

Bulletin #70, Legally Running a Company (or Else!) (August 22, 2003)

You are properly signing your contracts, you have selected the proper business entity, and you have an agreement in place for controlling the entity. (See *Contracts Bulletins 68 and 69.*) Now you need to properly manage your entity to limit individual liability.

There are still corporate “formalities” which need to be performed in order to prevent others from claiming that you are acting individually, as opposed to through your company. If you properly follow the simple tasks discussed below, the entity will be responsible for business debts. However, if you fail to follow these rules, you (and not your entity) can be personally liable.

In addition, performing the “formalities” listed below could be essential if you want to grow or sell your business in the future. Lenders and potential purchasers often require detailed business and financial records. Engaging in proper record keeping demonstrates your professional competence to both buyers and lenders.

The discussion below is based on a general understanding of the law. You should discuss with your attorney specific requirements for filing and maintaining records in your state.

PROPERLY MAINTAINING ENTITIES

It is crucial that you perform the “proper formalities” to place the world on notice that you are acting as an entity. The “formalities” include the following:

- **Select an Entity and File with the State** – Create an entity and file the formation documents with your State. (See *Contracts Bulletin #69.*)
- **Shareholder Stock Records** – Create and maintain appropriate shareholder certificates. (See Exhibit A attached – all exhibits are examples of documents relating to “C” corporations.) Keep records regarding numbers of shares or membership units of the entity to document ownership. (See Exhibit B attached.)
- **Hold Regular Meetings** – The entity should hold regular meetings with shareholders and directors to document important decisions or changes in leadership or ownership of the entity.
- **Keep Meeting Minutes** – A written record should be kept of the discussions and major decisions made at each meeting of directors or shareholders. (See Exhibit C attached.)

- Resolutions – Resolutions are documents which reflect important decisions to be made by the owners of an entity. For example, if the entity selects a new bank, changes officers or directors, or engages in important business transactions, a resolution records the decision by the entity’s leadership. Resolutions may be incorporated into minutes. Resolutions may also be signed by shareholders, members, directors or governors when no formal meeting is held. Instead, the resolutions are signed and approved in lieu of a meeting and are memorialized in a document often called an “Action by Consent.” (See Exhibit D attached.)
- Owners Duty – Owners of the entity must focus on the success of the entity and not their own individual personal interests. This means that you must not use the entity as your “alter ego,” but engage in business activities that allow the business to grow and meet its obligations.
- Property Ownership – Shareholders, officers, and directors must sharply distinguish between corporate property and personal property. For example, the “title” of property should be in the name of the company, as opposed to the individual shareholders or owners (e.g., if the company pays for a crane it uses for construction, the title for the crane should generally be in the name of the company and not the individual owner).
- Funds – Officers, directors/governors, and employees of the entity cannot mix personal and entity funds. The entity should hire an accountant or (at a minimum) have careful bookkeeping, which distinguishes between the entity and its shareholders. For example, the company should have a checkbook separate from its owners. Payments by customers must be deposited into the entity account and vendors should be paid from that account.
- Signature as an Entity – Officers, directors, and employees of the entity must sign contracts as representatives of the entity and not as individuals. (See *Contracts Bulletin #68*.)

RAMIFICATIONS OF FAILING TO MAINTAIN ENTITIES

If you fail to maintain the appropriate corporate formalities discussed above, you may be found personally liable for claims. Courts determine whether the business entity has become the “alter ego” of the individual running the business. The factors most frequently analyzed by courts in deciding if an individual is personally liable are:

- whether the business is under-capitalized;
- whether the individual’s and business’ funds have been intermingled or if the business’ funds have been diverted to the majority shareholders; and
- whether the corporate entity has failed to keep good and separate business records.

For example, in Clee v. Remillard Building, Inc., 649 F.Supp. 1127 (D.Conn.1986), the court found a Connecticut builder personally liable, because “[s]ince the corporation’s formation, [the builder] followed few corporate formalities, operating the corporation not as a separate entity but as the business of an individual.” For instance, the builder received checks from homeowners written to him personally, not the corporation. The builder cashed a number of those checks, rather than depositing them into the corporation’s account. The builder signed for materials individually and was billed individually for the materials. The builder also determined whether to enter into contracts and negotiated the price and the terms of the contract without reference to the corporation. Therefore, the court found it was appropriate to “pierce the corporate veil” because the corporation was the alter ego of the individual.

A general contractor in Ohio, who had hired a subcontractor to perform excavating work, was also

found personally liable to the subcontractor because he failed to follow corporate formalities. Longo Construction, Inc. v. ASAP Tech Service, Inc., 748 N.E.2d 1164 (Ohio. App. 2000). The subcontractor sued the general contractor for breach of contract after the general contractor failed to pay. The subcontractor collected against the CEO of the general contractor. The general contractor's CEO owned the corporation with two other shareholders, but (according to the court) "he acted as though the corporation was *his* corporation." He advanced to himself funds of the corporation and, prior to the dispute, sold all of the corporation's assets and kept the money. The only remaining asset owned by the corporation was an account receivable from a prior contract. When the corporation received payment for that account, the corporation immediately wrote the CEO a check for the same amount. The court found that such transactions evidenced a complete domination and control over the corporation.

CONCLUSION

Running a business requires not only providing quality work to your customers, but diligent financial and document record keeping. Maintaining the formalities discussed above can go a long way in protecting your personal assets and giving you peace of mind.

Sheet Metal and Air Conditioning Contractors' National Association
4201 Lafayette Center Drive Chantilly, Virginia 20151-1209
Tel (703) 803-2980 Fax (703) 803-3732 info@smacna.org



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