

## Legal: Corporate Protections and Their Limits

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Establishing a corporation or limited liability company is an inexpensive and simple way to reduce your risks and dramatically reduce your personal liability. Corporations generally are viewed as separate from their officers, directors and shareholders. This legal separation translates to individuals being excluded from the contract debts of the company. This corporate protection is not, however, unlimited. Individuals interested in establishing a corporation should know and understand the limits of protection afforded by a corporation.

### Contractual Obligations – The Rule Generally, and Specifics

Generally speaking, the officers, directors and shareholders of a corporation are not liable for the obligations of the corporation. Thus, the corporation's owners should not be liable for contractual responsibilities of the corporation. This doctrine is not limitless. For example, if a claimant is able to "pierce the corporate veil," that claimant may be able to recover against the individual company's owners or officers.

In addition, there are some practical considerations, particularly in today's economic environment. Banks are far more concerned with documenting deals appropriately and ensuring they have collection remedies and proper security or collateral prior to lending. This evolution translates to more attention being paid to personal guarantees of corporate debts by the owners or investors in a corporation.

The trend towards more personal guarantees of contractual obligations extends beyond banking relationships. Business owners can expect the potential for negotiation of personal guarantees to extend into other business relationships, such as leasing commercial space for a business, leasing vehicles, renting copiers or other office equipment, or other credit based commercial transactions. In the event of a personal guaranty, an individual should understand that guaranty obligations trumps typical corporate protections.

### Tort Obligations

You remain responsible for your own individual conduct even when you are acting as an employee, officer, director, or shareholder of a corporate entity. Thus, you can be held legally liable in tort for your actions even if they are part of your role with a corporation.

For example, if you are driving for work at the ABC Corporation and run into someone and hurt them, you can be sued individually for your negligent driving. Driving on behalf of the ABC Corporation does not shield you individually from your own individual negligence.

Even with tort claims, corporations offer a significant benefit. Officers, directors and shareholders are not liable individually for the torts of the corporation. Extending our driving example, if we

both were employees of the ABC Corporation at the time of your accident, you would be liable for your negligence, but I would not be personally liable by virtue of my role as an employee of the corporation. The same generally holds true for officers, directors, and shareholders.

### Conclusion

Corporations offer a significant level of protection for your individual assets. They are not, however, a complete escape hatch to responsibility of your own individual actions. Each state presents its own wrinkles on the types of claims possible, the types of defenses available, and how corporate formation impacts those claims, so you should study those issues closely to understand that law that applies to your business. Regardless of location, corporations offer an inexpensive and smart means of risk reduction that you should closely consider.

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