Personal Liability for Environmental Contamination Within Limited Liability Companies

The popularity of Limited Liability Companies ("LLCs") as a corporate form has made them an increasingly common entity in New Jersey. The growth of the LLC is occurring despite the lack of clear guidance on whether the members of the LLC may be held liable for environmental contamination on property owned by the LLC.

Under the New Jersey Limited Liability Company Act, members of LLCs receive the tax benefits available to partnerships as well as the advantage of the limited liability afforded to shareholders and directors of corporations. Therefore, the law regarding the liability of shareholders and directors of corporations for environmental contamination can be consulted for guidance concerning the liability of an LLC member. Although subject to interpretation, the liability of corporate officers, directors and shareholders is fairly well-defined by numerous judicial decisions.

Generally, shareholders and directors are held liable for contamination for which the corporation is liable only if the court finds sufficient cause to "pierce the corporate veil," or finds that the actions of the individuals themselves render them subject to liability. Courts generally pierce the corporate veil only if the corporation appears to have been incorporated fraudulently or as a sham to protect the individual shareholders. A court will examine many factors to determine whether it should pierce the veil, including whether corporate formalities are observed, whether individual and corporate finances are commingled, whether corporate property is diverted, and whether the corporation is undercapitalized. Therefore, to avoid personal liability for its members, an LLC should be sufficiently capitalized, keep funds separated and observe the formalities set forth in the Act.

Officers, shareholders and directors also have been held personally liable if they actively participated in the activities that caused the contamination, or had the authority to control those activities. If a court holds a member of the LLC personally liable because of that member's active participation in the operations of the property, personal liability should logically be limited to that individual member rather than extended to all members of the LLC. By contrast, if
a court were to pierce the corporate veil of the LLC to find the members personally liable, it very well could extend liability to all of the members because the liability results from imperfections in the corporate form.

According to the Act, and unless otherwise specified in the LLC operating agreement, an LLC must be dissolved and its assets must be distributed to the members after thirty years. At that time, the Act requires the LLC to pay, or make provision to pay, all creditors before distributing any assets to the members. However, because environmental contamination can exist undetected for many years, contamination could be discovered on the property after the LLC has been dissolved. Nevertheless, the Act does not appear to require the member to return the distribution it received when the LLC was dissolved unless the member received the distribution knowing that a claim for contamination existed against the LLC (or knowing it was likely to exist without further investigating its existence) and knowing that no provision to satisfy that claim was made prior to distributing the assets. Therefore, subject to the above discussion on piercing the corporate veil and personal involvement in the harm, the protection from liability afforded members of an LLC should remain even if the contamination is discovered after the LLC has been dissolved and its assets have been distributed. Of course, an LLC is a new corporate entity and, as such, liability of its members is subject to interpretation by future judicial decisions.

Practice:

Environmental Law