



Fine Print

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KNOW ABOUT PERSONAL LIABILITY FOR CORPORATE OBLIGATIONS

By D. David Carroll and Hollie K. Foust

One benefit of incorporation is to protect shareholders' personal assets from corporate liabilities. Normally, shareholders are not liable for the debts or obligations of a corporation. However, if a corporation cannot pay its debts, courts sometimes "pierce" this protection. When this so-called "piercing the corporate veil" is successful, a claimant may be able to collect from a shareholder's personal assets.

In Ohio, claimants must satisfy three elements to successfully pierce the corporate veil and collect from shareholders' personal assets. They must be able to show that:

- 1) the corporation is completely controlled and dominated by its shareholders;
- 2) the corporation was used to commit fraud or an illegal act; and
- 3) the fraud or illegal act must have resulted in an injury or unjust loss.

Shareholders can follow certain principles to reduce the risk of piercing of the corporate veil.

1) Make sure the corporation is completely separate from its shareholders.

■ Observe corporate formalities

and respect the legal separateness of the corporation. Issue stock in compliance with the law. Hold regular shareholder and director meetings when required and ask shareholders or directors, as appropriate, to approve actions outside the ordinary course of business. Officers and directors should exercise judgment, independent of those who elected them, that is in the best interest of the corporation. Shareholder votes must be based on the number of shares held. In some instances, a close corporation agreement may serve to reduce the need for certain of the required formalities mentioned above.

■ Maintain adequate corporate and financial records, especially when shareholders and directors approve significant corporate activities (e.g., borrowing, compensation and purchase decisions).

■ Use corporate funds and property only for corporate purposes, not for

cont. on page 2

PREPARATION CAN IMPROVE BANK LOAN EXPERIENCE FOR BUSINESS BORROWERS

By Paul E. Peltier and Timothy M. Oyster

Whether you are starting or expanding your business, chances are you will need to ask a bank for financing. You may assume a bank will evaluate your business based on dollars and cents, but do you really know how bank lending officers evaluate loan applications? Are you aware of the importance of intangibles such as community standing, reputation, community benefit and your business's likelihood of repaying the loan?

You can assume that the lending officer and the bank want your business to succeed so you can repay the loan, but you should know that the bank (especially if it is community-based) also has an interest in your business's success because of its positive impact on the community.

Before making an appointment with a loan officer, you should know what the bank is looking for and be prepared to provide the necessary information.

Information

You will need to provide the bank with the following:

■ two to three years of business tax returns;

cont. on page 2



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PERSONAL LIABILITY, cont. from page 1

personal use. Pay dividends when appropriate.

■ **Conduct business in the corporate name.** Use corporate letterhead and the full corporate name in estimates, quotes, bids, invoices, purchase orders, contracts, etc. Have corporate officers sign their names and official capacity on all contracts and other corporate documents.

■ **Keep corporate assets separate from shareholders' assets.**

■ **When starting a corporation, make sure there is enough capital to fund the type and size of the business and to cover accompanying risks.** Avoid regular shareholder loans or contributions.

2) **Make sure shareholders do not commit fraud or illegal conduct.**

■ **Shareholders should not siphon funds** to try to protect the corporation from judgments or other debts.

■ **Shareholders must not mislead third parties** by suggesting they will fulfill corporate obligations or that the corporation has assets that are really owned by shareholders.

Make sure the corporation does not incur additional debts or liabilities if it is insolvent or in financial distress.

The principles listed above can help keep shareholders from being liable for corporate obligations. However, in order to "pierce the corporate veil" and collect from shareholders' personal assets, a claimant also must show that the shareholders reaped corporate benefits and profits at the claimant's expense. The mere fact that the corporation ceased operation without being able to pay all of its debts is not enough to make shareholders personally liable for the corporation's obligations.

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PREPARATION, cont. from page 1

■ two to three years of personal tax returns;

■ a current financial statement;

■ a year-to-date Income Statement and Balance Sheet on your business entity;

■ a history of your business and/or a business plan. If the business is a start-up, then you will need to provide projections for the next three to five years and the basis for those projections.

Collateral

Banks must make sure businesses have enough collateral to secure loan requests. To determine whether your business has the necessary collateral, the bank will use the following criteria:

■ If you are using commercial real estate for collateral, the bank will want to know that, based on the property's appraised value minus any current mortgages, your business owns at least 20 percent of the interest in the property.

■ If you are using accounts receivable as collateral, then typically the bank will use the following formula: 100 percent of the receivable accounts, multiplied by the receivable collection rate, multiplied by 70 percent, minus any current liens against accounts receivable assets.

■ If you are using equipment and furniture as collateral, the bank will credit between 80 and 100 percent of a new purchase or 70 percent of the asset value after depreciation is figured and minus any current liens against the equipment or furniture.

■ If you are using cash assets, then typically the bank will consider 100 percent of the assets minus any cash asset liens.

■ If you are using marketable securities (such as stocks or bonds) as col-

lateral, then the bank typically will consider 70 to 75 percent of the portfolio's value and 65 to 70 percent of the mutual fund value, minus any current liens against your marketable securities.

Analysis

The bank will consider the following questions when deciding whether to grant your business a loan:

■ Is there sufficient collateral?

■ What is the personal credit history, the "debt-to-income" ratio and the liquidity of the business owners ("guarantors" of the loan)? (Typically, banks look for a business to have no more than a 40 percent debt-to-

income ratio.)

■ Does the business have sufficient cash flow to service the debt? To find out if your business has sufficient cash flow to cover a loan, you may wish to contact a lender, an accountant, or an attorney.

...The lending officer and the bank want your business to succeed so you can repay the loan, but the bank also has an interest in its positive impact on the community.

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Web site resource for small businesses:

To learn about programs offered by the U.S. Dept. of Labor's Office of Small Business, go to:
<http://www.dol.gov/osbp>.