LOOPHOLES IN CORPORATE LIABILITY LIMITATIONS

STEVEN A. O'ROURKE, J.D.
www.CalCorpLaw.com

You can reduce exposure to legal liability by learning the differences and interplay of the different legal regimes that apply to shareholders, directors and officers, respectively. When a prospective client asks me to create a corporation for which he would be (an) owner, an officer and (a) director, he usually states his purpose as wanting "personal immunity" As a matter of professionalism, I always assure the client knows the general law before I start preparing documents.

Shareholders are said to be "immune" from corporate liabilities. The California corporate *statute* says nothing about that; neither does the Delaware code. Indeed, for its first 60 years, the California constitution expressly provided that shareholders *were* liable for their pro-rata share. So, there is no structural reason why shareholders ought be immune. Rather, each state has a presumed intention generally to immunize shareholders. Lawyers refer to "piercing the corporate veil" (imposing corporate liability on shareholders) as an "equitable remedy", which means that courts may pierce the veil whenever justice requires. There is no prescribed test, so "expert" articles listing the "factors" must be read with caution. Takeaway #1 is: "A shareholder who has no other involvement can assume, but can never assure, shareholder immunity."

Shareholder immunity, even if not pierced, is somewhat a misnomer because any shareholder who acts in an *additional* role opens himself to liability for actions in that other role.

Shareholders who are also *directors* are not immune from the liabilities imposed on directors. Corporate law in most states allow corporations to eliminate some, not all, bases for director liability for failing to meet the director's fiduciary duty standard. Even when the corporate charter (some states call it the "Articles", some say "Certificate") or bylaws recite that the "liability of directors to the corporation are eliminated to the fullest extent permitted by law", bear in mind that the law has many exceptions regarding the "fullest" extent. A charter's "elimination" of liability applies only to the director's liability "to the corporation", not to 3rd parties such as employees, customers, suppliers, banks etc. And not for legal remedies other than payment of money. And state laws also preserve director liability for many acts. For example, California prohibits elimination of liability for "intentional misconduct", "absence of good faith", "improper personal benefit", "reckless disregard", and a "pattern of inattention". Consider the ease with which a director can be accused of failing to act in "good faith" or with necessary continuing "attention". Take away #2: a Director ought seek legal advice on how to prevent, eliminate, reduce, indemnify, insure, waive or contract-away director's liabilities.

In CA, DE and most other states, *officers* have the same fiduciary duties as directors but the corporation's charter cannot reduce or eliminate the scope of *officer's* liability for breaches. Takeaway #3: Officers ought also seek legal advice to control liability.

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