985). See also *HOK Sport, Inc. v. FC Des Moines, L.C.*, 495 F.3d 927 (8th Cir. 2007) (applying Iowa law and affirming a jury verdict that imposed liability based on piercing and alter ego theories).
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claims are best resolved without a jury.\textsuperscript{50} It remains to be seen whether the Iowa Supreme Court will modify the Iowa approach.

§ 13:23 Financial rights and obligations of members—Generally

Research References
West's Key Number Digest, Limited Liability Companies ⇔25, 30, 36

The ILLCA defined the term “membership interest” to include not only voting and related management rights, but also financial rights of members:

“Membership interest” or “interest” means a member's share of the profits and losses of the limited liability company and the right to receive distributions of the limited liability company's assets, and any right to vote or participate in management.\textsuperscript{1}

Re-ULLCA does not continue this definition. The closest Re-ULLCA term is “transferable interest,” which:

means the right, as originally associated with a person's capacity as a member, to receive distributions from a limited liability company in accordance with the operating agreement, whether or not the person remains a member or continues to own any part of the right.\textsuperscript{2}

The member's transferable interest is a pure financial right, analogous to a partner's “transferable interest in the partnership” under the IUPA.\textsuperscript{3} The nature and extent of a member's transferable interest will be determined by several matters, including the member's financial contributions to the company, the member's share of company profits and losses, as well as distributions to the member.

Like the ILLCA, Re-ULLCA includes specific statutory rules covering all of these issues, as well as rules defining the rights of a voluntary transferee of a member's transferable interest. Re-ULLCA also allows judgment creditors of a member to impose and foreclose liens on a transferable interest through the charging order remedy. The following sections cover each of these topics.

§ 13:24 Financial rights and obligations of members—Contributions

A member is not required to make any specific capital contri-


[Section 13:23]

\textsuperscript{1}I.C.A. § 490A.102(17).

\textsuperscript{2}I.C.A. § 489.102(24).

\textsuperscript{3}See § 6:7.
ability companies are closely-held, however, it is more likely that if members agree in advance to allow members to transfer their member status, that agreement will entail conditions to protect the interest of non-transferring members.

§ 13:29 Financial rights and obligations of members—Creditor rights

(1) The Charging Order—Generally. Can creditors of a limited liability company member reach her transferable interest for collection purposes? Only in limited circumstances. Re-ULLCA allows a judgment creditor of a member to apply to the court for imposition of a lien on the debtor-member’s transferable interest. This judicial remedy is known as a “charging order.” The order creates a lien on a judgment debtor’s transferable interest in a limited liability company, entitling the creditor to any distributions to which that member is entitled (just like a transferee).

(2) The Charging Order—Procedural Issues. Courts outside of Iowa have addressed various procedural questions relating to charging orders in the limited liability company context. It has been held that a trial court that enters a judgment against a limited liability company member also has authority to issue an order charging the judgment debtor/member’s transferable interest to satisfy that judgment—there is no need for the judgment creditor to initiate a separate action. Nor is it necessary for the court that issues a charging order to have jurisdiction over

[Section 13:29]

1I.C.A. § 489.503(1) (“On application by a judgment creditor of a member or transferee, a court may enter a charging order against the transferable interest of the judgment debtor for the unsatisfied amount of the judgment.”).

For an excellent and current discussion of limited liability company charging order issues, see Bishop, A Uniform Unincorporated Business: Understanding the Rights of Owner’s Personal Creditors, Business Law Today (April 2015); Adkisson et al., Recent Developments in Charging Orders, Business Law Today (Feb. 2013); Bishop, LLC Charging Orders: A Jurisdictional and Governing Law Quagmire, Business Entities (May/June 2010). For a more comprehensive general review of the charging order, see Rutledge & Wilson, An Examination of the Charging Order Under Kentucky’s LLC and Partnership Acts (Part I), 99 Ky. L.J. Online 85 (2011); (Part II), 99 Ky. L.J. Online 107 (2011). See also Professor Carter Bishop’s tabular review of the charging order provisions that exist in the various limited liability company acts across the U.S.: Fifty State Series: LLC Charging Order Statutes (available on SSRN.com).

2In the words of the statute, the charging order “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.” I.C.A. § 489.503(1).

the limited liability company itself.\textsuperscript{4}

In DuTrac Community Credit Union v. Hefel\textsuperscript{5} the Iowa Supreme Court answered several procedural questions relating to charging orders against transferable interests in Iowa limited liability companies. The court concluded that a limited liability company has standing to intervene in litigation in order to challenge a charging order issued against the transferable interest of one of its members.\textsuperscript{6} The court also held that a creditor who pursues a claim against a member in bankruptcy prior to obtaining judgment on that claim does not thereby elect remedies. Thus, if the creditor later obtains a judgment against the member, the charging order remedy is still available.\textsuperscript{7} Nor can a member's creditor waive its right to pursue the charging order remedy prior to obtaining judgment against the member.\textsuperscript{8}

Another issue presented in DuTrac was whether operating agreement provisions restricting transfer of member interests in a limited liability company could prevent issuance of a charging order or the transfer of a member's transferable interest pursuant to a foreclosure of the charging order lien. The court held no, reasoning that the transfer restriction in question did not apply to the member's transferable interest in the company (the member's right to distributions)—the interest to which the charging order lien attached.\textsuperscript{9} Courts in other states have used similar reasoning to allow judgment creditors to charge and foreclose on a member's transferable interest in the face of operating agreement provisions restricting transfer of member interests in a limited liability company.


\textsuperscript{5}DuTrac Community Credit Union v. Hefel, 893 N.W.2d 282 (Iowa 2017).

\textsuperscript{6}DuTrac Community Credit Union v. Hefel, 893 N.W.2d 282, 289-90 (Iowa 2017).

\textsuperscript{7}DuTrac Community Credit Union v. Hefel, 893 N.W.2d 282, 291-92 (Iowa 2017).

\textsuperscript{8}DuTrac Community Credit Union v. Hefel, 893 N.W.2d 282, 292 (Iowa 2017).

\textsuperscript{9}DuTrac Community Credit Union v. Hefel, 893 N.W.2d 282, 292-93 (Iowa 2017). The transfer restriction, applicable to “Units” of the limited liability company (as defined in the operating agreement) and “interests represented thereby,” forbade both voluntary and involuntary transfers of “Units,” including transfers by operation of law, except as expressly permitted by the operating agreement. The court interpreted this transfer restriction to apply to a member's “ownership interest” in the company—presumably meaning the member’s combined rights to participate in company governance and to receive distributions—and not to the member's transferable interest—his right to distributions from the company standing alone:

There is no language in [the] operating agreement that prevents the transfer of distributions. The operating agreement only prohibits the transfer of an ownership interest. Because the charging order does not transfer any ownership interest in Westgate, the operating agreement does not prevent the court from entering a charging order.
ment transfer restrictions.\textsuperscript{10}

If the operating agreement in DuTrac \textit{had} restricted transfer of members’ transferable interests in the company, there is still a question whether such a restriction could prevent a creditor from attaching a charging order lien to the interest. First, the charging order lien does not effectuate any transfer of a member’s transferable interest; the lien simply redirects the member’s distributions, if any, to the charging creditor.\textsuperscript{11} Second, operating agreements may not “restrict the rights under [Re-ULLCA] of a person other than a member or manager.”\textsuperscript{12} Similar arguments might be made concerning a charging order creditor’s right to foreclose the lien upon proper grounds, but query whether a foreclosure sale might be invalid if the purchaser knows that the foreclosure sale violates a transfer restriction.\textsuperscript{13}

If necessary, a court can appoint a receiver to collect the distributions to be paid to a judgment creditor pursuant to a charging order.\textsuperscript{14} Based on a recent Iowa Court of Appeals decision, Wells Fargo Bank, N.A. v. Continuous Control Solutions, Inc.,\textsuperscript{15} the appointment of a receiver may be helpful if the judgment creditor wants to obtain information from a limited liability company in order to verify its compliance with a charging order.

In Continuous Control Solutions a creditor with a judgment against three persons, each of whom were members of limited liability companies, obtained charging orders against the members’ interests in the companies. The judgment creditor persuaded the district court to further require the limited liability companies to provide the creditor with periodic financial statements in order to verify the companies’ compliance with the order. The judgment creditor and the district court relied on Re-ULLCA Section 489.503(2)(b), which authorizes a court that has entered a charging order to “[m]ake all other orders necessary to give effect to the charging order.” The limited liability companies appealed, and the Iowa Court of Appeals reversed the district court’s requirement that the companies provide financial statements to the judgment creditor. The court reasoned that a limited liability company may be compelled to disclose such information only


\textsuperscript{11}I.C.A. § 489.503(1).

\textsuperscript{12}I.C.A. § 489.110(3)(k).

\textsuperscript{13}I.C.A. § 489.502(6) (“A transfer of a transferable interest in violation of a restriction on transfer contained in the operating agreement . . . is ineffective as to a person having notice of the restriction at the time of transfer.”).

\textsuperscript{14}I.C.A. § 489.503(2).

when the court has also appointed a receiver for the distributions covered by the charging order pursuant to Re-ULLCA Section 489.503(2)(a).  

(3) The Charging Order—Foreclosure. If the distributions covered by the charging order will not satisfy the judgment within “a reasonable time,” the court can foreclose the charging order lien and order a sale of the transferable interest. A purchaser at such a foreclosure sale obtains only the transferable interest and does not become a member.

If the debtor-member satisfies the judgment prior to foreclosure of the charging order, the order is extinguished. The other members of the limited liability, and even the company itself, may satisfy the judgment, stepping into the shoes of the creditor with respect to the member’s distribution rights, including the charging order.

Neither a creditor with a charging order nor one who purchases the member’s transferable interest on foreclosure of the charging order is substituted for the member whose interest is charged. Thus, the charging creditor or purchaser on foreclosure will not necessarily bear tax liability with respect to allocations and distributions made with respect to the judgment debtor’s interest in the company.

(4) The Charging Order—Exclusivity Questions. Re-ULLCA limits a creditor of a member to the charging order remedy. The issue of exclusivity has been a contentious one in some jurisdictions, especially when persons attempt to use a

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16 Wells Fargo Bank, Nat. Ass’n v. Continuous Control Solutions, Inc., 821 N.W.2d 777, 2012 WL 3195759 at *3 (Iowa Ct. App. 2012) (table, unpublished decision). But see Law v. Zemp, 276 Or. App. 652, 368 P.3d 821 (2016), opinion adhered to as modified on reconsideration, 279 Or. App. 808, 2016 WL 4014078 (2016) (trial court issuing charging order against limited partnerships had ancillary authority to order partnerships to disclose financial information, but did not have ancillary authority to restrict partnerships from making loans or to restrict partners from encumbering or transferring their interests in the partnerships).

17 I.C.A. § 489.503(3). For a recent decision concluding that foreclosure of a charging order was appropriate, see Kriti Ripley, LLC v. Emerald Investments, LLC, 404 S.C. 367, 746 S.E.2d 26 (2013).

18 I.C.A. § 489.503(3).

19 I.C.A. § 489.503(4).

20 I.C.A. § 489.503(5).

21 Cf. Rev. Rul. 77-137, 1977-1 C.B. 178 (an assignee acquiring substantially all of the dominion and control over the interest of a limited partner is treated as a substituted limited partner for Federal income tax purposes.).

22 I.C.A. § 489.503. See also In re Lahood, 2009 WL 2169879 (Bankr. C.D. Ill. 2009) (concluding, based on express statutory language, that the charging order remedy in the Illinois Limited Liability Company Act was the exclusive vehicle for a creditor to impose a judicial lien on a member’s interest in a limited liability company).
single-member limited liability company as an asset protection device. The intent of those who create such a company is to prevent creditors of the company’s sole member from succeeding to the member’s owner status in the company through foreclosure or other judicial transfer remedy that a court might apply to a member’s entire interest in the company, including management rights. If the creditor of the sole member is instead limited to the charging order remedy and the limited financial rights of a transferee following any foreclosure, such an asset protection plan might work. At least one court has refused to so limit a creditor where the express language of the limited liability company act did not characterize the charging order as the creditor’s “exclusive” remedy.23

To the extent the charging order is the exclusive remedy for a creditor under Re-ULLCA, there is another route that may allow the creditor to reach company assets under Iowa’s version of the statute. If the charging order is foreclosed, the purchaser at the foreclosure sale becomes a transferee of the member’s transferable interest. At that point, if supporting grounds exist, the transferee might be able to obtain judicial dissolution of the company on grounds of fraud or oppression.24 This remedy does not exist under the uniform version of the Re-ULLCA.

23 See Olmstead v. F.T.C., 44 So. 3d 76, 2010-1 Trade Cas. (CCH) ¶ 77079 (Fla. 2010). The court held that in the absence of express statutory language in the Florida limited liability company act making the charging order remedy the exclusive creditor remedy, the charging order remedy was not exclusive in the context of a single-member limited liability company. The court thus answered in the affirmative the following certified question from the 11th Circuit Court of Appeals: “Whether Florida law permits a court to order a judgment debtor to surrender all right, title, and interest in the debtor’s single-member limited liability company to satisfy an outstanding judgment.”

Bankruptcy courts have also held that a single-member limited liability company membership interest may pass into the member’s bankruptcy estate despite contractual or statutory restrictions. See, e.g., In re First Protection, Inc., 440 B.R. 821, 54 Bankr. Ct. Dec. (CRR) 47, 64 Collier Bankr. Cas. 2d (MB) 821 (B.A.P. 9th Cir. 2010); In re Albright, 291 B.R. 538, 540, 50 Collier Bankr. Cas. 2d (MB) 1 (Bankr. D. Colo. 2003). See also Rutledge & Geu, The Albright Decision, Why an SMLLC is not an Appropriate Asset Protection Vehicle, 5 Bus. Ent. 16 (Sept./Oct. 2003).