Board Members and Investors Found Not Personally Liable Under Massachusetts Wage Act

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A unanimous Massachusetts Supreme Judicial Court recently ruled in favor of two former board member-investors of a biotechnology startup, finding the board member-investors not personally liable under the Massachusetts Wage Act for "wages" claimed by the company's former CEO.

At issue in *Segal v. Genitrix, LLC*, 478 Mass. 551 (2017) was whether the individual defendants, former board members of and investors in Genitrix, a Delaware LLC based in Boston, exercised sufficient management authority to impose personal liability on them under the Wage Act (M.G.L. c. 149 §148) for compensation due to the plaintiff. The plaintiff, Genitrix's former President and CEO, claimed that he was entitled to "wages" earned over a two-year period, for which he was not paid.

This scenario is thorny and all-too common for officers, directors, and investors involved with start-ups facing financial challenges. The consequences of being found liable under the Wage Act are severe and include automatic awards of triple damages and attorneys' fees plus 12% statutory interest. The amounts at issue in these types of cases can quickly exceed five-hundred thousand dollars, making them very difficult to settle.

Officers of start-up companies are often surprised to learn that they can sometimes be personally liable for failing to pay employees their wages or salary. This is an exception to the general rule that officers are not personally liable for the debts of corporate entities. However, the Wage Act imposes individual liability on "the president and treasurer of [the] corporation" <u>and</u> "***any officers or agents having management of such corporation***." M.G.L. c. 149 §148.

In *Segal*, the SJC concluded: "If personal liability is to be imposed on… directors and investors, it must be because they meet one of the express categories of corporate actors identified by the Legislature: the president, treasurer, or officers or agents having the management of the company." From this, the SJC held that two important requirements must be met in order to impose liability on an individual for Wage Act violations: the defendant must: (1) be an "agent," and (2) "have management" of the company. In discussing what constitutes an agent "having management" of the company, the SJC noted that the Wage Act expressly references *high-level officers* (e.g. president and treasurer) who are individually *responsible for the corporation's overall management, particularly its financial affairs*.

This case was unusual for three reasons: (1) the plaintiff was both the president and *sole* officer of Genitrix, and thus was the only person who could be liable under the Wage Act as a high-level officer; (2) the plaintiff's employment agreement charged him with the exclusive management of Genitrix's finances and payroll functions; and (3) the plaintiff himself made the decision not to receive compensation for his work, a decision he claimed to have based on Genitrix's financial struggles.

In finding the defendants <u>not</u> liable for the alleged Wage Act violations, the SJC held that the defendants were merely acting in their capacity as investors in Genitrix, stating: "While investors may exercise significant financial control over a company, by having power over their investments, they generally act as outsiders and not agents of a corporation." Furthermore, while a company's board sets policy and oversees management of a company, it does not typically perform management functions itself. The board of directors, either acting individually, or as a whole, cannot be an agent of the corporation because the board is generally not subject to control by the company. Only if an investor or board member is empowered to act as an agent of the corporation, and acts as such, can s/he be subject to personally liability for Wage Act violations.

This case is helpful to Board members and investors, but it does not rule out personal liability on different facts.

The take away from *Segal*: Board members and investors should try to avoid crossing the line into acts that make them look like agents making financial decisions concerning payment of compensation.

Moreover, underlying many of these disputes is the conscious or unconscious decision to defer compensation. Deferred compensation, the promise to pay in the future for past services, almost always results in a Wage Act violation of some kind. Deferred compensation arrangements can also trigger severe tax penalties. A simple solution may be to prospectively reduce an employee's salary (to not below minimum wage), and sometimes to limit working hours to less than 40 per week (to avoid claims for overtime pay). Early employees can be incentivized with bonus compensation and stock/stock options in ways that potentially can avoid expensive disputes over alleged non-payment of wages.

Click here for a link to the SJC's full opinion.

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