

Are your client's personal assets at risk even if he is not named as a defendant?

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When your client's corporation, LLC or trust is sued but has no assets, can you safely ignore the lawsuit if the client has not been named personally as a defendant?

After all, what harm can arise from a default judgment against a corporation or trust that has no ability to pay and is therefore judgment proof?

Stated another way, is there any way to collect that default judgment from your client personally?

The answer is yes. There are ways for a creditor to collect his judgment from your client's personal assets, and you need to be mindful of those ways at the outset of litigation when you are advising your client on whether he should bother spending the money to defend.

We are not talking here about situations where your client is a named defendant. It is well settled that corporate officers and managers of LLCs may be sued personally for their own wrongdoing on behalf of their corporations. *Nader v. Citron*, 372 Mass. 96, 103 (1977).

And under certain circumstances trustees may be held personally liable even when acting on behalf of their trusts. See, e.g., *First Eastern Bank N.A. v. Jones*, 413 Mass. 654, 659-60 (1992); *Gardiner v. Rodger*, 267 Mass. 274, 278 (1929).

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'Herman I and II'

As most of us know, corporate veils can sometimes be pierced to reach the assets of owners of corporations. See *Evan v. Multicon Const. Corp.*, 30 Mass. App. Ct. 728, 732 (1991).

So the first questions to answer are whether all corporate formalities have been properly observed and the corporation was not used to promote fraud. See *My Bread Baking Co. v Cumberland Farms, Inc.*, 353 Mass. 614, 620 (1968); *Pepsi-Cola Metropolitan Bottling Co. v. Checkers, Inc.*, 754 F.2d 10, 14-16 (1st Cir. 1985).

The next question is whether the allegations of the complaint reasonably can be construed to accuse your client personally of wrongdoing. The 1st Circuit recently found that a default judgment may be collected against a non-party implicated in wrongdoing through the allegations of the complaint. Never mind that the non-party was not named personally, not served personally with a summons and complaint, and no judgment ever entered against him personally.

In *Indianapolis Life Insurance Co. v. Herman*, 516 F.3d 5 (1st Cir. 2008) cert. den. 29 S.Ct. 137 ("Herman II"), the plaintiff brought an action against the defendant in her capacity as trustee of an ERISA trust, among other defendants. One of those defendants, Meiselman, brought a cross-claim against Herman in her capacity as trustee, and, for reasons having more to do with malpractice than strategy, Herman's lawyer filed no responsive pleading.

Meiselman then applied for default against Herman as trustee, and default entered against Herman as trustee. Meiselman subsequently moved for default judgment against Herman as trustee and, in August 2005, that motion was granted in the amount of nearly \$1 million. *Id.* 516 F.3d at 7.

You will not get all these details from the decision; you have to look at the appeal briefs and appendix (full disclosure: I represented Herman in this appeal). Herman's former attorney appealed the default on her behalf without success. *Indianapolis Life Ins. Co. v. Herman*, 204 Fed. Appx. 908 (1st Cir. 2006) ("Herman I").

Since judgment entered against Herman as trustee, and the trust had no assets, you would think the matter might end there. But in March 2006, Meiselman applied for and obtained an execution against Herman that conveniently dropped the "trustee" designation after her name. The execution therefore made it appear to the world that judgment had entered against her personally.

Meiselman then sought post-judgment discovery against Herman personally in an effort to collect that judgment, now over \$1 million with interest, directly from her personal assets. *Herman II*, 516 F.3d at 8.

Herman's motion to stay enforcement and correct the execution to conform to the judgment predictably argued that "the execution made her personally liable whereas she was actually

liable only in her capacity as trustee." Id. That motion was denied without opinion, clearing the way for Meiselman to proceed against Herman's personal assets in satisfaction of the judgment. Id.

On appeal, the 1st Circuit acknowledged that "[o]rdinarily, a money judgment against an individual in his official capacity runs only against the entity's assets." Id. at 8-9.

The 1st Circuit also noted that the case caption identifies Herman throughout the case as "trustee," and the final paragraph of the District Court's judgment awarded a money judgment against Herman as "trustee" and she was never "re-served in her individual capacity." Id. at 9.

Further, the original complaint brought by the plaintiff sued Herman in her capacity as trustee. Id.

How then did the 1st Circuit stand established law and the pleadings on their head to hold that Herman was personally liable for the judgment against her as trustee?

The 1st Circuit took the position that the "substance of the complaint and the parties' litigation conduct" determines the capacity in which a defendant is sued, and this approach "eschews mechanical reliance on the form of the caption or individual designation." Id. at 10.

The court then dove into the "factual recitations of the complaint" and determined that the allegations "make clear that it sought to recover damages as to Herman" personally because the facts alleged that Herman had "refused [Meiselman's] instructions to transfer his plan assets to an independent IRA, had caused almost \$50,000 to be diverted from his account to pay counsel to defend her and the company against Meiselman in litigation, had withheld salary due him, had improperly liquidated his investments and had charged him an improper management fee." Id.

The court concluded that "breach of fiduciary duty and conversion claims were certainly potentially available against Herman in her personal capacity." Id.

So never mind the niceties of proper service of process, proper caption designations or forms of judgment, and heed the warning of the 1st Circuit: "[a] reasonable litigant, advised by competent counsel, would have had good reason to fear that personal liability might be imposed under some of the theories in the complaint. Further, the complaint made clear that Herman was being charged in some measure with personal dishonesty" Id. at 11.

Thus, the court concluded that, in failing to respond to the cross-claim and allowing the default judgment to enter, Herman was "taking a substantial risk as to personal liability." Id. The failure to respond made her or her counsel "largely the author of her misfortune." Id. at 12.

Accordingly, in light of Herman II, before you let a judgment go to default against a judgment-proof corporation, LLC or trust, you need to carefully review the facts and claims alleged in the

complaint to determine if the complaint can be construed as raising substantive claims against your client personally, regardless of form.

Since corporations are run by their officers or managers, it will be the rare complaint that does not accuse the officer or manager of participating in some fashion in the alleged wrongdoing; and, since trusts are managed by their trustees, their conduct is also likely a part of the allegations against the trust.

Short of a full-blown defense, there are lesser options before you decide whether to fight. Consider bringing a motion to dismiss under Mass. R. Civ. P. 12(b)(6) for failure to state a claim on which relief can be granted against the officer, manager or trustee personally.

Alternatively, a motion for a more definite statement under Mass. R. Civ. P. 12(e) might clarify whether personal liability is sought.

Herman II also suggests that you could bring a motion to dismiss on behalf of the officer, manager or trustee for insufficient service of process or, relatedly, for lack of personal jurisdiction, under Mass. R. Civ. P. 12(b)(5) and 12(b)(2), respectively. Meiselman II, 516 F.3d at 9 fn.2.

Any of these motions might bring to a halt efforts to make your client personally liable for a judgment against his judgment-proof corporation or trust. But consider also that taking any of these actions may be an invitation to the other side to amend its complaint to expressly add the officer, manager or trustee as a defendant personally.

The strategy you choose will depend on many factors, including a candid assessment of your client's personal exposure to liability and the vulnerability of his personal assets to post-judgment collection efforts.

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