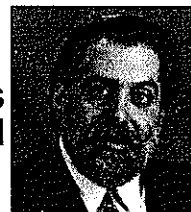


Corporate Exposure: Corporations and Personal Liability

Harry P. Mirijanian



The decision for entrepreneurs to incorporate has become quite commonplace. The logic behind incorporation for many is that it protects individuals from personal liability. Unfortunately, incorporation does not always protect or eliminate personal liability when sued. As a rule, the corporation will protect the individual in business and contractual arenas; there are, however, circumstances in which a plaintiff can "pierce the corporate veil" and hold individuals accountable.

For example, any person who knowingly commits fraud or any criminal act in the name of the corporation risks personal liability. In one case, a structural engineer knew that a particular property was structurally unsound, but he nonetheless intentionally reported incorrect findings under his corporation's name. After the defects were uncovered, a suit was brought against the corporation, and the engineer was held personally accountable. In another case, partners in a California corporation were held liable by the courts because their business was both underfunded and underinsured. Although the company was thriving, the partners never held more than a few thousand dollars' worth of assets and failed to purchase liability insurance protection. The partners were held personally accountable after the company suffered a loss for which they had no insurance or a separate fund for potential liabilities.

Although some are deeply concerned

with decisions like these, the logic appears straightforward. The courts are trying to prevent individuals from establishing corporations merely as a means of evading creditors. Conversely, when the corporation has maintained assets and sufficient insurance to satisfy a majority of the creditors and lawsuits, the courts are likely to recognize the corporation and protect the individuals involved.

Despite the existence of a corporation, individuals can agree to expressly bind themselves and not the corporation in certain circumstances. Contracts requiring execution can indicate that the officer signing the agreement is acting in an individual capacity and not as an agent, officer, or shareholder of the corporation. This practice is common with corporate bank loans and even office leases in which the principals of the corporation may be asked to sign personally or individually as a means of guaranteeing the conditions of the contract.

A final illustration: Some state and federal laws can negate the protection afforded by a corporation. For example, the Federal Superfund law has held corporate officers responsible for damages depending upon the officer's actions. The case that comes to mind involved officers who should have realized their practices were creating a hazardous waste condition. Instead of rectifying their operations, they chose to ignore the logical consequences and subsequently created a hazardous waste site.

Do these examples imply that individuals should not incorporate? A tough question—certainly too complex to address here, especially given the numerous exceptions and qualifications. But two subjects require careful review. The first is intent. Why is the corporation being formed? Is it for business expansion and development purposes or as a vehicle to seek some type of remediation

and protection? If your reasons are well-intentioned, then the corporation will likely offer the protection you seek. The second consideration is the procurement of appropriate insurance. Whether or not an individual incorporates, appropriate insurance should be in place to protect the organization as well as the individuals involved. A simplified version of this approach is seen in the workers compensation arena. To prevent workers from suing their employers, workers compensation policies have become the sole means of remedy with few exceptions. Other examples include malpractice and E & O insurance (which will respond to operating errors that may occur during the normal course of business). General liability policies will protect the corporation against suits for bodily injury and possibly property damage to others caused by your operations. Directors' and officers' liability insurance can protect individual officers or directors of a company, assuming it is properly structured.

A professional insurance broker can help you secure the necessary coverages to protect both your personal and corporate assets. Naturally, there is no insurance policy that will cover any tort of unlawful event.

In summary, it is important to realize that a corporation in itself is not complete protection against being held individually. There may be gaps that create situations for which individuals may be held liable. A strong insurance product and a knowledgeable attorney can assist you in your decision to incorporate. ■

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