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The Corporation In Contempt: What To Do?

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It can be said that all of a litigator's efforts during the course of a case are ultimately spent trying to obtain a desirable court order. For example, the civil attorney hopes for a large judgment that, assuming there are sufficient collectable assets (no doubt a large assumption in many cases!), can ultimately form the basis of an order to sell, liquidate or otherwise collect on those assets. For the family court litigator, the goal is a final order (either through agreement or contested hearing) addressing who pays for what? Who has custody of whom? Who's restricted from doing what? Etc.

In hopes of obtaining that final order, we may utilize various court orders to move a case forward during the course of litigation. If a party fails to respond to the subpoena, for example, the attorney can file a motion for an order compelling a response. Should that party then willfully fail to comply with the court's order, they are in contempt. Most of us are familiar with the remedies at the court's disposal if the contemnor is an individual, and how to go about requesting those remedies. But what happens if the contemnor is a corporate entity? What remedies are available? Who is responsible to appear on behalf of the corporation? If you have an order requiring Verizon or Wells Fargo to produce documents and the company fails to comply, do you hold the local branch manager in contempt, or is it the CEO?

Very large corporations generally have departments and processes in place to respond to subpoenas and orders. As a result, they will often comply fairly quickly. Smaller closely-held entities, especially in cases where the shareholders or members are also named as individual defendants, usually do not have such processes. They may more often be under the mistaken belief that because the order is to the corporate entity, no one will be held personally responsible. Effectively applying and utilizing the contempt powers of the court with corporate contemnors can help save time and ensure that all resources are at your disposal.

Review of the court's contempt power

The recognition of a court's power to punish those parties that have disobeyed its order(s) pre-dates the prevalent use of the corporation, at least in its modern form. The pre-civil war South Carolina decision of Johnson v. Wideman1 makes clear that a court may punish the contemnor by either fine or imprisonment. The court in Johnson also noted that contempt proceedings are separate and distinct from the merits of the underlying case, and do not terminate even if the underlying case is concluded. Modern cases note additional remedies for contempt, such as striking pleadings, suppressing evidence against the contemnor, and granting summary judgment.2

With the proliferation of the corporation in the post-war era, courts have been faced with the conundrum of effecting corporate compliance when the corporate entity, and not any particular shareholder, officer or individual executive, is in contempt.

The "responsible party" rule

In Wilson v. United States,3 the US Supreme Court made clear that the contempt powers of the court can reach through the corporate veil and extend to an individual shareholder. In determining which shareholder(s) or parties should be held responsible, the Court stated:

"A command to a corporation is in effect a command to those who are officially responsible for the conduct of its affairs. If they, appraised of the writ directed to the corporation, prevent compliance, or fail to take appropriate action within their power for the performance of the corporate duty they, less than the corporation itself, are guilty of disobedience and may be punished for contempt."

Throughout the remainder of the 20th century and into the 21st century, lower courts have had to analyze the application of the responsible party test. In so doing, a court has to determine who may be held in contempt before determining how the party may be punished.

Not surprisingly, bankruptcy courts provide abundant examples of interaction with a contemptuous corporation. Section 105 of the bankruptcy code specifically allows the court to make a finding of civil contempt against ALL parties and grants it the authority to issue any necessary order, process or judgment.

In re Continuum Care Services, Inc.4 shows that it is the court's authority to ascertain who was/is the party responsible to bring the corporation in compliance. This appears to be the rule nationwide and should give considerable pause to any corporate manager or officer, any partner in a general partnership, any member of an LLC, or other participant of a corporate entity. Because the court has the jurisdiction to determine, in its judgment and by its own volition, who the responsible party is, the court can presumably disregard "official" titles, or rely on them conclusively and exclusively. This poses a potential hazard in a scenario where the corporate officer's title doesn't square with the officer's real responsibilities and authority. When would such a scenario occur?

A common scenario can be found in the use of the manager-managed LLC. Business and corporate lawyers may advise a client to organize in this manner as a way to provide additional liability protection, at least for non-managing members. In theory, the manager of a manager-managed LLC is designated as such in the organizing documents. As a result, there are numerous presumptions that attach to the manager's authority and role in the company (e.g., the authority to sell real estate). In practice, however, those members who are at greater financial risk may designate the less wealthy member as the "manager." That person may be little more than a strawman with no knowledge or dealings in the business. This obviously raises issues involving corporate formalities that are usually seen in a civil veil-piercing analysis. It also places the manager in a possibly perilous position with the contempt powers of the court.

If a company, for whatever reason, is refusing to comply with a court order and is facing a contempt finding, there is little incentive for the non-managing member(s) to acknowledge that they have organized their business in a borderline fraudulent manner. To do so would not only be strong evidence to a creditor's attorney but would also, more immediately, put the non-managing members in focus to the judge. One can easily see the manager trying to explain to the judge how he really doesn't know anything about the company's dealings or records and how he is really not a manager, despite having represented otherwise in public filings.

With the court having found our poor manager to be the responsible party for bringing the corporation into compliance, the next question is what possible penalties could the manager face? Could the court incarcerate him? The answer is absolutely YES!

In re Spanish River Plaza Realty Co., Ltd.5 is an example of the court using the extraordinary threat of incarceration to bring a corporate entity into compliance. The debtor in that case was a limited partnership with one asset, a shopping center plaza. The court found that both the general and limited partners had used funds from the debtor in possession's account, in violation of a previous court order, for personal use.

But wait, doesn't a party have a right to trial before being ordered for jail time? This is where the distinction between civil contempt and criminal contempt becomes critical. The key difference between the two rests in the contemnor's ability to abate or purge himself out of contempt. In civil contempt, the contemnor is said to "hold the keys to his own jail cell."6 A common application of this rule is a person who has been incarcerated for refusal to pay child support.7 Once the child support is paid, he is no longer in contempt and will be released. In a criminal contempt proceeding, the party would not have that option and would be obligated to serve whatever sentence the judge issued regardless of the contemnor's further action.

In Spanish River, the court took time to note two key points. The first was that incarceration alone did not convert the contempt from civil to criminal. The second was that the burden is on the contemnor to establish that it is factually impossible for the contemnor to pay. Citing case law that upheld 18 months' incarceration for similar circumstances, the court stated that it can continue the incarceration until the fine is paid. The nuanced distinction between civil and criminal contempt will undoubtedly become very important to counsel whose client is being taken out of the courtroom in handcuffs.

The use of incarceration is not a resource available only to bankruptcy judges. Though South Carolina has few if any reported cases directly addressing the issues of holding individuals accountable for corporate contempt, the North Carolina case of State ex rel Grimsley v. West Lake Development, Inc.8 shows that the principles employed in bankruptcy are also applicable in state courts. In Grimsley, the lower court had issued an order requiring Westlake Development, Inc. to install various erosion control measures. When the measures were not done, the court found that the general manager was "responsible for the implementation of sedimentation and erosion control measures as they relate to that tract of land ... which is the subject of this action." Based on this finding, the general manager was incarcerated and ordered to pay a fine. The lower court's ruling was affirmed by the court of appeals.

Interestingly, it appears that the order of incarceration in Grimsley was instituted against the general manager as a first measure. There is nothing indicating a continuing pattern of violations or even particularly egregious conduct that one would normally associate with the use of incarceration, especially in this context.

A recent Michigan case, In re Moroun,9 provides another example. In that case, the trial court, in a hotly contested action involving a highway construction project, issued the following order against two agents of the contractor:

IT IS ORDERED THAT Manuel "Matty" Moroun and Dan Stamper shall be imprisoned in the Wayne County Jail until the Detroit International Bridge Company complies with the February 1, 2010 Order of this Court.

IT IS ORDERED THAT the imprisonment of Manuel "Matty" Moroun and Dan Stamper shall cease when the Detroit International Bridge Company has fully complied with the February 1, 2010 Order of this Court or they no longer have the power to comply with the February 1, 2010 Order of this Court.

The Michigan Court of Appeals upheld the incarceration of the corporate officers as being within the power of the trial court despite counsel's objections based on due process grounds.

Conclusion

No lawyer enters into litigation with the goal of having the opposing party found in contempt of court. However, it is only with the court's contempt power and the threat of possible recourse that the court can ensure compliance with its orders. This is equally true for corporate entities and the people involved in their operations. Whether representing or opposing a corporate entity, it is critically important to be aware of how the court's contempt power applies to a

corporate entity. Just because an individual isn't named in the court's order doesn't mean that the court won't come looking for an individual.

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Endnotes

1 23 S.C.L. (Dud.).

2 Griffin Grading v. Tire Serv. Equip., 334 S.C. 193, 511 S.E.2d 716 (Ct. App. 1999).

3 221 U.S. 361 (1911).

4 375 B.R. 692, 694 (Bankr. S.D. Fla. 2007).

5 155 B.R. 249, 254 (Bankr. S.D. Fla 1993).

6 Hicks v. Feiock, 485 U.S. 624, 633 (1988).

7 See Poston v. Poston, 331 S.C. 106, 502 S.E.2d 86 (1998) (providing a detailed discussion of the distinction between civil and criminal contempt in this context).

8 323 S.E.2d 448 (N.C. Ct. App. 1984).

9 814 N.W.2d 319 (Mich. Ct. App. 2012).

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