A CHECKLIST FOR PROTECTING LIMITED LIABILITY

To impose personal liability on corporate shareholders it is necessary to prove: (1) such unity of interest and ownership that the separate personalities of the corporation and the individual do not exist, and (2) treating the acts as those of the corporation alone would result in inequity. Associated Vendors, Inc. v. Oakland Meat Co., Inc., 210 Cal. App. 2d 825 (1962). Most states have similar rules on personal liability for corporate (or limited liability company or limited partnership) debts. Even with limited liability, corporate shareholders, officers, and directors can be liable for company related obligations if they are personally involved in tortious (wrongful) conduct, discussed below.

The following are several actions that can be taken to minimize the chance of an adverse determination on limited liability. Much of this is basic, but it is some of it is not. This is not intended to be all-encompassing. For implementation, see a competent attorney.
.

1. Entity. Form a limited liability entity such as a corporation, limited liability company, or limited partnership.

2. Capital. Contribute adequate initial capital to the company to bring the company through several months or more of operations.

3. Commingling. Don't commingle personal and company funds or the funds of two entities.

4. Loans. Document all loans from the company to insiders or from insiders to the company with promissory notes and with board approval.

5. Non-Company Spending. Don't use company funds for personal or other than company purposes.

6. Stock Authority. Obtain company authority to issue stock or membership interests.

7. Stock Issuance. Issue stock or membership interest certificates.

8. Acting as Limited Liability Entity. Make it clear in all business dealings that the company is a limited liability entity in stationery, business cards, and promotional and other material, by using "Inc., "LLC", or "LP" or the equivalent. Sign all legal documents stating your office and the name of the company at the place of signature.

9. Holding Self Out as Liable. Don't hold yourself out as being personally liable for company debts.

10. Keeping Adequate Records. Maintain minutes and adequate company records, including annual minutes of shareholders and boards of directors for corporations. Minutes are less essential for LLCs and LPs, but still very helpful.

11. Shareholder Approval. Have the shareholders approve all share transactions and buy-sell agreements (for a closely held company), approve all changes in the board, and annually elect the board.

Law Office of Bradley Smith, 1754 Technology Drive, Suite 229, San Jose, CA 95110, (408) 573-1010, brad@bsmithlaw.com.

12. Board of Directors Approval. Have the board approve or ratify all major contracts, especially those involving real estate, approve or ratify all major company policies, approve all changes in officers, and annually appoint the officers.

13. Separate Entities. Keep the records of separate entities separate.

14. Separate Control. Avoid control of two entities by identical persons.

15. Arms Length. Maintain arms length relationships between related entities.

16. Sharing Employees. Avoid sharing employees among different entities unless you keep adequate records separating their functions and compensation with respect to each entity.

16. Company as Shell. Don't use company as mere shell or conduit for another person or entity, including a parent company.

17. Misrepresentation. Don't misrepresent the identity of owners or management or any other material information.

18. Asset Diversion. Don't divert assets from the company to a stockholder or other person or entity to the detriment of creditors.

19. Asset and Liability Manipulation. Don't manipulate assets and liabilities between entities with assets concentrated in one entity and liabilities in the other.

20. Formation to Hold Liabilities. Don't form a company for the purpose of receiving the existing liability of another person or entity.

21. Fraudulent Intent. Don't contract with the intent of avoiding performance by using the corporate shield to avoid personal liability.

22. Illegal Transactions. Don't use the company as a subterfuge for illegal transactions.

23. Tortious Conduct. Be careful to avoid tortious (wrongful) conduct. Officers, directors, and shareholders can be personally responsible for company torts if they order, authorize, or participate in tortious conduct. This can include negligence, intentional acts, misrepresentation, fraud, and strict liability.

24. Insurance. Obtain adequate business liability insurance, and, if possible, errors and omissions insurance and officers and directors insurance, in addition to workers compensation insurance.

25. Payroll Taxes. Keep payroll taxes up to date. Responsible persons may be personally liable.

26. Entity Purchase of Real Estate. Purchase real estate in the name of the entity. Don't buy it as an individual and later transfer it to the entity. Environmental or other liability may attach to all owners.

Law Office of Bradley Smith, 1754 Technology Drive, Suite 229, San Jose, CA 95110, (408) 573-1010, brad@bsmithlaw.com.