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New York Expands Liability for Employee Claims for Unpaid Services Performed in New York to the Top 10 Shareholders of Privately Held Corporations Organized in Other States

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Under a New York law in effect for decades, the top 10 shareholders of a ***privately held*** New York corporation can be held liable in certain circumstances for amounts owed to the corporation's employees. On January 19, 2016, this law was amended to extend liability to the top 10 shareholders of privately held corporations ***organized in other states*** for unpaid services performed by employees in New York.

For years, practitioners have pointed to this law as a reason for choosing a state of incorporation other than New York. The stated rationale for this amendment is the belief that more corporations will be incorporated in New York if the law cannot be circumvented simply by incorporating in a different state. [1] However, the real effects are more far-reaching, as privately held corporations now must also consider whether doing business in New York is worth the risk of exposing their largest shareholders to additional liability.

As amended, Section 630 of the New York Business Corporation Law ("NYBCL") permits an employee of a privately held corporation formed in a state other than New York to hold the top 10 shareholders (determined based on the fair value of their respective beneficial interests) jointly and severally liable for amounts owed in respect of unpaid services performed in New York. Such amounts include, among other things,

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.

Because liability is joint and several, employees can elect to recover from only one, a few or all of the top 10 shareholders, though shareholders that pay more than their pro rata share are entitled to contribution from the other shareholders. Although the shareholders of public corporations are statutorily exempt from this law, it should be noted that the public corporation itself could be exposed to liability to the extent its private subsidiaries fail to pay their New York employees.

For an employee to hold any of the top 10 shareholders of a privately held corporation liable under NYBCL Section 630, he or she must:

- first give written notice to the applicable shareholder(s) that he or she intends to hold such shareholder(s) liable within 180 days of the termination of the services performed in New York (or, if within such time period the employee demands an inspection of the corporation's records to determine the top 10 shareholders, within 60 days of being granted such inspection);

- seek to recover the amounts owed from the corporation and obtain a judgment against the corporation that remains unsatisfied prior to commencing his or her action against the shareholder(s); and

- commence such action within 90 days after the judgment against the corporation is unsatisfied.

While the requirements above relate primarily to procedure, the requirement that the employee first obtain a judgment against the corporation is of particular importance because it has the effect of limiting the potential for shareholder liability to situations in which the corporation is insolvent or bankrupt. In all other contexts, the corporation should generally be able to satisfy the claim directly without the need to shift the liability to its shareholders.

Several legal scholars and practitioners have urged the New York Legislature to repeal NYBCL Section 630 due to significant policy and constitutional concerns. The general perception is that the amendment is completely at odds with the veil-piercing principles of the rest of the NYBCL and is problematic under the commerce clause of the Constitution and the internal affairs doctrine. The ability of NYBCL Section 630 to withstand the anticipated legal challenges and its economic consequences remain to be seen.

If you have any questions about these changes and how they might apply to your particular circumstances, please contact us.

[1] Section 609 of the New York Limited Liability Company Law contains provisions analogous to NYBCL Section 630, but has not been amended in the same manner so it does not yet apply to the top 10 members of limited liability companies formed in other states. Of course, it is possible that it will be similarly amended in the future.

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