

Commercial Law

James K. Borcia
Tressler LLP, Chicago

Appellate Court Upholds Piercing the Corporate Veil Against Non-Shareholder Employee

The Illinois Appellate Court, First District, recently dealt with the issue of piercing the corporate veil and, in so doing, clarified a muddy issue. In *John Buckley and Mama Grimm's Bakery, Inc. v. Haithham Abuzir*, 2014 IL App (1st) 130469 (April 10, 2014), the court held that a non-shareholder can be liable for a debt against a corporation. The court also decided that the business was nothing more than a dummy corporation and alter ego of the defendant. *Id.* ¶¶ 10-11. Illinois courts have long held that the failure to follow corporate procedure may lead to the individual liability of a shareholder, director, or officer. Now, according to *John Buckley*, even a non-shareholder—who is not an officer, director, or employee of a corporation—may be found individually liable for a judgment against a corporation where the non-shareholder exercises only equitable ownership and control over a corporation, even if there were no allegations that the non-shareholder engaged in any wrongdoing.

In *John Buckley*, a bakery corporation and its individual owner sought to pierce the corporate veil of a pastries corporation to collect a judgment directly from its individual financier and controller. The trial court granted the individual defendant's motion to dismiss because he was not a shareholder, director, officer, or employee of the defendant bakery corporation. *Id.* ¶ 5. The plaintiffs appealed the dismissal. *Id.* ¶ 6.

On appeal, the plaintiffs argued that the defendant made all of the bakery corporations' business decisions and exercised such control over it that it amounted to a dummy corporation and alter ego of the individual defendant. *Id.* ¶ 3. The individual defendant made two arguments: (1) Illinois courts only pierce the corporate veil to impose liability on a corporation's shareholders, officers, directors, or employees, and he was none of these; and (2) he was not a party to the underlying action and was therefore deprived of the ability to defend himself against the allegations made against the defendant pastries corporation. *Id.* ¶¶ 8-9.

As to the second issue, the court held that if the plaintiffs proved the defendant was the alter ego of the bakery corporation, the decision not to defend the underlying suit would have been his own. *Id.* ¶ 9. After acknowledging that courts around the country were split on the issue of whether the corporate veil may be pierced to reach non-shareholders and individuals lacking a corporate title at all, the *John Buckley* court determined that the majority of jurisdictions have held that the defendant's lack of shares or corporate title does not preclude veil-piercing. *Id.* ¶ 29. Relying on *Fontana v. TLD Builders*, 362 Ill. App. 3d 491 (2nd Dist. 2005), the *John Buckley* court concluded that Illinois is in line with the majority and held that equitable ownership as pleaded by *John Buckley* may satisfy the unity-of-interest-and-ownership prong for piercing the corporate veil, regardless of whether an individual is a non-shareholder or otherwise lacks a formal title within the corporation. *Id.* In *Fontana v. TLD Builders, Inc.*, 362 Ill. App. 3d 491 (2005), plaintiff property owners hired the defendant's construction corporation to construct a single-family home. The builder abandoned the

project, and the plaintiffs sued, seeking to pierce the corporation's veil and hold the defendant personally liable. *Id.* at 494-95. Following a bench trial, the trial court pierced the veil and held the defendant and his corporation jointly and severally liable. *Id.* at 499. On appeal, the defendant argued that the trial court erred in piercing the corporate veil, because he was a non-shareholder and, therefore, the unity-of-interest-and-ownership prong could not be met. *Id.* at 500-01. The *Fontana* court disagreed. *Id.* at 501. Noting that piercing the corporate veil is an equitable remedy that looks to substance over form, the court held that status as a non-shareholder does not preclude piercing the corporate veil, because equitable ownership may satisfy the unity-of-interest-and-ownership prong. *Id.* at 501, 503.

Illinois courts have long held that the failure to follow corporate procedure may lead to the individual liability of a shareholder, director, or officer. Now, based on *John Buckley*, a non-shareholder may be found individually liable for a judgment against the corporation where the non-shareholder exercises only equitable ownership and control over a corporation. This is true, even if there are no allegations that the non-shareholder engaged in any wrongdoing in the underlying case.

The *John Buckley* decision reiterates that closely held corporations must maintain the corporate form. Simply forming a corporation is not enough for individual clients to avoid personal liability, even if the individual is not a shareholder, director, or officer of the corporation. This case stresses the importance of quality legal advice, not just in setting up the corporation, but also in operating the company as a corporation. Thus, lawyers advising such clients must stress the importance of maintaining corporate formalities in addition to the importance of adequate capitalization, issuance of stock, election of a board of directors, recording of meeting minutes, and other corporate formalities.

About the Author

James K. Borgia is a partner with the Chicago firm of *Tressler LLP*, and is active in the firm's litigation practice with an emphasis on commercial and complex litigation. He was admitted to the bar in 1989 after he received his J.D. from Chicago-Kent College of Law. Mr. Borgia is a member of the Chicago and Illinois State Bar Associations, as well as the IDC and DRI.

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Illinois Association of Defense Trial Counsel, PO Box 588, Rochester, IL 62563-0588, 217-498-2649, 800-232-0169, idc@iadtc.org