Foreign Corporation Shareholders Now Liable for Unpaid Wages in New York

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Corporate and Securities Alert
2.9.16

It is a long-standing legal principle in New York that the top 10 shareholders of a privately held New York corporation, as determined by value of their interest, can be held liable for amounts owed to the corporation's employees. Effective January 19, 2016, the top 10 shareholders of privately held corporations organized in other states can now be held similarly liable.

More specifically, under the amended Section 630 of the New York Business Corporation Law (NYBCL), a New York employee of a privately held corporation formed in a state other than New York may seek a judgment against the top 10 shareholders of the foreign corporation for claims relating to:

1. salaries, overtime, vacation, holiday and severance pay;
2. employer contributions to or payments of insurance or welfare benefits;
3. employer contributions to pension or annuity funds; and,
4. other amounts due and payable for services rendered by the employee.

The amendment does not change certain key requirements of the statute, which must first be satisfied before an employee can seek to impose liability on an individual shareholder. For example, the employee must send written notice to the shareholder that he intends to hold him liable within 180 days after termination of the employee's services, or within 60 days after the employee has been given the opportunity to examine shareholder records. Additionally, an employee cannot commence an action against a shareholder until the employee obtains a judgment against the corporation and the execution of that judgment is returned unsatisfied.

The liability of the top 10 shareholders is joint and several. This means that the employee can seek a judgment against any one of the top 10 shareholders for the full amount of the claim. The shareholder or shareholders who are sued can then seek contribution from other shareholders if they become liable for more than their pro rata share of the amounts due under any judgment.

The amendment to the NYBCL comes on the heels of last year's amendment to the Wage Theft Prevention Act, which added a provision to the New York Limited Liability Company Law which imposed personal liability for unpaid wages on the 10 members of a domestic LLC with the largest ownership share. Although the amendment to the NYBCL removes the domestic incorporation limitation, no similar amendment has been made to the LLC law to date.

Section 630 is frequently cited as a major reason why corporations have chosen to incorporate in a state other than New York even though the business primarily operates within New York. With these new changes, founders of, and investors in, early stage ventures and small businesses may need to think twice about where they locate their business operations. While proponents of the law thought it would encourage more corporations to form in New York, the change may have exactly the opposite effect, as it may discourage new businesses from operating in New York and cause hesitation for investors considering investing in corporations with New York based employees.

The requirements noted above do provide protection for shareholders in cases where the business is solvent and able to pay its debts. However, new businesses, particularly those that are backed by angel and venture capital investors, are at the most risk for failure and, therefore, are the most likely to cause potential liability for shareholders. It remains to be seen whether this will impact the formation and growth of new businesses within New York or drive existing businesses to migrate away from the state.

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