

May 2001

AVOIDING PERSONAL LIABILITY THROUGH PRESERVING YOUR CORPORATE STATUS

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A common motivation behind forming a corporation or a limited liability entity is the limitation of personal liability for company debts and personal injury and property damage claims. Under the protection of a "corporate shield," liability of an individual member or shareholder is limited to the person's investment in the company. However, a doctrine known as "piercing the corporate veil" permits creditors or plaintiffs to ignore the corporate form and, under certain circumstances, hold officers, directors, or shareholders of a corporation or the managers or members of a limited liability company personally liable.

Business Owner Held Personally Liable For Corporate Debt

In the recent Indiana Court of Appeals case of *D.S.I v. Natare Corporation*, Mart, the owner of two swimming pool businesses, failed to withstand the Court's scrutiny of his corporate veil. Mart was the sole shareholder and director of two corporations, D.S.I. and Aquatic Renovations Systems, Inc. The two corporations shared office space, business facilities, and expenses. When questioned at trial, Mart was unable to establish, through corporate records, the separate corporate existence of each corporation. The Court of Appeals considered these facts in affirming the trial court's decision to hold Mart personally liable for actions taken under the perceived corporate shield of the corporations. Keeping proper records to establish the separate corporate existences may have allowed Mart to limit his personal liability exposure.

Factors Considered in Piercing the Corporate Shield

Courts typically consider many factors when deciding whether to pierce a corporate veil; however, it is important to note that a court may pierce the corporate veil upon finding only one factor. The following is a partial list of factors companies should take into consideration when protecting themselves from veil piercing:

- **Failure to Observe Required Corporate Formalities** - Corporations and limited liability companies should follow proper company form by holding annual, regular and special meetings. Any actions to be taken by the company out of the ordinary course of business should be approved at such meetings.
- **Absence of Corporate Records** - Consistent and complete corporate records establish proper corporate form. A company should maintain complete records of its Bylaws or Operating Agreement, written minutes of all meetings, accounting and bookkeeping records, and all statements and receipts.
- **Payment by the Company of Individual Obligations** - Personal debts of the owners of a company should never be paid by the company. All company bank accounts should be maintained in the full company name, and all business disbursements should be made from these accounts, rather than personal accounts.
- **Avoid Co-Mingling of Assets and Affairs** - Company assets, including business equipment and supplies, should be owned wholly by the company. Additionally, as in the Mart case, if two companies have the same or similar ownership and control, each company should maintain separate assets and records. In the event one company borrows capital or assets from the other company, proper documentation in the form of promissory notes and leases should be maintained in the

company records and payments from one company to the other should be made as required in the note or lease.

- **Maintain Proper Capitalization** - Companies whose business entails higher risks should increase capitalization accordingly, especially if adequate insurance is not maintained by the company.
- **Fraudulent Representations by Shareholders, Directors, Members or Managers** - Both employees and owners of companies should realize that the corporate shield cannot protect them from their own fraudulent representations.
- **Establish Signatory Capacity when Executing Documents** - All legal documents should be executed by an officer of the company in their official capacity on behalf of the company. The recommended form is as follows:

COMPLETE NAME OF COMPANY

By: _____

Officer Name, Position

In the event a financial institution requires owners or officers of the company to co-sign on a loan note, the owners or officers should sign only as guarantors and not as principals.

Following these recommendations to maintain proper company form should help business owners avoid personal liability. If you have any questions about maintaining your business' corporate status, give the attorneys at KDDK a call.