

Walking the Edge of Personal Liability for Business Owners

Special points of interest:

- **Business owners can take simple steps to limit their personal liability**
- **Corporate owners are better able to limit liability than sole proprietors or partnerships**
- **Follow the guidelines in this article to limit your personal liability as a business owner**

The Michigan Court of Appeals recently decided a case that caused me to reconsider the limits of personal liability for owners of small companies. The case I am referring to is *Lipp v. John Bruce d/b/a J.B. Log Homes, Inc., No. 20274, October 9, 2007* (“Lipp”).

The *Lipp* case is not exactly a major breakthrough in Michigan law. In fact, the opinion is not even “published” – which means that it will never be seen in one of the gilded books on every lawyer’s shelf. Nevertheless, unpublished opinions provide legal guidance on specific issues, and this case contains an important lesson for small business owners.

The plaintiffs in the *Lipp* case were Jack and Janet Lipp. They entered into written contract with J. B. Log Homes, Inc. for the construction of a custom log home. The home turned out to be defective. Mr. and Mrs. Lipp sued John Bruce for breach of contract and negligence in the construction of the residence. They named John Bruce, individually, and J.B. Log Homes, Inc., as separate defendants. The Lipp’s alleged that John Bruce was negligent in constructing

the home, and that J.B. Log Homes, Inc. breached its construction contract.

The Lipp’s were successful in their suit, and were awarded a verdict of \$60,000.00. However, the trial court dismissed John Bruce as an individual defendant based on the fact that he did business as a corporation, and that the business entity should not be disregarded. That left the corporation as the only defendant. As a result, Mr. and Mrs. Lipp were not able to collect their judgment from John Bruce even though he was the sole owner of his company, and he personally directed all of the work on the Lipp’s home. The court’s decision caused a major problem for the Lipp’s because Bruce’s corporation did not have sufficient assets to pay the judgment. They appealed, but things did not go their way at the appellate level either.

The Lipp’s appealed on two grounds: 1) that John Bruce should be personally liable for his negligent conduct; and 2) the corporate entity of J. B. Log Homes, Inc. should be disregarded. This second argument is commonly referred to as “piercing the corporate

veil” - which would also leave John Bruce personally liable to pay the judgment.

In this article, I am going to focus on the first argument raised by the Lipps because the Court’s decision has such broad application for small business owners in Michigan. I’ll address the issue of “piercing the corporate veil” at a later time.

The Lipps argument to the Court of Appeals was simple — John Bruce was negligent in constructing their home, so he should not be permitted to use his corporation as shield against personal liability. The Court rejected their contention, and in doing so, provided this analysis:

“While agents and officers of a corporation are generally not personally liable for contracts made on behalf of the corporation, they may be held individually liable for the torts they commit while acting on behalf of the corporation. Although plaintiff’s claim that Bruce was negligent in this case, and despite the fact that negligence is a tort, plaintiff’s argument that Bruce should have been held personally liable for his negligent conduct must fail as a matter of law.”

Plaintiffs assert that Bruce should have been held personally liable for the negligent construction of their log home. But the failure to properly perform a contractual duty cannot give rise to a negligence action unless plaintiff alleges a violation of a duty separate and distinct from the duty imposed under the contract. Such a separate duty was not alleged here. In this case, plaintiff’s allegations of “negligence” were based solely on Bruce’s alleged breach of the obligation undertaken pursuant to the contract with plaintiff’s.”

Focus attention on the statement, “*failure to properly perform a contractual duty cannot give rise to a negligence action*”. This

legal principle has been around for several years, but it has never been extended quite so far as in the *Lipp* case.

Lipp is the first case of which I am aware that the owner of single-shareholder corporation has escaped personal liability for negligent conduct based upon a written contract covering the scope of the work he performed. Based on the Court’s analysis in the *Lipp* case, John Bruce could not be held personally liable for his negligence as long as the work he was doing was specifically covered by a written contract.

Business owners who find themselves in the same position as John Bruce can learn a valuable lesson from his experience: corporate owners may be protected against personal liability for *negligent conduct* as long as a *written contract* covers the work they are performing. Therefore, an action for breach of contract against the corporation may be the only remedy available to an aggrieved party where a written contract covers the same conduct that is alleged to have been negligently performed.

Small corporations with one or two owners are easy to create, and have proliferated across the state. Most small corporations do not have significant assets, but rather, are intended to provide their owners with a protected company name, and a “big business” identity. Before *Lipp*, I would have said that these corporate structures do not provide significant protection from personal liability for negligent conduct by their owners. Now, we cannot be so sure.

There still exists a hodgepodge of decisions in Michigan on the subject of personal liability for owners of corporations. Courts are quick to point out that every case turns on its own facts. The Michigan Supreme Court has not yet weighed-in with a definitive decision on the subject. However, based on Michigan law as it currently exists, business owners should follow these guidelines to limit their personal liability:

1. Small business owners should do business as a limited liability company or corpora-

tion, even if the owner is the sole member or shareholder of the company.

2. Once the company is formed, owners must operate the company as a separate entity. This means that the owner should not co-mingle business assets with personal assets, nor should the owner make withdrawals from the corporate account for personal expenses.

3. Whenever possible, a contract covering the scope of the work to be performed should be signed between the corporation and its customers. The existence of a written contract is critical to the determination of whether negligent conduct is “separate and distinct” from the duty imposed under the contract. The contract should cover all aspects of the work to be performed – even conduct that is incidental to the finished product.

4. Corporate formalities should always be observed. This means that the business owner should sign every business document in the name of the company. All other corporate formalities should be observed, including annual meetings of shareholders and directors, meeting minutes, adherence to by-laws, current share certificates, and written resolutions related to the conduct of the company. When a company is sued, the plaintiff’s attorney will request a copy of the corporate record book. Therefore, these documents must be organized and kept up to date.

There is no surefire way for business owners to protect themselves from personal liability. Nevertheless, adherence to these guidelines will provide an opportunity to prevail in a lawsuit where a business owner faces an allegation of negligence in the performance of his or her job.



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