

**LIMITED PARTNERS NOW VULNERABLE TO LIABILITY
UNDER CORPORATE VEIL-PIERCING PRINCIPLES**

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The primary motivation to form any type of business entity is to protect the entity's shareholders, members, or owners (collectively, "owners") from entity liability. This protection or insulation from entity liability is sometimes referred to as a corporate "veil". Parallel to this insulation from liability are "veil-piercing" principles which New Jersey courts use to police abuses of the legal entity form. In particular, courts allow for liability to "pierce" through the corporate veil and apply directly to the entity's owners in situations when an entity: (1) fails to follow legal formalities such as filing requirements; (2) is gross undercapitalized; (3) is an "alter-ego" of its owners; (4) is used for unlawful purposes or to perpetrate a fraud; or (5) is a merely a façade for its owners. The overarching purpose of "veil-piercing" principles are to prevent the corporate (or LLC) form from being used to evade the law or "defeat the ends of justice". Traditionally, veil-piercing principles only applied to corporations and limited liability companies ("LLCs").

However, in the recent Canter v. Lakewood decision, the Appellate Division extended veil-piercing principles to apply to New Jersey limited partnerships under certain cases. See Canter v. Lakewood of Voorhees, et al., A-1795-10T1 (App. Div. 2011). In Judge Simonelli's decision, the Court held that the veil insulating limited partners from liability in a limited partnership may be pierced upon a showing that the limited partner: "[1] participated in the control of the limited partnership's business by taking or attempting action not within the safe harbor of N.J.S.A. 42:2A-27b or [2] dominated the limited partnership and used the limited partnership to perpetrate a fraud or injustice, or otherwise circumvent the law". Id. (emphasis supplied). The latter "Domination" test may be proven using veil-piercing analysis by clear and convincing evidence.

In its decision, the Court reviewed the Uniform Limited Partnership Law ("ULPL"), which New Jersey subscribes to, as well as Delaware law. While similar to New Jersey's LLC act and Business Corporations Act in setting forth the limitations on limited partner liability, the ULPL is unique in that it also enumerates the conditions in which such limitations do not apply:

Except as provided in subsection d., a limited partner is not liable for the obligations of a limited partnership unless he is also a general partner or, in addition to the exercise of his rights and powers as a limited partner, he takes part in the control of the business. However, if the limited partner's participation in the control of the business is not substantially the same as the exercise of the powers of a general partner, he is liable only to persons who transact business

with the limited partnership with actual knowledge of, and reliance on, his participation in control.

See N.J.S.A. 42:2A-27(a). Notably, the ULPL also provides a safe harbor provision, defining particular activities that a limited partner may engage in for a partnership that do not constitute the participation in the control of a business. See N.J.S.A. N.J.S.A. 42:2A-27(b).

In Canter, the Court examined whether Seniors Healthcare, Inc. (“SHI”), the limited partner of Lakewood of Voorhees Associates, LP (“Lakewood”), was liable for injuries sustained by the plaintiff in a negligence action against Lakewood. The motion judge applied veil-piercing principles to Lakewood and denied SHI’s motion for summary judgment by concluding that a genuine issue of material fact existed as to whether SHI controlled Lakewood. On appeal, SHI argued that only the limited prohibited conduct enumerated by the ULPL applies to limited partnerships. SHI alternatively argued that even if veil-piercing principles applied to limited partnerships, there was no genuine issue of material fact as to whether it participated in the control of Lakewood by taking action outside of the safe harbor provisions of the ULPL.

The Court considered whether SHI dominated Lakewood using veil-piercing principles and evaluated whether Lakewood was: grossly undercapitalized, a mere instrumentality of SHI, failing to subscribe to corporate formalities, lacking corporate records, controlled by SHI’s directors on a day to day basis, or merely a façade. It concluded that the lower court erred in denying summary judgment as the evidence was “insufficient to establish a genuine issue of any material fact, such that Lakewood’s veil should be pierced to impose liability on SHI for Lakewood’s negligence.” Id.

The Appellate Division’s ruling in Canter marks first time veil-piercing principles were applied to an analysis of limited partner liability. While, limited partnerships are generally not the most popular legal entity choice with the onset of LLCs, they have frequently been the entity of choice in connection with real estate investment projects as they allow for passive investors to be insulated from personal liability.

Although the ULPL provides for a number of acceptable activities that limited partners can take in connection with their business, Canter expands the scope of activities that could give rise to liability to a limited partner by applying veil-piercing principles to the facts. While the ULPL sets forth certain “control and domination” conduct prohibited by limited partners, such conduct can now also be analyzed under the lens of veil-piercing principles.

Limited partners that are currently active in their limited partnerships should verify that their involvement in limited partnerships is within the strict confines of the ULPL safe harbor provisions. Any actions taken outside the limited safe harbor may be subject to

veil-piercing test. Limited partners should review their practices to ensure that they do not expose themselves to any type of liability arising against the limited partnership.

While the genesis of the Canter case arose from a personal injury matter, limited partners found to be in domination of the partnership under the veil-piercing analysis could be exposed to any type of liability of the limited partnership, including liability arising from financing or other debts incurred by the partnership. Conversely, litigants taking action against limited partnerships can now assess whether to also take action against a partnership's limited partners.

Accordingly, limited partners should be on high alert to avert any potential liability arising as a result of Canter.

Harwood Lloyd's Commercial Department regularly advises businesses on legal entity formation issues and is experienced in representing entities in connection with commercial disputes.