



Mary Hanson



About the Business Advisor

The Business Advisor is written and published by Mary Hanson, a business attorney in Torrance, California.

Mary Hanson has a law degree from the University of Wisconsin and an MBA from the University of Southern California. She has practiced business law exclusively for more than 30 years.

She provides legal services related to owning, operating, buying, selling, and structuring businesses. Her clients are business owners in many different industries. She handles corporations, LLCs, new businesses, new ventures, and a broad range of contracts and business decision-making.

Her interests include flying and World War II.

Her law office is located in the Del Amo Financial Center, 21515 Hawthorne Blvd. #885, Torrance, California. She can be reached at (310) 543-1355 or by e-mail at mhanson@bizadvisor.com

LIABILITY: POINTS AND CONSIDERATIONS

by Mary Hanson

A major concern for any business owner is liability resulting from business activities.

Each business has its own unique variety of risks, and a business owner should make a point of identifying each type of risk to which the business is exposed. Possible types of risks include:

- liability for failure to perform contractual obligations
- liability for products that cause injury or damage
- liability for services that cause injury or damage
- liability for accidents caused by employees
- liability for employee actions
- liability for violations of employment law
- liability for injury to persons on the business premises
- penalties for noncompliance with laws and regulations
- penalties and interest for non-payment of taxes

In order to reduce the exposure to liability or address liability with insurance coverage or other methods of protection, the business owner needs to begin with recognition of the risks associated with the business activities.

We can only meaningfully seek protection from liability if possible or likely types of liability have been identified.

Some types of liability as a result of an act or omission by the business can be addressed more easily than others. Liability arising from contracts can be addressed by changing the terms of the contract. High liability products and services can be avoided.

The most significant risks for a business are related to catastrophic events and accidents. Losses resulting from “acts of God” such as floods and tornados cannot be predicted. The amount of the loss can be enormous, although the level of loss should be related to the value of the business assets.

Liability for losses incurred by third parties (caused by a business) can be even greater than those incurred directly by the business. The level of liability to third parties resulting from an accident is not related to the size of the business. An uninsured liability to a third party can destroy a business.

There are different ways of addressing liability. It is important to understand how each type of liability protection works and the limitations of each. However, one must recognize that there is no such thing as complete protection from liability.

Two of the most common types of liability protection are incorporation of the business (or use of some other type of separate entity) and insurance coverage. They are two very different ways of addressing risk.

▼

“.. it is important to recognize that any contractual obligation just gives you a right to sue the other party if they don't perform.”

Insurance vs. Incorporation

An insurance policy only provides protection to a person or business identified as the “insured” or an “additional insured.” An error in identifying the insured party can mean that there is no coverage.

Also, an insurance policy only covers the risks specifically identified in an insurance policy. No matter what the policy is or what it is called, it does not cover “everything.” And you need to consider whether some things that might otherwise have been covered by the type of policy are not covered because they are listed as “exclusions.”

An insurance policy only provides coverage up to the policy limit, e.g., \$1,000,000. It does not cover claims that are less than the deductible, e.g., a claim for \$300 when the policy deductible is \$500.

If someone files a claim against your business based on something that is covered by your insurance, your insurer will provide legal defense under most insurance policies. You don't have to research the law and hire your own attorney to respond to the claim or lawsuit.

If an individual incorporates a business to obtain protection from liability and relies on the corporate status to provide protection without the corporation obtaining insurance, the corporation and its owners do not have any protection that is anything like insurance coverage. If the corporation receives a claim (for any amount - \$500 or \$10,000 or \$1,000,000) the corporation needs to resolve the claim or hire an attorney

to handle it. A corporation that is sued must hire an attorney to provide a defense.

The protection provided by incorporation (or by other entities used in business) is that the individual is NOT the business. Every claim against the business is not a claim against the owner. A judgment against the corporation cannot, without a claim made against the owner, end up with an attachment of the owner's personal assets.

However, if a successful lawsuit bankrupts the company, the owners may or may not be able to walk away from the corporation without personal liability or other problems.

Most owners would have difficulty walking away from their incorporated business, closing the business and losing the entire value of the business. And it is often unrealistic for the individuals who own the corporation to think they will avoid personal liability. No corporation or other entity will automatically protect the business owner from all claims.

Personal Claims

Small business owners are particularly vulnerable to personal claims. A claimant pursuing the business may attempt to pierce the corporate veil and hold the shareholders liable for an obligation or claim against the business, based on assertions that the corporation or limited liability company was not properly established or not properly maintained.

Often the individuals are personally active in the business and an injured

LIABILITY: POINTS AND CONSIDERATIONS

party or claimant will make a direct claim against the business owner – as the negligent driver of a vehicle, negligent supervisor of employees, negligent hirer of dangerous employees, or negligent provider of services.

An entity is valuable in insulating one owner of a business from personal liability for the acts or negligence of co-owners. The corporation (or other entity) is liable for the acts of employees (including the acts of owners), but each owner does not have to worry that he or she will be held personally liable because of an accident or other liability event caused by a co-owner.

A business owner relying on a corporation for protection from personal liability will also want to obtain insurance to cover the liabilities that the business will face. Insurance in effect protects both the corporation and the shareholder by resolving covered claims.

Contracts and Risk

Business risk can also be reduced by contractually transferring liabilities to others parties. Contracts with vendors, customers, and others can clarify that those other parties are responsible for certain losses rather than the business. However, a small business may lack the negotiating power to move risks to other parties to a transaction. And a small business may not be familiar with the risks and how to change contract terms to shift the liability.

A typical risk-shifting provision deals with the risk of loss of products in transit. If a vendor agrees in a sales contract to cover the risk of loss in transit, then the vendor

needs to keep sending product to the customer until it finally arrives in good condition. The vendor has the risk of loss and needs to obtain any necessary insurance.

Every type of contractual risk-shifting should be considered when contract terms are set or negotiated.

One of the most important contractual methods of shifting liability is indemnification. The party providing the indemnification (the party agreeing to indemnify the other party – protecting them from liability) is agreeing to act like an insurance company, paying claims made against the indemnified party.

A well-drafted indemnification provision is similar to an insurance policy, setting out the types of liability covered and including the equivalents of coverage limits and deductibles.

A poorly drafted indemnification provision can be so unclear that the provision is unenforceable – or that the provision arguably covers everything.

A more important issue is often the financial capability of the indemnifying party to provide the “coverage.” If the indemnifying party is a small business or an individual, the value of the indemnification needs to be questioned.

In addition, it is important to recognize that any contractual obligation just gives you a right to sue the other party if they don’t perform. The words on the page don’t protect you. The performance of the other party or parties to a contract provides the protection. It may be necessary to legally pursue



“.. it is often unrealistic for the individuals who own the corporation to think they will avoid personal liability.”



BusinessAdvisor

a resource for business owners

FROM THE LAW OFFICE OF MARY HANSON

Publisher's Note

Business owners often look for additional methods for limiting their exposure to liability from business activities. The most extreme approaches include moving to a country that doesn't have an extradition treaty with the U.S., and putting property in someone else's name. I suppose these approaches should work, but I wouldn't recommend either one.

I have seen a situation where a business owner facilitated his wife's maintenance of separate property, including the family home. Even if his business was subjected to devastating claims, his family would have a roof over its head because his wife's separate property (if properly maintained as such) would not be subject to the claims arising from the business in his name.

A typical grantor trust (living trust) is NOT a method of protection. Holding business assets or other assets in such a trust does not provide any protection from personal liability.

Business owners need to regard themselves as risk managers, identifying potential risks and taking logical steps to reduce exposure to risk and steps to address liability.

Mary Hanson
Attorney/Publisher

the indemnifying party to receive the benefit of the contractual protection.

In managing risk, a business owner or manager is best advised to never sign a contract in which his or her business agrees to indemnify any other party for any kind of liability, except liability arising out of the acts or negligence of his or her business – and then only to the extent covered by insurance.

Risk Management

The list of possible persons or businesses that could make a claim against your business includes customers, employees, contractors, vendors, end-users (if your products are not sold directly to users), and third parties who are affected by some accident caused by your

business (e.g., by an employee driving a car or delivery truck causing a traffic accident).

Determine the likelihood of each particular type of claim. Determine what the dollar amount of each type of liability might be. It should be possible to estimate contractual liability quite accurately and meaningfully. Catastrophic risks need to be considered with a range of low and high liability.

Consider changing the way you do business, how you hire employees, the products you sell, the services you provide, etc. It is often possible to reduce liability in meaningful ways by doing business in a different way or changing what the business offers. **BA**

BusinessAdvisor

a resource for business owners

FROM THE LAW OFFICE OF MARY HANSON

21515 Hawthorne Blvd. • Suite 885 • Torrance, California 90503 • (310) 543-1355

PRSR STD
US POSTAGE
PAID
TORRANCE CA
PERMIT #43

RETURN SERVICE REQUESTED