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STATUTORY DEVELOPMENTS

THE SOUTH CAROLINA LIMITED LIABILITY COMPANY ACT OF 1994

I. INTRODUCTION

The 1994 session of the South Carolina General Assembly placed South Carolina on the roster of states that have adopted some form of limited liability company act.[1] Modeled after the November 1992 draft of the ABA Prototype Act,[2] the South Carolina Limited Liability Company Act[3] (Act) provides an attractive new option for lawyers and business organizers. Although the Limited Liability Company (LLC) has existed in the United States since 1977,[4] only in the last six years has it become available in most states. Much has been written by scholars and students about this new business form,[5] yet little case law has developed. This survey first examines the South Carolina Act, providing a brief overview and comparing specific provisions to those of other business forms. Second, it explores the liability that may be imposed upon members through application of the common-law doctrine of "piercing the corporate veil."

II. OVERVIEW OF THE LLC ACT

An LLC may be formed by two or more persons[6] by filing articles of organization with the Secretary of State.[7] The articles need only contain the name of the LLC, the address of the initial registered office and the name of

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1. According to a recent report, as of February 10, 1995, 47 states and the District of Columbia have enacted a limited liability company act. Legislation was pending in the remaining three states. BUS. L. TODAY, March/April 1995, at 57.

2. The Prototype Act is reprinted in 1 LARRY E. RIBSTEIN & ROBERT R. KEATINGE, RIBSTEIN & KEATINGE ON LIMITED LIABILITY COMPANIES app. B. (1992).

3. S.C. CODE ANN. §§ 33-43-101 to -1409 (Law. Co-op. Supp. 1994).

4. Wyoming was the first state to adopt this business form. *See* WYO. STAT. §§ 17-15-101 to -136 (1977).

5. For an in-depth discussion of generic limited liability companies, see Thomas E. Geu, *Understanding the Limited Liability Company: A Basic Comparative Primer (Part One)*, 37 S.D. L. REV. 44 (1991-92); Thomas E. Geu, *Understanding the Limited Liability Company: A Basic Comparative Primer (Part Two)*, 37 S.D. L. REV. 467 (1991-92); Robert R. Keatinge et al., *The Limited Liability Company: A Study of the Emerging Entity*, 47 BUS. LAW. 375 (1992); RIBSTEIN & KEATINGE, *supra* note 2.

6. Under the Act, a "person" is defined as "an individual, a general partnership, a limited partnership, a domestic or foreign limited liability company, a trust, an estate, an association, a corporation, or any other legal entity." S.C. CODE ANN. § 33-43-102(M) (Law. Co-op. Supp. 1994).

7. S.C. CODE ANN. § 33-43-201 (Law. Co-op. Supp. 1994).

the registered agent, the date of dissolution, an election of whether the company will be member- or manager-managed, and the name and signature of each initial member.[8] The filing of the articles with the Secretary of State is conclusive proof of the formation of the LLC.[9] Unlike the Uniform Partnership Act, the Act does not require that an LLC file an annual renewal application.[10]

While the Act contains many default provisions that govern the relationship, rights, and duties of the members, the statute is far less complete than the Business Corporations Act. Therefore, in most cases members will enter into an operating agreement that further defines the relationship and serves much the same function as the bylaws of a corporation or a partnership agreement. The default provisions provided in the Act are intended, in many instances, to protect the partnership tax status of the LLC. Thus, drafters of operating agreements should carefully consider the tax implications of modifying the statutory provisions. The operating agreement becomes the primary governing document of the LLC; where optional provisions of the articles of organization are inconsistent therewith, the operating agreement prevails.[11]

The Act sets forth several types of documents that must be maintained by the LLC at its principal place of business.[12] Nevertheless, consistent with the notion of simplifying formalities, the Act specifically provides that failure to keep any of the required records "shall not be grounds for imposing liability on any member or manager for the debts and obligations of the limited liability company."[13]

Perhaps the most compelling reason for forming an LLC rather than a corporation is the availability of partnership tax status. Profits of a corporation are taxed twice before inuring to the benefit of a shareholder--once at the corporate level, and again at the personal level after distribution. The subchapter S election is meant to allow small businesses to avoid this double taxation, but is fraught with restrictions that limit its application.[14] Under the Act, the earnings of an LLC are taxed only once, at the individual level.

This partnership tax status is available if an LLC exhibits no more than two of four corporate characteristics: centralized management, continuity of

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8. S.C. CODE ANN. § 33-43-202(A)(1)-(5) (Law. Co-op. Supp. 1994).

9. *See* S.C. CODE ANN. §§ 33-43-201, -206(A) (Law. Co-op. Supp. 1994).

10. *Compare* S.C. CODE ANN. § 33-41-1110(A) (Law. Co-op. Supp. 1994) *with* S.C. CODE ANN. § 33-43-202(A) (Law. Co-op. Supp. 1994).

11. S.C. CODE ANN. § 33-43-202(C) (Law. Co-op. Supp. 1994).

12. S.C. CODE ANN. § 33-43-405(A) (Law. Co-op. Supp. 1994).

13. S.C. CODE ANN. § 33-43-405(E) (Law. Co-op. Supp. 1994).

14. For example, to be eligible for subchapter S status, a corporation may have no more than 35 shareholders, who must all reside within the state of incorporation. *See generally* I.R.C. §§ 1361-1399 (1986 & Supp. 1995).

life, free transferability of interest, or limited liability.[15] To prevent the LLC from being classified as a corporation for tax purposes, the drafters of the South Carolina Act have attempted to make the statute "semi-bulletproof."[16] The election to form an LLC by definition establishes the limited liability characteristic of the company. Furthermore, the drafters have assumed that in most cases a second characteristic, centralized management, will be established by the election to have the company be manager-managed.[17]

To prevent a "third strike," the Act imposes restrictions on the duration of the LLC and the transferability of an interest in the LLC. When forming an LLC, the members must specify a date on which the company will automatically dissolve.[18] The Act also specifies certain events that will trigger the dissolution of the company.[19] While the remaining members may choose to continue the business, this election may only be made within ninety days of dissolution.[20] Furthermore, the Act restricts the ability of members to transfer their interests. An assignee of an LLC interest may become a member only upon unanimous consent of the other members at the time of the assignment.[21] The restrictions on duration and transferability may not be altered by any *ex ante* written agreement of the members.

Another significant feature of the LLC is the liability shield provided to members. A member of an LLC, simply by reason of membership, is not liable for obligations of the company that arise in "contract, tort, or otherwise."[22] As to professional service companies, however, the rule is limited, allowing a member of an LLC that provides professional services to become liable for his personal negligence and for the negligence of others if "he is at fault in appointing, supervising, or cooperating with them."[23] The Act does envision, and in some cases provides for, acts by a member which will expose him to liability. Furthermore, while the statute does not directly address the issue, some scholars believe that the common-law principles of piercing the

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15. Treasury Regulation § 301.7701-2(a)(3) states that "[a]n unincorporated organization shall not be classified as an association unless such organization has more corporate characteristics than noncorporate characteristics." Treas. Reg. § 301.7701-2(a)(3) (as amended in 1993). This provision is often referred to as the "three-strike rule."

16. Martin C. McWilliams, Jr., *Limited Liability Companies - A New Item on South Carolina's Business Menu*, S.C. LAW., Sept./Oct. 1994, at 23, 24.

17. *Id.* at 24.

18. S.C. CODE ANN. § 33-43-202(A)(3) (Law. Co-op. Supp. 1994).

19. S.C. CODE ANN. §§ 33-43-802, -901.1 (Law. Co-op. Supp. 1994).

20. S.C. CODE ANN. § 33-43-901(C) (Law. Co-op. Supp. 1994).

21. S.C. CODE ANN. § 33-43-706(A) (Law. Co-op. Supp. 1994).

22. S.C. CODE ANN. § 33-43-304(A) (Law. Co-op. Supp. 1994).

23. S.C. CODE ANN. § 33-43-304(B) (Law. Co-op. Supp. 1994). This provision almost duplicates that of the Professional Corporations Act. *See* S.C. CODE ANN. § 33-19-340 (Law. Co-op. 1990).

corporate veil will be applied to LLCs in a manner similar to that applied to corporations.[24]

III. MEMBERSHIP, RIGHTS, AND DUTIES: A COMPARISON OF THE LLC ACT AND RELATED SOUTH CAROLINA STATUTES

The Limited Liability Company suffers a bit of an identity crisis. Rather than being a purely unique business form, the LLC is a hybrid of the corporate and partnership forms.[25] Various traits of each "parent" are evident in the LLC Act, some appearing almost unmodified, some showing the effects of cross-breeding. In many ways, organization under the Act creates an entity that looks like a corporation to the outside world, but to the members, looks like a partnership. Unlike the partnership and the corporation, there is no common-law ancestor of the LLC. This lack of a common-law heritage further amplifies the identity problem of the LLC.

An individual may become a member of an LLC in two ways: by acquiring an interest[26] directly from the company or indirectly from another member. To acquire a membership interest directly from the company, one must either comply with the relevant provisions of the operating agreement or receive unanimous consent of all the members.[27] In order for one to become a member through assignment, the members must unanimously consent to the assignment at the time the assignment is made.[28] Unlike the requirements under the direct method, the requirement of unanimous consent may not be modified by the operating agreement or agreed to in advance of the assignment. This rigidity in the statute is intended to prevent the free transferability of interest in an LLC, a characteristic deemed corporate by the Internal Revenue Service.[29]

The membership requirements incorporate parts of both the Business Corporation Act[30] (BCA) and the Uniform Partnership Act[31] (UPA). Under the UPA, an individual may become a member of a partnership only with the

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24. For a discussion of potential liability of members, see *infra* Part IV.

25. *See* Sandra K. Miller, *What Standards of Conduct Should Apply to Members and Managers of Limited Liability Companies?*, 68 ST. JOHN'S L. REV. 21, 32-36 (1994); McWilliams, *supra* note 16, at 23.

26. Like a partnership, there is a bifurcation of an LLC interest and membership. An LLC interest is merely a "right to share in profits and losses, and right to share in distributions," S.C. CODE ANN. § 33-43-102(H) (Law. Co-op. Supp. 1994), and may be obtained through assignment, S.C. CODE ANN. § 33-43-704 (Law. Co-op. Supp. 1994).

27. S.C. CODE ANN. § 33-43-801(A)(1) (Law. Co-op. Supp. 1994).

28. S.C. CODE ANN. § 33-43-706(A) (Law. Co-op. Supp. 1994).

29. *See supra* notes 15-21 and accompanying discussion.

30. S.C. CODE ANN. §§ 33-1-101 to -20-105 (Law. Co-op. 1990 & Supp. 1994).

31. S.C. CODE ANN. §§ 33-41-10 to -1220 (Law. Co-op. 1990 & Supp. 1994).

unanimous consent of all the members, as modified in the partnership agreement.[32] Under the BCA, an interest, or share, of the corporation is freely transferable, except to the extent restricted by the articles of incorporation, the bylaws, or a shareholder agreement.[33] Unlike the transfer of a corporate share, assignment of a partnership interest does not convey all of the rights of a partner.[34] The Act allows a complete transfer of interest, but only upon the consent of the other members.

The rights which inure to the interest holders of the various organizations differ. The BCA provides that, in total, the shareholders of a corporation must have at least the right to vote and to receive net assets upon dissolution.[35] The UPA provides three specific rights of a partner:[36] (1) rights in specific partnership property,[37] (2) the right to share in the profits and surplus,[38] and (3) the right to participate in management.[39] Article 4 of the Act sets forth the rights of LLC members, primarily the right to manage and the right to vote.

An LLC may be managed by some or all of the members, or by professional managers. The right to manage the company is vested equally in each member, unless the articles of organization delegate this function to managers or the operating agreement provides otherwise.[40] If the articles vest management in managers, the right of managers is exclusive, subject to limitations imposed by the operating agreement. The operating agreement may further modify the statutory provisions by setting forth the method of election and removal of the managers, defining who may be a manager, and establishing the term of office of the management.[41]

The shareholders of a corporation do not have a right to manage the corporation, but rather, this right is statutorily granted to the directors.[42] While this right may be modified by the articles of incorporation or an agreement among the shareholders,[43] the typical corporation is managed by

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32. S.C. CODE ANN. § 33-41-510(7) (Law. Co-op. 1990).

33. S.C. CODE ANN. § 33-6-270 (Law. Co-op. 1990).

34. S.C. CODE ANN. § 33-41-740 (Law. Co-op. 1990).

35. Because a corporation may issue more than one class of shares, the rights of any particular class of shares may be strictly limited. However, among the various classes, these two rights must be present. S.C. CODE ANN. § 33-6-101(b) (Law. Co-op. 1990); *see also* S.C. CODE ANN. § 33-7-210 (Law. Co-op. 1990) (outlining the voting entitlement of shares).

36. These rights are enumerated in § 33-41-710. *See* S.C. CODE ANN. § 33-41-710 (Law. Co-op. 1990).

37. S.C. CODE ANN. § 33-41-720 (Law. Co-op. 1990).

38. S.C. CODE ANN. § 33-41-730 (Law. Co-op. 1990).

39. S.C. CODE ANN. § 33-41-510(5) (Law. Co-op. 1990).

40. S.C. CODE ANN. § 33-43-401(A) (Law. Co-op. Supp. 1994).

41. S.C. CODE ANN. § 33-43-401(B) (Law. Co-op. Supp. 1994).

42. S.C. CODE ANN. § 33-8-101(c) (Law. Co-op. 1990).

43. *See* S.C. CODE ANN. §§ 33-8-101, 33-18-200(h) (Law. Co-op. 1990).

a board of directors unless the board has been dispensed with altogether. Under the UPA, each partner has an equal right in the management of the partnership subject to modification by the partnership agreement.[44] The Act falls closer to the UPA by initially giving the members equal rights to manage, but allowing delegation; under the BCA, the right to manage must be withdrawn from the directors.

Concomitant with the right to manage is the ability to act as an agent for the company. Except when the right to manage has been given to managers, each member of an LLC is an agent of the LLC for carrying on the business of the company.[45] This section of the Act almost duplicates that of the UPA.[46] By comparison, no shareholder or director is, by virtue of being such, an agent of the corporation.

Like the right to manage, the right to vote on certain matters may also be delegated to managers and may be modified by a written operating agreement. The default provisions of the Act give members the right to vote on "any matter connected with the business of the limited liability company."[47] In contrast to a corporation managed by directors, in order for a vote to carry, it must be affirmed by more than half of the members.[48] The Act is thus more like the UPA, which requires the approval of a majority of the partners in "ordinary matters connected with the partnership business."[49]

Under the Act, in order to amend the operating agreement or take any action in contravention of the agreement, there must be unanimous consent or approval of all of the members.[50] This provision may be modified only by a written agreement of the members.[51] By comparison, the bylaws of a corporation may be amended by an affirmative vote of a majority of either the board of directors or the shareholders.[52]

The duties of a member, mostly borrowed from the UPA, include a duty of loyalty, a duty of care, and a duty of good faith and fair dealing.[53] A

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44. S.C. CODE ANN. § 33-41-510(5) (Law. Co-op. 1990).

45. S.C. CODE ANN. § 33-43-301 (Law. Co-op. Supp. 1994).

46. S.C. CODE ANN. § 33-41-310 (Law. Co-op. Supp. 1990).

47. S.C. CODE ANN. § 33-43-403(A) (Law. Co-op. Supp. 1994).

48. *Id.*

49. S.C. CODE ANN. § 33-41-510(8) (Law. Co-op. 1990).

50. S.C. CODE ANN. § 33-43-403(B) (Law. Co-op. Supp. 1994).

51. *Id.* This provision can be read to imply that in most cases an operating agreement need not be in writing.

52. S.C. CODE ANN. § 33-10-200 (Law. Co-op. 1990).

53. While the South Carolina statute is more specific on this subject than that of some other states, many questions remain unresolved regarding application of common law. For a general discussion, see Steven C. Bahls, *Application of Corporate Common Law Doctrines to Limited Liability Companies*, 55 MONT. L. REV. 43 (1994); Miller, *supra* note 25, at 21; Elizabeth M. McGeever, *Hazardous Duty?: The Role of the Fiduciary in Noncorporate Structures*, BUS. L. TODAY, Mar./Apr. 1995, at 51.

member's duty of loyalty is set forth in section 33-43-402 of the Act. The duty of loyalty includes the duty to account to the company for profits gained as a result of membership in the company, to refrain from acting for an adverse party dealing with the company, and to refrain from competing with the company. However, a member does not breach this duty simply by furthering his own interest.[54] These duties may not be eliminated, even by unanimous written consent of all the members. However, members may define in the operating agreement or articles of organization what conduct is permitted, so long as it is not manifestly unreasonable.[55]

Under the Act, members engaging in management are prohibited from "engaging in grossly negligent conduct, intentional misconduct, and knowing violation of the law."[56] This definition of care provided by the Act is similar to the level of care that is required of directors and officers of corporations[57] under the business judgment rule.[58] Like the other duties, the duty of care may not be diminished, even with the unanimous consent of the members.[59] Borrowing further from principles of agency, the Act requires that members discharge their duties to the company with good faith and fair dealing.[60] This duty is extended to require similar behavior toward fellow members.[61]

While the liability of a member of an LLC is limited, a member is clearly not absolved from all liability associated with the entity. Members may become personally liable in four ways: (1) intentional personal torts; (2) wrongful distributions; (3) failure to make contributions; and (4) claims by creditors after dissolution.

The Act states that no member "solely by reason of being a member or being a manager" will be liable for obligations of the LLC.[62] However, a member can clearly cause himself to become liable to a third person either in contract, by waiving the statutory protection, or in tort, through personal negligence.

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54. S.C. CODE ANN. § 33-43-402(D) (Law. Co-op. Supp. 1994).

55. S.C. CODE ANN. § 33-43-402(A) (Law. Co-op. Supp. 1994).

56. S.C. CODE ANN. § 33-43-402(B) (Law. Co-op. Supp. 1994).

57. The general duties of directors and officers of corporations are set forth in §§ 33-8-300(a) to -410. S.C. CODE ANN. § 33-8-300(a) to -410 (Law. Co-op. 1990).

58. For examples of the application of the business judgment rule in South Carolina, see Goddard v. Fairways Dev. Gen. Partnership, ___ S.C. ___, 426 S.E.2d 828 (Ct. App. 1993); Dockside Ass'n v. Detyens, 294 S.C. 86, 362 S.E.2d 874, *aff'g*, 291 S.C. 214, 352 S.E.2d 714 (Ct. App. 1987).

59. S.C. CODE ANN. § 33-43-402(B) (Law. Co-op. Supp. 1994).

60. S.C. CODE ANN. § 33-43-402(C) (Law. Co-op. Supp. 1994).

61. *Id.* It is likely that the duty of good faith and fair dealing will be applied with the same strictness as that applied to partnerships under *Meinhard v. Salmon*, 164 N.E. 545, 546 (N.Y. 1928). *See* Miller, *supra* note 25, at 45-49. The duties of a member to other members may be analogous to those imposed by the courts in corporate shareholder relations.

62. S.C. CODE ANN. § 33-43-304(A) (Law. Co-op. Supp. 1994).

It is anticipated that most LLCs, like most corporations, will be held by a small number of members[63] and will have few assets, at least at formation. As has been the accepted practice for closely held corporations, lenders will almost always require that one or more members co-sign or guarantee any obligation of the LLC. If the LLC defaults on the obligation, the member cannot then seek the protection of the Act to shield him from liability.

Additionally, the maxim that each person is liable for his or her own torts is also applicable in this setting. A member of an LLC, having committed a tort, may not hide behind the LLC shield, even if the negligent acts were done in performing the business of the corporation, were ratified by the LLC, or were within the scope of the agency relationship. This does not represent any change from the law under the BCA or the UPA.

A member may be liable to the LLC for any wrongful distribution for which the member votes or assents.[64] This liability apparently may be imposed regardless of whether the member received anything in the distribution.[65] This liability is limited somewhat by the showing requirements levied on a plaintiff seeking to impose such liability: a member will only be held liable if it is shown that the distribution was in violation of section 33-43-604 or the operating agreement *and* that the member breached a fiduciary duty as defined in section 33-43-402 in approving the distribution.[66] The liability of a member is further limited in that contribution may be sought from other members who could also be held liable or from those who received the improper distribution.[67]

Upon the formation of the LLC, the members will agree on the contributions that will be made by each member in return for their interest in the company. These may take the form of immediate transfers of assets to the company or of promises to transfer assets or provide services in the future.[68] A creditor who extends credit to the LLC with knowledge and in reliance on these promises of contributions, may enforce the obligation if such has been reduced to writing.[69] The member's liability will be limited to the amount due under the obligation.[70]

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63. *See* Bahls, *supra* note 53, at 46-53; Keatinge, *supra* note 5, at 395; Miller, *supra* note 25, at 66-70.

64. S.C. CODE ANN. § 33-43-605(A) (Law. Co-op. Supp. 1994).

65. The requirements for a proper distribution are set out in § 33-43-604. These requirements are copied almost verbatim from the BCA and include both a cash flow and a balance sheet test. *See* S.C. CODE ANN. § 33-6-400(c) (Law. Co-op. 1990).

66. S.C. CODE ANN. § 33-43-605(A) (Law. Co-op. Supp. 1994).

67. S.C. CODE ANN. § 33-43-605(B) (Law. Co-op. Supp. 1994).

68. S.C. CODE ANN. § 33-43-501 (Law. Co-op. Supp. 1994).

69. S.C. CODE ANN. § 33-43-502(E) (Law. Co-op. Supp. 1994).

70. A similar provision is contained in the BCA. It is unclear, however, whether the right under the BCA extends only to those creditors who act in reliance on the promise of future

A member of an LLC may be liable to creditors with allowed claims after the dissolution of the company.[71] In this case, a member is liable to the extent of the lesser of his pro rata share of the distribution of the assets of the corporation, or the amount actually distributed to him. In total, the member will not be liable for claims in excess of the total distribution received.[72]

IV. PIERCING THE VEIL

The doctrine of piercing the corporate veil is among the most uncertain in the area of corporate law.[73] This uncertainty results primarily from a lack of articulable standards by which the doctrine is to be applied.[74] This uncertainty will only increase under the Act as courts are called upon to interpret its provisions and apply the piercing doctrine to the LLC. To date, no case law has developed to guide courts or practitioners in the application of this common-law doctrine.[75] Only Colorado has statutorily provided a method for the application of this doctrine to a LLC, stating that the courts should apply the same standard as that for a corporation.[76]

A properly-functioning LLC should appear to the outside world as any incorporated organization. If creditors and other third parties regard an LLC in the same manner that they do a corporation, then they should be similarly protected from insider abuse. On this basis, the ability to pierce the veil of the LLC should not be substantially increased or diminished because the organizers have chosen an LLC over a corporation as their business vehicle.

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contribution. *See* S.C. CODE ANN. § 33-6-220(a) (Law. Co-op. 1990).

71. *See* S.C. CODE ANN. § 33-43-908 (Law. Co-op. Supp. 1994).

72. S.C. CODE ANN. § 33-43-908(D) (Law. Co-op. Supp. 1994).

73. For a general discussion of the many approaches taken by various jurisdictions, see ROBERT C. CLARK, CORPORATIONS § 2.4. (1986). *See also* Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. Chi. L. Rev. 89 (1985).

74. Circuit Judge Russell commented:

> The circumstances which have been considered significant by the courts in actions to disregard the corporate fiction have been "rarely articulated with any clarity." Perhaps this is true because the circumstances "necessarily vary according to the circumstances of each case," and every case where the issue is raised is to be regarded as "*sui generis* . . . [to] be decided in accordance with its own underlying facts."

DeWitt Truck Brokers, Inc. v. W. Ray Flemming Fruit Co., 540 F.2d 681, 684 (4th Cir. 1976) (footnotes and citations omitted).

75. *See* Bahls, *supra* note 53, at 60-66; Susan P. Hamill, *The Limited Liability Company: A Possible Choice for Doing Business?*, 41 FLA. L. REV. 721, 744 (1989); Keatinge, *supra* note 5, at 445-47; Ann Maxey, *West Virginia's Limited Liability Company Act: Problems With the Act*, 96 W. VA. L. REV. 905, 948-61 (1994).

76. *See* COLO. REV. STAT. § 7-80-107 (Supp. 1994).

The purpose of the corporate shield is well understood and respected. The United States Supreme Court has pointed out the significance of the corporate form, and its attendant liability shield, stating:

> [n]ormally the corporation is an insulator from liability on claims of creditors. The fact that incorporation was desired in order to obtain limited liability does not defeat that purpose. Limited liability is the rule not the exception; and on that assumption large undertakings are rested, vast enterprises are launched, and huge sums of capital attracted.[77]

Even so, the Court recognized that this shield ought not be impenetrable. Quoting Chief Judge Cardozo, the Court warned that limited liability may be denied "when the sacrifice is so essential to the end that some accepted public policy may be defended or upheld."[78]

The South Carolina courts have also acknowledged the importance of the corporate liability shield and the limitations upon it. In *Sturkie v. Sifly*[79] the court stated:

> [i]f any general rule can be laid down, it is that a corporation will be looked upon as a legal entity until sufficient reason to the contrary appears; but when the notion of legal entity is used to protect fraud, justify wrong, or defeat public policy, the law will regard the corporation as an association of persons.[80]

Nevertheless, this doctrine "is not to be applied without substantial reflection."[81]

The standards for piercing were established by the Fourth Circuit in *DeWitt Truck Brokers, Inc. v. W. Ray Flemming Fruit Co.*,[82] and further

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77. Anderson v. Abbott, 321 U.S. 349, 361-62 (1944) (citations omitted).

78. *Id.* at 362 (quoting Berkey v. Third Ave. Ry., 155 N.E. 58, 61 (N.Y. 1926)).

79. 280 S.C. 453, 313 S.E.2d 316 (Ct. App. 1984).

80. 280 S.C. at 457, 313 S.E.2d at 318. Prior to *Sturkie*, the Fourth Circuit, applying South Carolina law, stated:

> This concept of separate entity is merely a legal theory, "introduced for purposes of convenience and to subserve the ends of justice," and the courts "decline to recognize [it] whenever recognition of the corporate form would extend the principle of incorporation 'beyond its legitimate purposes, and [would] produce injustices or inequitable consequences.'"

DeWitt Truck Brokers, Inc. V. W. Ray Flemming Fruit Co., 540 F.2d 681, 683 (4th Cir. 1976) (footnote omitted) (citing Krivo Indus. Supply Co. v. National Distillers & Chem. Corp., 483 F.2d 1098, 1106, *modified factually*, 490 F.2d 916 (5th Cir. 1973); Sell v. United States, 336 F.2d 467, 472 (10th Cir. 1964); Stone v. Eacho, 127 F.2d 284, 288-89 (4th Cir.), *cert. denied*, 317 U.S. 635 (1942) and Jennings v. Automobile Sales Co., 107 S.C. 514, 93 S.E. 188 (1917)).

81. *Sturkie*, 280 S.C. at 457, 313 S.E.2d at 318.

82. 540 F.2d 681 (4th Cir. 1976).

developed by the South Carolina Court of Appeals in *Sturkie v. Sifly*.[83] Under the *DeWitt-Sturkie* analysis, the standard to be applied is a two-pronged test.[84] "The first part of the test, an eight-factor analysis, looks to observance of the corporate formalities by the dominant shareholders. The second part requires that there be an element of injustice or fundamental unfairness if the acts of the corporation be not regarded as the acts of individuals."[85]

The application of this doctrine to an LLC requires an understanding of two fundamental principles: the "separateness" of an LLC as a legal entity and the principal-agent relationship of an LLC to its members. It is well settled that "a corporation is an entity, separate and distinct from its officers and stockholders."[86] An LLC should equally be recognized as a legal entity, separate and distinct from its members. Some commentators have expressed some reservations concerning whether LLCs are conclusively separate entities.[87] Professor Keatinge, for example, points out that only Virginia has specifically defined an LLC as an "entity."[88] While the South Carolina statute has defined an LLC as an "organization"[89] rather than an "entity," there is no indication elsewhere in the statute that the legislature intended for an LLC to be anything but a separate entity. Indeed, the Act provides that an LLC "shall possess and may exercise all the powers and privileges as an individual that are either necessary or convenient."[90] The Act specifically allows an LLC to own property,[91] transfer property,[92] and sue and be sued in its own name.[93]

The second fundamental principle bearing on a piercing analysis is that members, simply by being members, are agents of the LLC unless their ability to act is limited by an operating agreement.[94] Accordingly, members have the power to act on behalf of the company in carrying on the business of the LLC. This relationship also allows third parties to rely on negotiations with a member on behalf of an LLC as binding on the organization. Unless a member, by some affirmative act, indicates to a third party that the member is not acting for the LLC, the LLC should be bound by the third party's reliance.

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83. 280 S.C. 453, 313 S.E.2d 316 (Ct. App. 1984).
84. *Sturkie*, 280 S.C. at 457-58, 313 S.E.2d at 318.
85. *Id.* at 457-58, 313 S.E.2d at 318 (citing *DeWitt*, 540 F.2d at 685).
86. *DeWitt*, 540 F.2d at 683.
87. *See, e.g.*, Keatinge, *supra* note 5, at 406-07.
88. *Id.*
89. S.C. CODE ANN. § 33-43-102(G) (Law. Co-op. Supp. 1994).
90. S.C. CODE ANN. § 33-43-106 (Law. Co-op. Supp. 1994).
91. S.C. CODE ANN. § 33-43-701 (Law. Co-op. Supp. 1994).
92. S.C. CODE ANN. § 33-43-702 (Law. Co-op. Supp. 1994).
93. S.C. CODE ANN. § 33-43-1201(A) (Law. Co-op. Supp. 1994).
94. S.C. CODE ANN. § 33-43-301(A) (Law. Co-op. Supp. 1994).

Because the statutory requirements imposed on LLCs are different from those required of corporations, rote application of *DeWitt-Sturkie* is inappropriate.[95] First, the absence of corporate formalities and records is almost presumed under the Act. The Act states, for example, that lack of records "shall not be grounds for imposing liability on any member or manager for the debts and obligations of the limited liability company."[96] Moreover, the Act envisions that an LLC will be dominated by its members by expressly granting the members the right to manage the business.[97] Accordingly, piercing on basis of dominance also seems inappropriate.

As the above analysis demonstrates, the eight factor *DeWitt-Sturkie* test should be replaced with an analytic methodology more appropriate to this newer business form. The determination of whether an LLC should be pierced might better be made, for example, by considering the two fundamental principles set forth above: whether the members have treated the LLC as a separate legal entity and whether the members have behaved as agents of the LLC.

How should a court determine if an LLC should be treated as a separate legal entity? Relevant factors here might include whether the LLC has observed the formalities required of an LLC under the Act; whether the members have maintained separate funds and accounts from those of the LLC and whether separate books and records were kept; whether the LLC was properly capitalized for its business purpose; and, if the LLC is principally owned by another entity, whether the two share common management and members. In determining whether the principal-agent relationship envisioned by the Act is intact, a court could consider whether the management of the business has been dominated by a single member in contravention of an operating agreement; whether the members hold the business out as the principal for whom they are acting; whether members have usurped the power of managers in a manager-managed company; and whether a member has observed the duties owed to the LLC in carrying on its business.

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95. The first prong of *DeWitt-Sturkie* involves the consideration of eight factors. If a court finds that a sufficient number exist, then the corporate form has been ignored by the shareholders and sufficient justification for piercing the veil exists. The eight factors are:

> (1) whether the corporation was grossly undercapitalized; (2) failure to observe corporate formalities; (3) non-payment of dividends; (4) insolvency of the debtor corporation at the time; (5) siphoning of funds of the corporation by the dominant stockholder; (6) non-functioning of other officers or directors; (7) absence of corporate records; and (8) the fact that the corporation was merely a facade for the operations of the dominant stockholder.

Cumberland Wood Prods., Inc. v. Bennett, 308 S.C. 268, 271, 417 S.E.2d 617, 619 (Ct. App. 1992).

96. S.C. CODE ANN. § 33-43-405(E) (Law. Co-op. Supp. 1994).

97. S.C. CODE ANN. § 33-43-401 (Law. Co-op. Supp. 1994).

The second prong of the *DeWitt-Sturkie* test, requiring that failure to pierce the veil result in fundamental unfairness,[98] is equally applicable in an LLC context. "The essence of the fairness test is simply that an individual cannot be allowed to hide from the normal consequences of carefree entrepreneuring by doing so through a corporate shell."[99] To establish this prong, a plaintiff must show "(1) that the defendant was aware of the plaintiff's claim against the corporation, and (2) thereafter, the defendant acted in a self-serving manner with regard to the property of the corporation and in disregard of the plaintiff's claim to the property."[100] The policy furthered by this analysis should not be curtailed by use of an LLC and may be protected by careful application of these standards.

V. CONCLUSION

The Limited Liability Company Act was enacted in order to allow business venturers to obtain the benefits of partnership taxation and informality, while affording protection from liability for obligations properly incurred by the company. Failure by the courts to recognize these underlying purposes and application of too liberal standards for piercing the LLC veil has the potential to deny this business form its essential benefits. On the other hand, abuse of this business form by business organizers and legal practitioners may cause courts to err on the side of safety, thereby establishing precedent to limit future use of the corporate protection. Until this aspect of the law is clarified, great caution is warranted from both sides of the bar.

Everett A. Kendall, II

98. *Sturkie*, 280 S.C. at 457-58, 313 S.E.2d at 318; *see also* Federal Deposit Ins. Corp. v. Sea Pines Co., 692 F.2d 973 (4th Cir. 1982) (holding that when a corporation becomes insolvent, the duty of the directors shifts from the shareholders to the creditors); State v. Hill, 286 S.C. 283, 333 S.E.2d 789 (Ct. App. 1985) (holding that the corporate veil may not be used to shield a director from criminal liability).

99. Multimedia Publishing of South Carolina, Inc. v. Mullins, ___ S.C. ___, ___, 431 S.E.2d 569, 573 (1993).

100. *Cumberland*, 308 S.C. at 272, 417 S.E.2d at 619 (citing *Sturkie*, 280 S.C. at 459, 313 S.E.2d at 319).