

EROSION OF CORPORATE LIABILITY PROTECTIONS

In the aftermath of recent scandals (*e.g.* Enron, Anderson Consulting, Madoff), the law has shifted somewhat in the direction of weakening corporate¹ liability protection by making it easier to “pierce the corporate veil.”² This is where the court allows a plaintiff to reach the personal assets of the company owner(s)³ rather than limiting recovery to the company’s assets.⁴

Florida courts focus on three key factors in deciding whether or not to shield owners from personal liability:⁵

1. Was the company controlled by its owner(s) in such a way that it was merely an “alter ego” used for the owner’s benefit,⁶
2. Some sort of improper conduct in either the formation or the use of the corporate form,⁷ *and*
3. The improper conduct imposed an injury on the claimant.

Most courts tend to focus the analysis on the second element: “A critical issue in determination of whether the corporate veil will be pierced for imposition of personal liability is whether corporate entity was organized or operated for an improper or fraudulent purpose.”⁸

The central issue then becomes identification of the degree and types of misconduct that results in personal exposure. Example of what the court might look for include the following:

- use of company to evade existing obligations (i.e. defraud creditors),⁹
- a perpetual monopoly, *or*
- use of company to protect against criminal liability

While this standard provides some guidance, it remains purposefully broad. Notwithstanding, owners can take certain precautions to minimize their exposure. For example, owners can limit the risk of personal liability by making good-faith attempts to pay the company’s creditors. This is not to say owners must necessarily pay company bills from their

¹ The same protection entails under certain other business forms as well, (i.e. limited liability company).

² Also known as “disregarding the corporate fiction.”

³ The term “owner,” as used here, encompasses shareholders, directors, and other controlling parties, as the case may be.

⁴ Under the same principle, plaintiffs can reach assets of other companies belonging to the owner.

⁵ 8 Fla. Jur 2d Business Relationships §13 (2006); *Mullin v. Dzikowski*, 257 BR 356 (SD Fla. 2000); *Dania Jai-Alai Palace, Inc. v. Sykes*, 450 So. 2d 1114 (Fla. 1984); *Seminole Boatyard, inc. v. Christoph*, 715 So. 2d 987 (1998).

⁶ For example, where the owner commingles his money with the corporation’s money, or the owner uses corporate property for private purposes. Basically, any evidence that the owner does not respect the corporation as a separate entity could be used to meet the “alter ego” element.

⁷ *Dania Jai-Alai Palace*, 450 So. 2d 1114; *Hilton Oil Transp. v. Oil Transp. Co., S.A.*, 659 So. 2d 1141, 1151 (Fla. 3d DCA 1995); *Ally v. Naim*, 581 So. 2d 961, 962 (Fla. 3d DCA 1991).

⁸ *Kanov v. Bitz*, 660 So. 2d 1165 (3d DCA 1995).

⁹ Undercapitalization of the business and/or failing to maintain liability insurance to cover damages resulting from the company’s negligence or intentional wrongdoing are traditionally looked at to determine these first two elements.

own pockets in order to avoid having a judge pierce the corporate veil. Rather, the emphasis is on “good faith.” If there is no perception of misconduct, then the company’s inability to pay its creditor’s should not obviate the liability protection.

Also, be advised that, given today’s political and legal climate, any criminal conduct will likely expose owners to personal liability. Courts are alert to owners filling their personal pockets through unscrupulous means while allowing the company to bear the repercussions.

The final guideline is for small business owners who are perhaps less careful about separating personal assets and liabilities from those of the business than they could be. For example, it is common for some owners to pay personal expenses with the company credit card or utilize company equipment for personal business, etc., especially when there is just one owner or the owners are a couple. While common, this kind of disregard for the corporate entity can lead to exposure.

The court’s concern is that commingling resources may leave the company undercapitalized, so the company may not be an autonomous entity capable of assuming its own liabilities. For example, the company might be unable to pay its debts because the owner improperly spends company funds for personal use. In that scenario, it might be unfair to leave a plaintiff whose suit is against the company without any means of recovery.

One way to alleviate this concern is for the company to maintain adequate insurance, but perhaps the easiest and most cost-effective thing to do is to respect the company’s autonomy and keep personal and business finances separate.

Of course, this short article is meant only to be a broad overview of the topic. There are other factors to consider and a myriad of strategies that can be employed to limit an owner’s personal exposure. If any of the points herein strike a chord, consider meeting with a business attorney to discuss your particular situation.

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