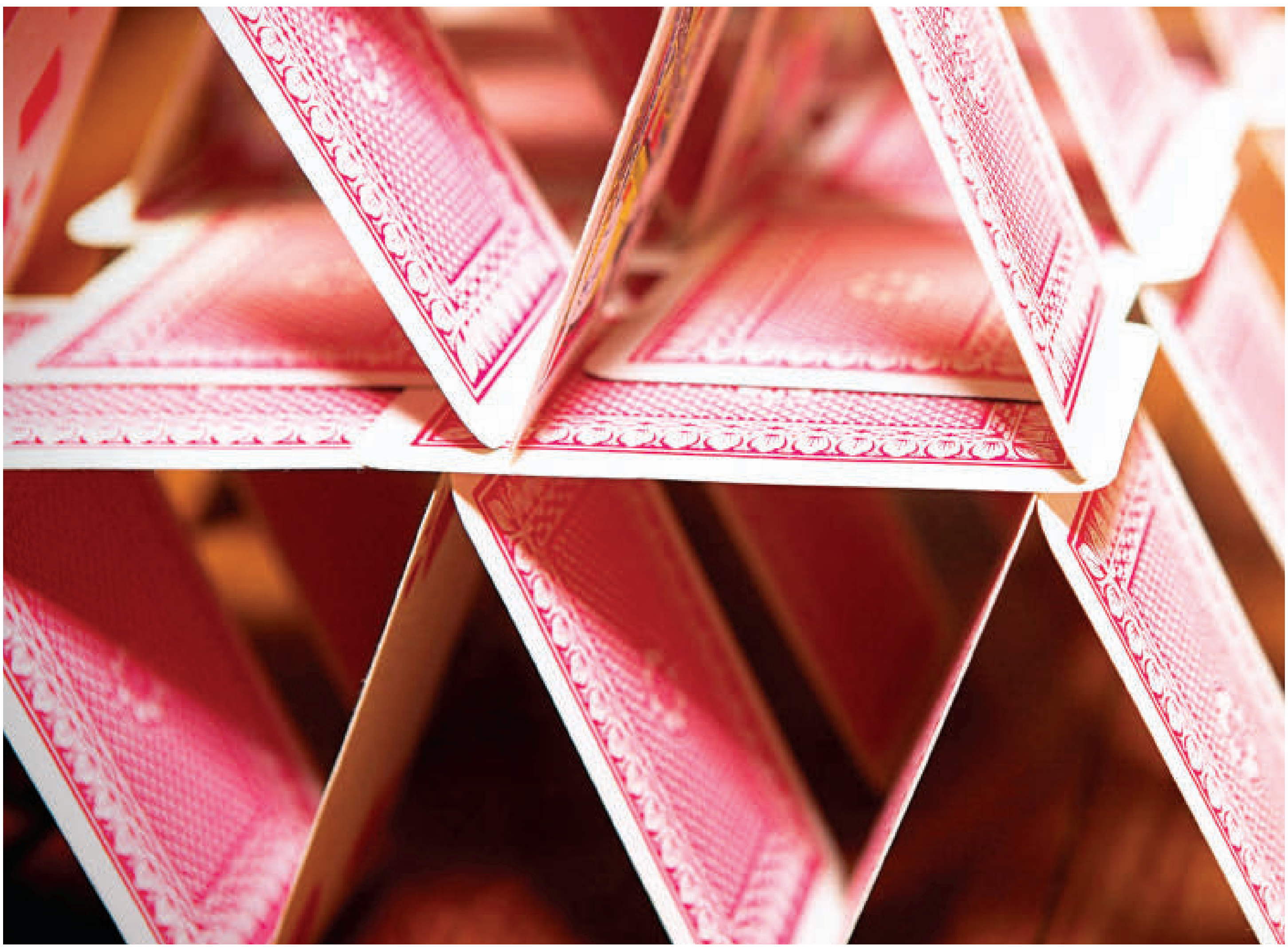
Avoiding a **House of Cards**

Appropriately Protecting Assets Through Corporate Structuring

By Lewis Harper and Kalliopi Kousis

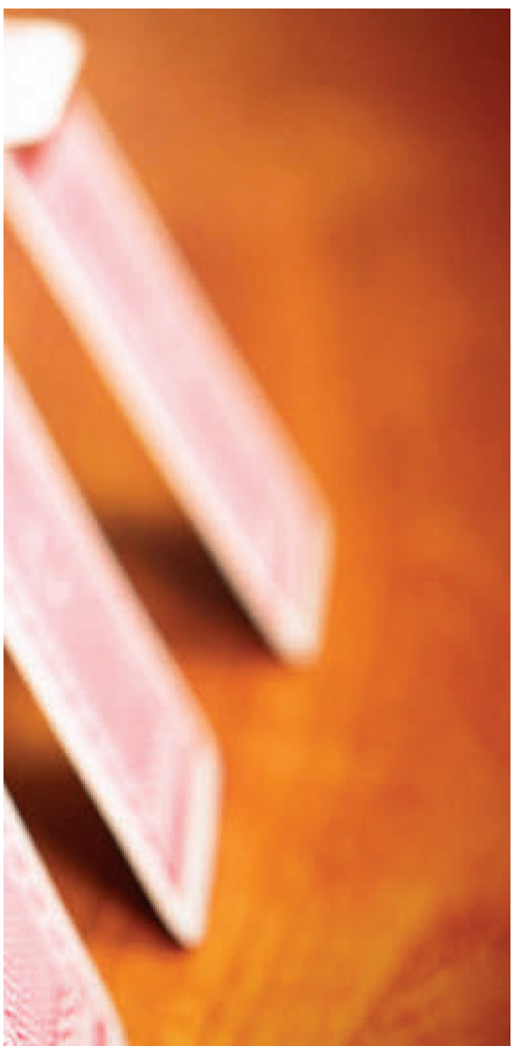
A house of cards is a structure created by stacking playing cards on top of each other. Many of us have played this game, and many students are initiated into their first year of engineering school through an annual competition of building "card towers." As you know, the structures created rely on nothing more than balance and friction. The larger the structure, the more likely it is to fall, due entirely to the higher number of balanced cards. The difference between a children's game and a world record 75-story card building — knowledge, skill and experience.

Corporations of all sizes use differing corporate structures to protect and shield corporate assets. Larger companies use corporations or other business structures in distinguishing layers to add additional protection. Layering, building entities in hierarchical relationship has been used in numerous industries, including the transportation industry. The important elements of corporation structuring, as with building a record-breaking card tower are still knowledge, skill and experience.



Our insureds' quest is to protect the assets of its transportation business from legal exposure. In today's litigious society, especially in the transportation industry where catastrophic injuries occur on a daily basis, protecting assets through corporate structuring is an appropriate goal. Some insureds wrongly assume that building simple corporate structures or replicating companies built by another transportation company is an easy and inexpensive method to shield corporate assets.

The insured builds their layers to allay their fear of the loss of corporate assets in litigation. However, in some instances, the fear materialized, the corporate house of cards crumbles. The shareholders of the parent companies lose assets and are exposed as a result of improperly formed corporations at the hands of the inexperienced insured who relied on a faulty assumption that simple replication of a corporate structure utilized in another industry will suffice.



Although the structure built by the insured appears to be built in an intricate and elaborate card tower, the insured regrettably finds an extraction of a single card built on a shaky foundation causes immediate collapse. The transportation industry relies heavily on contracts, agreements and business relationships to build their companies. Knowing the nuances of the transportation industry is essential and vitally important in corporate formation and corporate structuring. The failure of an insured to respect the rules governing corporate formation, structures and agreements, through the lens of transportation is catastrophic.

The danger? Many smaller entities, in order to avoid costs may resort to cost-saving measures in their formation. They may also do so with their corporate agreements — including leases, independent contractor agreements, trailer exchange agreements and sub-hauler agreements. In addition, some insureds will utilize the same directors and officers with a different label in an attempt to create the impression of distinct and separate companies. However, the only difference between these dissimilar companies is the color of the check drafted. Obviously this is not legally advisable. Properly formed corporate entities with distinct names cannot and should not share the same directors, officers, bookkeepers, accountants and office space. However, it happens often, unfortunately to the detriment of the entity hoping to shield its assets.

One of the Federal Motor Carrier Safety Administration's missions is to regulate the transportation industry for good of the public. The courts routinely interpret contracts and corporate agreements in complex litigation claims with an eye toward public safety. It is not out of the reach of the court to roll up all the entities, disregarding that the leasing company is separate and apart from the independent contractor agreement formed either for convenience or for the sole purpose of creating corporate layers. Faced with an option of wading through a house of cards — a corporate structure built to avoid liability and ruling in favor of an injured party — the court may, and will disregard those entities and if available, pull in any additional insurance policies. The court extracts that single card from the house of cards without reservation.

In light of an inevitable discovery battle, especially where fatalities and horrific injuries are involved and where limited amounts of insurance may be available, the experienced plaintiff's attorney will look for other assets within the house of cards. Is there a leasing company affiliated with the insured's tractor-trailer? Is there a sub-hauler agreement? Is there an indemnity agreement that fails to protect the insured? Before we know it, there is a grand fishing expedition in search for some nefarious conduct, costs soar and the management of litigation becomes complex and expensive. Insurers need to look deeper into the corporate structures associated with our insureds. As attorneys, we need to educate our clients on the basics of corporate theory in the transportation industry.

It should go without saying, but experience bears out, like the collapsed house of cards, insureds expose assets or open themselves to disaster. The solution for the insured is to understand the basics of corporate formation, seek counsel familiar with both corporate law and transportation, follow the advice of counsel, and diligently maintain the corporate formalities keeping entities distinct and separate. If litigation occurs, it will be plain to the Court that these entities are not a façade that were formed for the evident purpose of diverting liability. Hence, form a legally sound corporation, unlike the shaky house of cards, and you will be far more successful in your endeavor to protect an entity's assets. LM

Lewis Harper is the Director of Complex Claims for Carolina Casualty Insurance Company. Kalliopi Kousis practices law in New Jersey and New York with the law firm Gallo Vitucci Klar LLP.