

## LEGALLY SPEAKING

# Avoiding the pitfalls of personal liability when making management decisions



by Gerald M. Newman  
ERA General Counsel

Often in sales representative corporations, the sole or majority shareholder of the company also wears the hat of president, CEO and all-around manager. These combined responsibilities require that the owner make many management decisions necessary to successfully run the corporation. While these decisions are presumptively made with the best interests of the corporation in mind, certain decisions regarding personnel can often lead to litigation by an aggrieved employee. This, of course, is the nature of business and is often considered when the management decision is made. However, occasionally, aggrieved employees sue not only the corporation, but also the individual decision maker, who, of course, is the sole or majority shareholder, president, CEO and manager of the corporation.

While most business owners think that they are protected by the law of limited corporate liability, there are possible scenarios where the court will "pierce the corporate veil" and hold individual business owners liable for their management decisions. Although these scenarios are the exception and not the rule, every business owner should be aware of the "line in the sand" when the law of limited corporate liability no longer applies.

The significance of being just individually named in a lawsuit can be great. If the individual is not immediately dismissed from the lawsuit, s/he may be subject to the rules of discovery, which typically require the individual to answer questions regarding personal matters and to turn over personal information regarding the individual's finances. The cope of this discovery can be great. The standard used by the court includes not only relevant evidence but also information that may lead to relevant evidence. The aggressive plaintiff's attorney may

pursue the individual's personal information with a vengeance.

The prospect of having the individual's personal information disclosed is only part of the problem. If the employee's suit is successful against the individual company owner, the employee can go after the individual's personal finances to recover on the judgment. Also, there is the prospect of punitive damages if the court finds fraudulent or egregious activity.

In a recent case, Mr. X was the president, CEO and sole shareholder of a small sales representative company. As the president of the corporation, Mr. X controlled all aspects of the business, including negotiating all contracts with principals and negotiated all of the employment agreements with its sales reps. After several years with the company, one of the sales reps started his own business and left the company. Mr. X paid the rep his commissions earned through the date of his resignation per their oral agreement. The rep disagreed with the amount of the commissions owed and sued the company and Mr. X (individually). In his lawsuit, the rep claimed that Mr. X should be held individually accountable because he made all of the corporation's decisions regarding the commissions owed, which, subsequently, resulted in Mr. X's personal financial gain. The employee also alleged that Mr. X had another corporation operating out of the same offices and operated a satellite office out of his summer home in Florida. The court dismissed Mr. X in his individual capacity — holding that the employee did not allege sufficient facts to pierce the corporate veil — but did so only after the court decided that Mr. X had run the corporation in such a way as to avoid individual liability. This included ad

*(continued on page 24)*

*Gerald M. Newman, partner in the Chicago law firm of Schoenberg, Fisher, Newman & Rosenberg, Ltd., serves as general counsel to ERA and is a regular contributor to The Representor. He participates in Expert Access, the program that offers telephone consultations to ERA members.*

*Allen S. Kirsh, an associate at Schoenberg, Fisher, Newman & Rosenberg, Ltd., co-authored this column.*

*You can reach Gerry Newman or Allen Kirsh at 312-648-2300, or fax them at 312-648-1212, or send e-mail to [gerry.newman@sfn-law.com](mailto:gerry.newman@sfn-law.com) or [allen.kirsh@sfn-law.com](mailto:allen.kirsh@sfn-law.com)*

**Electronics Representatives Association**



**Executive Committee of ERA**

*Chairman of the Board:*  
Clark Moulthrop, CPMR

*President:*

Jess Harper, CPMR

*Senior Vice President/Fiscal & Legal:*

Mark Motsinger, CPMR

*Senior Vice President/Education:*

Mike Kunz, CPMR

*Senior Vice President/Membership:*

David Rossi

*Senior Vice President/Industry:*

Bryan Shirley, CPMR

*Executive Vice President &*

*Chief Executive Officer (Ex-Officio):*

Raymond J. Hall

**Insurance Trustees of ERA**

*Chairman:*

Tim Eyerman, CPMR

*Trustees:*

Norman MacInnis, CPMR

Gene Peake, CPMR

Joel Schwartz

Gene Peake

Byron Brewer (NEMRA)

*Trust Administrator:*

Raymond J. Hall

**ERA National Staff**

*Executive Vice President*

*& Chief Executive Officer:*

Raymond J. Hall,

rhall@era.org

*Administrative Director:*

Tom Shanahan,

tshanahan@era.org

*Executive Assistant to the CEO:*

Karin Derkacz,

kderkacz@era.org

*Assistant, Communications*

*& Circulation:*

Larry Bauer,

lbauer@era.org

*Database Manager:*

Katherine Green,

kgreen@era.org

*Information Services Coordinator:*

Joan Hackett

info@era.org

*Chapter Management Services Director:*

Tess Hill

thill@era.org

*Trade Show Coordinator:*

Chris Kosch,

ckosch@era.org

*Editor:*

Bettina Lee,

blee@era.org

*Assistant, Accounting:*

Anthony Vela,

tvela@era.org

*Director, Finance & Operations:*

William R. Warfield,

bwarfield@era.org

**LEGALLY SPEAKING**

*(continued from page 21)*

equate capitalization of the business, adhering to the corporate formalities, and not commingling corporate funds with personal funds. A review of these factors may assist the small-business owner to protect himself/herself from individual liability.

**Adequate capitalization**

More often than not, when the court decides to pierce the corporate veil, it is because the corporation appears to be merely a facade by which the individual does business. This is typically established by showing that the corporation does not maintain adequate capital to meet its responsibilities. Whether the capitalization of the corporation is adequate depends on the nature of the business and the amount of potential corporate liability. Therefore, the amount of capitalization cannot be illusory compared with the type of business and the expected risk of loss. This will typically be determined based upon the equities of the situation. In other words, is the corporation run with so few funds as to merely be a flimsy organization set up by the shareholder to avoid personal liability? If the corporation is adequately capitalized in accordance with its business purpose, then it has begun a strong case against piercing the corporate veil and avoiding personal liability for the shareholder.

**Adhere to the corporate structure**

The court will also look to see if the formalities of a corporation are being followed. This includes regular corporate meetings with minutes, issuing stock, payment of dividends if required, filing all necessary reports, and keeping accurate corporate records. The incorporating attorney will be able to advise the corporation on these requirements and the applicable laws in the state of incorporation.

**Do not commingle corporate funds with personal funds**

A very important factor to protect an owner from individual liability is to completely separate corporate finances from personal finances. This may seem like a simple principle, but individual business owners often overlook routine transactions that may appear (or later be twisted by ambitious attorneys) to be commingling of funds. The most simple measure is to be certain that the corporation has, in its own name, all of its own banking accounts necessary to run the business, and do not pay for personal expenses from corporate accounts. This is the first place a suspecting plaintiff will look to see if you have commingled funds.

Be sure that all utility bills are in the name of the corporation. This includes telephones and beepers, although the occasional personal call on a company phone should not result in piercing the corporate veil. Also, be sure that all corporate vehicles are in the name of the corporation and that all premises used by the corporation are either owned or leased by the corporation and not by the individual shareholder. Also, if the corporation has satellite offices, be sure that those are also in the name of the corporation and not the individual shareholder.

Lastly, be sure that all loans or capital contributions to the corporation are fully documented.

**Final thoughts**

The factors discussed above are not reviewed individually, but instead cumulatively when the court decides to pierce the corporate veil. Moreover, the court reviews these factors only to decide the central question of whether the existence of the corporate identity perpetuates a fraud on creditors or would otherwise work a gross injustice to the law of limited corporate liability.

With these factors in mind, sole or multiple shareholders can control and dominate their corporations without the fear of individual liability. While no measure of protection can stop being named individually in the occasional lawsuit, these suggestions should assist your attorney in a swift and relatively painless dismissal.