# DO YOU STILL THINK A CORPORATION PROVIDES UNLIMITED LIABILITY PROTECTION?

**By: Howard B. Young**

## New York Business Corporations Law Section 630

Shareholders routinely take for granted that they have no liability for corporate activities beyond their original investment. Indeed, most lawyers would so advise their client. However, there are numerous exceptions-some well known, others much more subtle. Recently, a doctor client of mine invested in a closely held company incorporated in New York which had a can't miss product. The company couldn't successfully commercialize it and left many unpaid creditors including employees. Under Section 630 of the New York Business Corporations Law, the 10 largest shareholders of a closely held company (this doesn't apply to publically held companies or investment companies) are jointly and severally liable for all debts, wages or salaries due and owing to any of its laborers, servants or employees. Wages and salaries include vacation, overtime, deferred compensation, holiday and severance pay, contributions to welfare benefit plans and other monies properly payable directly or indirectly to the employees. My doctor client, perhaps the 9$^{th}$ or 10$^{th}$ largest shareholder, is now being sued for millions of dollars. If the larger shareholders are uncollectible, my unsuspecting and totally passive investor will not only lose his original investment but may also now be liable for unpaid employee benefits and wages.

How does an investor protect himself or herself in these situations. One of the ways to do so is to have an effective asset protection plan in place so that if the unexpected catastrophic event ever occurs (as it has for my doctor client), at least the investor's other assets are protected.

## SHAREHOLDER LIABILITY FOR ENVIRONMENTAL VIOLATIONS

One of the known exceptions to limited liability in the corporate shareholder setting is when the veil of the corporation is pierced and liability is assigned to a shareholder. The long standing test in Ohio, which is fairly typical of the tests in other states, was that the corporate form could be disregarded when "(1) control over the corporation by those to be held liable was so complete that the corporation has no separate mind, will or existence of its own, (2) control over the corporation by those to be held liable was exercised in such a manner as to commit fraud or an illegal act against the person seeking to disregard the corporate entity and (3) injury or unjust loss resulted to the plaintiff from such control and wrong." In finding that the sole shareholder of a company operating a landfill in Ohio was personally liable for the company's

environmental violations, the court held that even though the company was adequately capitalized and observed all corporate formalities if the shareholder had sole control of the corporation's actions and that as a result of the corporation's actions the plaintiff suffered injury, the shareholder is personally liable. So in State ex rel. Petro v. Mercomp, Inc., 167 Ohio App.3d 64, 2006-Ohio-2779, Harry Rock, the sole shareholder of Mercomp, Inc. found himself liable for all of the financial exposure his corporation had to the State of Ohio for failing to close a landfill in accordance with Ohio law. This result was obtained even though there was no allegation that Mr. Rock himself did anything improper or illegal; indeed it was the actions of the corporation in violating applicable environmental regulations which were attributed to him that led to his liability.

The lesson here is that any entrepreneur running his solely owned company may be personally liable for the actions of the company even if the company is adequately capitalized, has not committed a fraud on its creditors and committed such acts unknowingly. It behooves every owner of a closely held company to consider a plan of asset protection to minimize the accessibility of his personal assets to creditor claims.