Despite Ruling Against Business Owner, Ky. Supreme Court Upholds Important Protection for Single-Owner Entities

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Kyle Melloan and David Treacy

Most Kentucky business owners know that owning their business through a formal entity, such as a corporation or limited liability company (LLC) has certain advantages. Many also know that to realize those advantages, they must maintain a distinction between themselves and the entity. Otherwise, they may open their personal assets up for attack by the entity’s creditors—a process known as "piercing the corporate veil." Recently, the sole member of a Kentucky LLC found himself in the unusual position of asking that his own LLC be disregarded. The Kentucky Supreme Court refused. Although this case went against the business owner, the decision strengthens an important protection for single-owner entities generally.

Turner v. Andrew, 2011-SC-000614-DG (Ky. Nov. 21, 2013), began as a vehicle accident that damaged a truck owned by an individual, Andrew, but used in Andrew’s trucking business. Andrew had formed his business as an LLC, with himself as the sole member. Faced with the truck’s loss, Andrew sued the other driver and his employer, asking that they pay the cost of the truck damage and lost profits from being unable to use the truck. Andrew clearly could sue for the damage to the truck as its owner, but the defendants argued that the lost profits belonged to the LLC, not Andrew individually. Because the LLC was not a plaintiff in the lawsuit, the defendants asked to dismiss the lost profits claim. Andrew’s response was to ask to disregard the LLC and allow him, as its sole member, to assert the claim. The trial judge ruled for the defendants and dismissed Andrew’s claim for lost profits, but the Kentucky Court of Appeals disagreed. To the Court of Appeals, because "Andrew was the sole owner of his trucking company ... operated his business from his residence, and ... purchased the truck in question as an individual," he could bring the claim. These two approaches went to the Kentucky Supreme Court, which agreed with the trial judge. As the Supreme Court explained, if it was the LLC’s profits that were lost, Andrew could not recover them because the LLC was a separate and distinct legal entity from Andrew himself—even if Andrew was the only member.

Andrew’s case is not typical. Normally a third party seeks to disregard the separate existence of a business entity, not the business’s owner. Recognizing this, the Supreme Court emphasized that it based its opinion on Kentucky’s established veil-piercing law. To the Court, although instances arise where an LLC or other entity should be disregarded, this was not one of them. This decision is important to single-owner entities in two ways.

First, it reminds us that you can’t ignore a corporate entity when it’s convenient. Although the Court did not completely rule out the possibility of allowing business owners to disregard their entities, it certainly will take more than Andrew’s circumstances. This makes it even more important to work with a legal professional to choose the correct business entity initially and follow-up as the business grows and changes to see if a different form is needed.

Second, the Turner decision, despite being against the business owner, is an important recognition that the protections LLCs and other entities provide apply to single owners. If the situation had been reversed and Andrew’s LLC was the only party at fault, the other driver may have attempted to make Andrew pay. The decision that Andrew and his LLC were not "legally interchangeable" should mean that another party could not pierce the LLC’s veil to reach Andrew’s assets solely because Andrew was the only member.

While Turner protects single-owner entities, it also reminds us that maintaining an entity’s advantages requires careful maintenance. Just as the Court did not allow Andrew to benefit...
from using an LLC only to disregard it when he wanted to, courts are not inclined to allow business owners to ignore the formalities and distinct existence of an entity in their daily practice only to then raise the entity as a shield against lawsuits. The same care used in choosing a business entity should be used in maintaining it. Third parties have been allowed to veil-pierce and reach an individual owner’s assets. Although those situations are fact-specific, generally business owners can minimize the chance by taking actions that establish the separateness of their legal entity from themselves (and any other entity). Some basic steps include (1) observing entity formalities (such as following a governing document and keeping entity records); (2) keeping assets separate (such as by using a separate bank account for the entity); (3) keeping the entity properly capitalized (having adequate funds to pay normal operating expenses) and appropriately insured; and (4) conducting the entity’s business in its own name, not the owner’s name (such as by only signing contracts as an entity representative). Business owners should consult with counsel on how to minimize the prospect of veil-piercing in their business and maintain the protection at the heart of the Turner decision.