LIFTING THE CORPORATE VEIL: A GENERAL DISCUSSION OF EXECUTIVE AND MANAGERIAL PERSONAL LIABILITY

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By

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To James

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Introduction

In light of the existing research and information related to personal liability of corporate officers and directors, I present the material I have found as a useful source of information for executives who may be affected by personal liability issues. The data presented is a collection of information focusing on three areas of law in which personal liability arises: securities industry, environmental law, and Occupational Safety and Health Administration (OSHA) regulations. The last section will conclude the topic on personal liability with methods of protection and prevention.

I chose these three areas of law for three central, but similar, reasons: (1) These issues are commonly dealt with by businesses on a daily basis, (2) The risk for civil or criminal liability in executive or managers' personal capacity is probable in these areas of business, (3) The amount of information in these areas is extensive; any executive or manager possibly affected by legal accountability should be aware of the seriousness of the subject.

This topic is quite relevant for the current generation of managers, which is a substantial reason for choosing to research this topic. Compiling this data into a single reference will be a useful source for upper management when questioning the likelihood of personal legal responsibility actually affecting them. Currently, sources detailing the ramifications of personal liability are under-represented in business community literature.

Personal legal liability is not limited to executives and managers. Directors and officers are usually considered to be executives, which will be the premise in this thesis. Directors and officers are included in the top management team (TMT), including positions such as Chief Executive Officer (CEO), Chief Financial Officer (CFO), Chief Operating Officer (COO), any other "officers" the organization specifies, and the board of directors (BOD) ("directors").

Individuals operating small businesses in which only a few individuals, including themselves, are in decision-making capacities, also risk personal liability. Owners of private organizations are considered to be the executive and manager, unless specified otherwise. However, an owner may not evade personal responsibility by enumerating other officers and director. Although other managers are not considered executives, they may also be in positions where they risk personal liability. Managers who may be liable include top managers not included as executives, middle-level managers, and front-line managers. Employees serving in non-management roles face liability only in limited capacities. Occupations in which this type of employee is most susceptible to personal liability are those in the securities industry. The Securities and Exchange Commission (SEC) governs activities for employees dealing with monetary transactions, and because only the employee is responsible for violation of SEC laws, personal penalties will result.

Other employees exposed to substantial independence in their position within the company will also benefit from this knowledge. Accountability outside the corporation should be taken seriously by all employees, considering liability trends have shifted from blaming faceless corporations to the individuals within those corporations. Poor decision-making could lead to time consuming and expensive legal proceedings in which one is ordered to pay fines from personal funds or sentenced to prison. Corporate leaders and representatives also may not be aware of the probability and seriousness of liability in their personal capacities for various legal violations, which is another reason for the importance of the collection of this data.

Based on the literature I found during the researching of this thesis, I have developed three conditions explaining the situations in which executives may find themselves personally liable.

1. When the executive or manager commits an act known to be a crime,
2. When the executive or manager is aware of violations of the law, but takes no action to correct them,
3. When the executive or manager is unaware of the violation, took no action to purposefully commit a crime, and was not aware of failing to correct a violation.

In the following sections, I will develop these conditions, with the intent of warning executives and managers of the possibility of being affected by legal liability. Included in each section's discussion will be information dedicated to explaining the reasons for its importance and relevance to this thesis' overall contention, and how it may affect people in position of risk in their personal capacities.

The first section will be an overview of general information a manager should understand about the United States legal system. There are two relevant court systems used when issues of executive personal liability arise: civil and criminal. First and foremost, the differences between the civil and criminal court systems should be understood and will be defined.

Different types of violations may lend itself to either a civil suit or criminal prosecution. The simplest difference between civil and criminal proceedings is which type of opponent files legal action against the defendant. Individuals in the general population pursue cases in the civil court system, and use this process to recover from injuries. When the state or a section of the government, such as the Department of Justice, is the opponent, referred to as a prosecutor, the suit becomes involved in the criminal court system. However, it is possible for the prosecution to instate only civil penalties, such as fines, and not criminal penalties.

Corporate representatives may find themselves fighting legal cases in either of the court systems, and each system is not mutually exclusive. A manager may find herself battling lawsuits in both court systems simultaneously, possibly for the same offense. I will also demonstrate in this section how double jeopardy is not applicable in this situation.

An examination of current trends will further develop the rationale behind the evolving director and officer personal liability in Section II. Legislative action has had a significant contribution to the changed attitudes toward executive liability lawsuits; however, many are finding that legislation is not an effective answer to the problems corporations must address.[1] Specific congressional action allowed further limitation of executive liability in the securities industry with the Private Securities Litigation Reform Act (PSLRA). Legislation pertaining to each legal topic will be discussed in the relative section.

Section III, financial crimes, will examine specific cases to resolve issues questioning the plausibility of executive liability in the financial industry. The first condition, the situation in which an executive or manager knowingly commits a crime,

[1] "Designed by Committee," The Economist, 15 June 2002.

will be illustrated in this section because crimes in this area of business are often intentional and the individual is aware that he or she is breaking the law. It will also demonstrate the effects laws currently have on civil and criminal cases and situations in which employees and management may be held accountable for financial fraud. Since the courts began placing responsibility on the individual committing the crime, financial crimes has been a problem area because of the rapid increase in lawsuits pertaining to securities fraud. A possible reason companies in this industry are more susceptible to individual liability is because companies where securities sales and dealings is the nature of the business, many more employees are exposed to resources enabling them to commit financial crimes. Similarly, the plethora of securities fraud cases may also be related to the much larger population of prospective offenders. Executives and employees alike share the same degree of risk of committing financial crimes and are accountable for their actions. To present this topic with an accurate picture of liability, this section is used to describe situations in which the employee is fully aware of the wrongdoing.

The PSLRA has had a tremendous effect on legislative and judicial trends concerning the amount of lawsuits claiming securities crimes. Specifically, the PSLRA will be referenced to demonstrate how it is used to enable the court systems to manage excessive filings of civil lawsuits claiming securities fraud. To illustrate the trends of public policy affecting corporate directors and officers' personal responsibility, I will also include information related to the purpose of passing this act and how it has helped reduce illicit lawsuits claiming securities fraud. With the recent case of Enron, many shareholders have filed securities fraud lawsuits against the company's corporate executives. Many of these cases will still need to be substantiated through the provisions set forth in the PSLRA, and if deemed legitimate by the courts, the cases will proceed through the system.

Environmental law will be presented in the fourth section, involving situations in which management find themselves in legal predicaments. Environmental law has become a concern for many industries and companies who may cause damage to the environment by the nature of their business. Because these companies' production may harm the land or air, by law, they also have a responsibility to clean up any damages or pollutants in the environment they have caused. The Environmental Protection Agency (EPA) has taken an active role in pursuing offenders and ensures related laws are enforced. Not only does the EPA pursue corporations violating the environmental laws, they also pursue individuals making the decisions to refuse or neglect to abide by the laws. Anyone affected by these industries should be concerned about EPA regulations.

Using environmental law as an example of director and officer liability will add value to the analysis of this topic by demonstrating that the acts of violation in this area are more passive than it is in the financial industry. In this section, my second condition will be developed: executives and managers may be held legally accountable, civilly or criminally, simply by failing to act when they are expected to perform a duty. Executives and managers in this area may be found guilty of inaction, rather than actively pursuing misdeeds, such as fraud, as in the financial industry.

In Section V, OSHA regulations will be used to demonstrate how executive accountability is prevalent and plausible even when the responsible person is unaware of the violation, my third condition. In this area of law, awareness of the violation is not required in order for an executive, manager, or even a lower ranking employee, to be legally accountable. For industries and organizations in which OSHA adherence is crucial, the TMT should have a special interest in seeking information to protect them from liability. Although this section is not an all inclusive list of OSHA regulations, I will present common situations in which executives and managers were found to have violated OSHA regulations, and were penalized in their personal capacities.

I will complete my material in the sixth section with an overview on how executives may avoid legal liability. In this last section, I will substantiate the importance of executive protection, and present common methods of protection and prevention. After addressing ways in which an executive, manager, or employee may find herself in legal trouble, I will complete my analysis by providing resources executives and managers have to protect themselves from legal recourse.

In order to complete the topic of executive personal liability, the most common methods executives use to protect themselves from liability will be included in this section's analysis. Particularly, corporate indemnification and liability insurance contracts for executives will become an integral theme in this section. Because it is not always clear that these are two separate methods of protection, I will clarify the differences between indemnification and insurance, and how they commonly affect corporate representatives. This section will describe common exclusions from liability contracts, thereby indicating desirable qualities in executive liability contracts. I will also include cases implicating conflict between the insured and the insurer. An examples will illustrate when the reasons for a claim is not clearly included in the insurance contract.

Section I

Civil, Criminal, and Executive and Managerial Liability

The civil and criminal court systems each have unique and alternate purposes, each one created to ensure justice for the common good of the community. However, they have distinct differences. The civil court system is tailored to provide a means of remedy for disputes between citizens, while the criminal court system functions to punish citizens for crimes against social order.

Civil Liability

An individual has the right to use the court systems to attempt to collect compensation for harm caused by another citizen. The other party to the case may be an individual, a business, or the government. For the purposes of this thesis, the two main remedies used to resolve civil disputes are money damage awards and injunction. A monetary remedy occurs when the plaintiff receives a financial award, which the court has determined to adequately compensate the victim or plaintiff. When a plaintiff or prosecutor sues for injunction, the remedy will be an action, in which the defendant is ordered perform. A court has two types of injunction remedies. Injunction can be used to prevent the defendant from performing an act, such as polluting. It can also be used to force a defendant to perform a duty, such as cleaning up pollution.

A plaintiff would also use the civil court system when suing a corporation. Within the past twenty years, plaintiffs generally sued the corporation as an entity itself, and not the individuals within the firm. In this case, any remedies the court grants to the petitioner will be paid by the corporation out of corporate funds. However, in recent years, executives and managers have experienced a dramatic increase in actions filed against them in their personal capacities. Civil lawsuits against executives have proven to have devastating effects for them in their personal and professional capacities. It is not only a problem for the court system, but legislators and judges alike have difficulty in determining an appropriate remedy for misdeeds committed while acting as an agent of a corporation.

An executive or manager may be sued in a civil court system by an unlimited number of plaintiffs for wrongdoings committed in a professional capacity. Professionals in this capacity should be aware that double jeopardy only applies to the criminal court system, and not the civil court system. Double jeopardy occurs when an individual is prosecuted for the same offense more than once in the criminal court system. The Constitution of the United States protects individuals from double jeopardy in the Fifth Amendment.

There are no restrictions concerning how many different actions may be brought against one particular defendant in a civil court. Any number of plaintiffs may file action against the defendant for the same injury to attempt to collect remedy. Each one of these parties has the right to use the court system to collect compensation for damages. Only the statute of limitations may limit the amount of time a claimant has to pursue remedy. The only situation in which the judicial system prevents an individual from pursuing legal action is when a plaintiff has already sued the defendant for the same action. This differs from double jeopardy in two ways: a plaintiff may only file a civil case, and double jeopardy only applies in criminal cases. Secondly, a plaintiff may only file suit for the same action against the same defendant once. For example, if a plaintiff sues a defendant for damages from an automobile accident, the plaintiff cannot begin fresh legal action against the defendant for the same cause. The plaintiff's only option, if she wishes to further pursue legal action, is to appeal to the next higher court under particular circumstances.

During the appeals process, no new evidence or arguments may be introduced. An appeal is specifically designed to ensure the law has been interpreted correctly and fairly by the court. In the criminal court system, the government has only one opportunity to prosecute the defendant for a particular offense. The party with the unfavorable outcome has the option to appeal the case to the next higher court. Since lawsuits are by nature asking for interpretation of the law, different interpretations may arise from different courts. Because of this, either party may not agree with the interpretation of the law, and therefore, appeal for further interpretation. For example, a manager who is convicted of environmental crimes may appeal his sentence to a higher court. He believes he abided by the law, and does not agree with the penalties instated. During the appeals proceedings, the judgment may be reversed. The prosecution, which would be the Justice Department, also has the right to appeal the case to attempt to instate or reinstate criminal charges and civil penalties. The appeals process is a matter of interpretation of the law. Appeals may continue up the ladder of courts, ending with the Supreme Court. However, appealing a case does not guarantee the next highest court will hear the case. In this situation, the highest court hearing will be the final decision.

Criminal Liability

A company can be held responsible for engaging in criminal activity, yielding the company criminally liable. A corporation is considered to have committed a criminal act when an agent, or someone with substantial discretion representing the business entity is "(1) willfully ignorant of, (2) condones, or (3) participates in criminal conduct."[2] A business entity may also face criminal liability for the acts, omissions, or failures of an employee acting within the capacity of his employment.[3] The courts have used methodological reasoning for holding corporations responsible for the actions of its employees, without holding the employees responsible for his or her own actions. First, the wrongful act committed must be done within the scope of employment.[4] Second, the employee must be acting to benefit the corporation, even if that behavior only partially benefits the entity.[5] Lastly, the intent of the employee's action must be attributed to the corporation.[6]

Respondeat superior is the classic theory behind courts imputing liability to the corporation and indemnifying the employees for illegal acts. The doctrine of respondeat superior imposes liability on a corporation if it meets three requirements: "(1) an agent commits a crime, (2) within the scope of employment, and (3) with the intent to benefit

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[2]Jonathan C. Poling and Kimberly Murphy White, "Corporate Criminal Liability," *American Criminal Law Review* 38 (2001): 525, 525-554.

[3] Ibid., 528

[4] Ibid., 529.

[5] Ibid.

[6] Ibid

the corporation."[7] This doctrine reasons that liability is placed on the corporation instead of the employee. Corporations have incentives to take precautions to deter wrongful employee behavior when it is forced to internalize punishment through risking corporate assets.

Common law tradition, with respect to criminal liability, attributes accountability to corporations for illegal act committed by agents, regardless of the employee's rank in the company.[8] Federal courts have consistently ruled to impute responsibility to corporations, and several states have developed specific laws dealing with criminal acts committed by upper management.[9] Standards have been developed when deciding if a corporation is blameworthy, and liability should be imputed to the corporation, or if liability should be imposed on the individual.

Consider the scandal with which Arthur Andersen and Enron were involved. A federal jury convicted Arthur Andersen on June 15, 2002, and held the company criminally liable for obstructing the government's attempts to audit Enron.[10] Although the jury did not convict the company based on the shredding of audit documents, the jury convicted the firm on the premise that at least one individual of the firm acted knowingly

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[7]V. S. Khana, "Corporate Lıabılity Standards: When should Corporatıons be Held Crımınally Lıable?" *Amerıcan Crımınal Law Revıew* 38 (2000): 1243-1243, 1239-1283.

[8]Jonathan C. Polıng and Kımberly Murphy Whıte, "Corporate Crimınal Lıabılıty," *Amerıcan Crıminal Law Revıew* 38 (2001): 530, 525-554.

[9]Ibıd.

[10]Jonathan Weıl and Alexeı Barrionuevo, "Arthur Anderson ıs Convicted on Obstructıon-of-Justice Count," *Wall Street Journal,* 15 June 2002.

and with intent to commit the crime.[11] The firm's sentence has not been delivered, but the company may be fined up to $500,000.[12]

The states developing standards of accountability, which save the individual from personal liability, and instead, responsibility will be imputed to the corporation. Primarily, the wrongdoing does not necessarily require the agent to have ratified it in order to impute liability to the corporation.[13] States also require the act to have benefited the company.[14] This standard of accountability is quite loose; in order to fulfill this element, the company does not actually need to receive a benefit for this standard to apply. The employee's intention is the only necessary requirement for sufficient use of this element.[15] Similarly, since courts realize the high probability that employees are acting in their own personal gain, for this element to apply, it is not necessary for the employee to want to benefit the corporation.[16] The courts have gone so far as to allow culpability of a corporation although the employee acted against the express policies, even if the corporation received no benefit.[17]

However, the courts do not allow each and every management misdeed to be charged to the organization. There are misdeeds committed by members of the TMT conspicuous enough in which the courts do not hold the corporation accountable. The

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[11]Ibid.

[12]Ibid.

[13]Jonathan C. Poling and Kimberly Murphy White, "Corporate Criminal Liability," *American Criminal Law Review* 38 (2001): 531, 525-554.

[14]Ibid., 532.

[15]Ibid.

[16]Ibid.

[17]Ibid.

line is drawn when corporate representatives of this rank acts to benefit a third party although the acts are explicitly contrary to the wellbeing of the corporation.[18] A company may also escape criminal liability when the employee breaches a fiduciary duty to the company.[19]

Furthermore, executives and managers may also be criminally charged with criminal acts committed in their professional capacity. Violations of criminal code undoubtedly endanger the executive to charges of criminal liability. The executive risks criminal prosecution by the government or one of its agencies in his or her personal capacity. Crimes of this nature are uncovered by any indemnification protection a company may offer. This will be discussed in more detail in the next section.

Executive and Managerial Personal Liability

Courts have long abandoned the tradition of accepting the doctrine of respondeat superior as the reason for holding corporations responsible for agent's criminal acts, and have begun imputing liability on executives and managers for their own misdeeds. Although once believed the doctrine of respondeat superior prevented wrongdoing through close corporate scrutiny, the courts began to recognize the corporation as an intangible, almost a ghostly, entity who feels no pain of imprisonment or financial punishment. When a corporation is forced to pay a large sum of money, no specific person is reprimanded for the mistake, nor is one person particularly ordered to pay to remedy the wrongdoing thereby punishing the culprit. Instead, the corporation pays the

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[18]Ibid., 533.

[19]Ibid.

remedy out of the corporate pocket, harming only the shareholders by decreasing the value of the firm.

The court not only recognized that corporations were insensitive and desensitized to monetary penalties, but also that many corporate representatives began causing extraordinary harm by poor decision-making, without regard to how it might affect other stakeholders. Corporate representatives used the guardianship to their advantage, expecting protection from accountability for making risky decisions, ultimately placing the company in a worse financial position. The executives and managers responsible for ensuring ethical activities of the corporation's employees no longer saw incentives to prevent wrongdoings from their own employees. This realization led the courts to begin placing the blame on the individual responsible for the misdeed, hopefully to further deter misdeeds beyond the checks and balances system the company used. Individuals understand the effects of civil and criminal wrongdoings, and the threat of the consequences is now believed to deter intentional mismanagement and wrongdoing.

Corporate representatives, including executives, managers, and even employees facing little risk in their positions with organizations, should be aware of the fundamental judicial process. It is also important for these individuals to know their rights within the judicial system, such as knowing the intricacies of double jeopardy, and the difference between the civil and criminal court system. Simply stated, the civil court system is used to resolve disputes between individuals. Individuals in the community have access to the court system and to use a third party with authority to civilly resolve disputes with other individuals in the community. The criminal court system is used when an individual, and sometimes corporate entity, violated criminal code. The government is the only party who may prosecute an individual, and bring action against him in this system.

The next section examines trends that have had an impact on the interpretation of laws specifically dealing with executive and managerial personal liability. Although many legislative initiatives have attempted to find a resolution to the fairness of personal liability, the effectiveness of the law can only be observed after it has been put into effect.

Section II

General Trends of Executive and Managerial Liability

Business Judgment Rule

Common law developed the business judgment rule, but the principle itself has no point of inception.[20] It has been regularly defined by the Delaware Supreme Court as:

> [A] presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interest of the company. Absent an abuse of discretion, that judgment will be respected by the court[, with t]he burden [being] on the party challenging the decision to establish facts rebutting the presumption.[21]

It is a principle developed by common law, which presumes two legal elements help executives and managers avoid personal liability.[22] Primarily, the rule presumes that actions taken by executives and management are done so in good faith and with appropriate care.[23] Secondly, the rule provides protection for decision-making individuals from injury or loss to the organization provided the individual acted within that presumption.[24] The business rule essentially presumes executives and managers

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[20]Peter V Letsou, "Symposium· Theory Informs Business Practice· Implications of Shareholder Diversification on Corporate Law and Organization. The Case of the Business Judgment Rule " *Chicago-Kent Law Review* 77 (2001). 179, 179-210

[21]Ibid

[22]Craig LaChance, "Nature V. Nurture. Evolution, Path Dependence and Corporate Governance." *Arizona Journal of International and Comparative Law* 18 (2001). 284, 279-310.

[23]Kent Greenfield and John Nilsson, "Gradgrind's Education· Using Dickens and Aristotle to Understand (and Replace?) the Business Judgment Rule." *Brooklyn Law Review* 63 (1997)· 816, 799-859.

[24]Ibid.

make decisions on an informed basis, in good faith, where they honestly believe their actions are for the best interest of the organization.[25]

Individuals in decision-making capacities within organizations have a duty of care to act as would an ordinarily prudent person, and make decisions on behalf of and in the best interest of the shareholders.[26] Executives and managers have superior knowledge of operating an organization, beyond most shareholders: the very reason they are hired and given wide latitude in making decisions. Judges also recognize a rationale, stating "directors are better equipped than courts to make business judgment."[27] When an issue is brought to legal scrutiny, judges abstain from evaluating the decision itself, and defer to the organization's decision makers discretions.[28]

The business judgment rule increases the protection for individuals with decision-making discretion within organizations when legal action is filed against them. It is difficult for stockholders to challenge decision-makers because they have broad discretion of conducting business affairs.[29] The challenger, possibly a stockholder, bears the burden of persuading the court that the decision-maker did not behave in good faith, did not make a decision reasonably believed to be in the organization's best interest, or did not exercise the duty of care as would a prudent person in similar circumstances.[30] In

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[25]Ibid., 817.

[26]D. Gordon Smith, "A Proposal to Eliminate Director Standards from the Model Business Corporation Act," *University of Cincinnati Law Review* 67 (1999): 1203, 1201-1228.

[27]Craig LaChance, "Nature V. Nurture: Evolution, Path Dependence and Corporate Governance," *Arizona Journal of International and Comparative Law* 18 (2001): 284, 279-310.

[28]Kent Greenfield and John Nilsson, "Gradgrind's Education: Using Dickens and Aristotle to Understand (and Replace?) the Business Judgment Rule," *Brooklyn Law Review* 63 (1997): 818, 799-859.

[29]Craig LaChance, "Nature V. Nurture: Evolution, Path Dependence and Corporate Governance," *Arizona Journal of International and Comparative Law* 18 (2001) 285, 279-310.

cases resembling this, excluding situations of negligence, the court would not make judgments as to whether the decision made was correct, but whether the defendant acted within the presumptions of the business judgment rule.

Revised Model Business Corporation Act

The Model Business Corporation Act (MBCA) was initially passed in 1969, and has been revised more than once since its inception.[31] A critical revision occurred in 1974 where the Committee on Corporate Laws of the Section of Business Law of the American Bar Association (the "Committee") revised the act to include a statutory statement of the duty of care.[32] The act was revised to promote the uniformity of standards by which decision-making individuals will be legally judged.[33]

The most recent amendments to the MBCA in 1998 stray from the structure of the duty of care and business judgment rule. Instead, the Committee included features defining the standards of conduct and the standards of liability for executives and managers. The first Part describes the relationship between the two and argues the dichotomy is both descriptively accurate and normative useful.

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[30]Kent Greenfield and John Nilsson, "Gradgrind's Education: Using Dickens and Aristotle to Understand (and Replace?) the Business Judgment Rule," *Brooklyn Law Review* 63 (1997): 817, 799-859.

[31]Craig A. Peterson and Norman W. Hawker, "Does Corporate Law Matter? Legal Capital Restrictions on Stock Distributions," *Akron Law Review* 31 (1997): 182, 175-227.

[32]Peter V. Letsou, "Twelfth Annual Corporate Law Symposium: Developments in the Law of Business Organizations: Introduction," *University of Cincinnati Law Review* 67 (1999), 950, 945-951.

[33]D. Gordon Smith, "A Proposal to Eliminate Director Standards from the Model Business Corporation Act," *University of Cincinnati Law Review* 67 (1999), 1201, 1201-1228.

When the Act was revised again in 1983, the Committee attempted to address the business judgment rule and include it as part of the standards of conduct.[34] The Committee proposed the changes as an effort to "coordinate and harmonize the business judgment rule and the revised Model Act."[35] However, after receiving critical comments from members of the business and legal community, the Committee decided against incorporating the new language into the Act.

The Committee addressed three parts of the Act to clarify components previously unaccepted by a significant portion of the legal and business community. Part I addressed the concerns described in the preceding paragraph; it defined the standards conduct and liability for decision making corporate representatives.[36] Part II contended that the 1983 amendments attempted to modify the direction of common law resulting in confusing and unnecessary standards.[37] Part III concludes the duty of care is supported under common law and the executive and manager standards should be removed from the MBCA.[38]

The Model Business Corporation Act is essentially a tool legislators created to help clarify and control the duties and responsibilities decision-making representatives have toward the ultimate priority: maximizing shareholder wealth. Its revision is an indication of a persistent quest of legal and business communities' efforts of finding a fair balance between executive and managerial duties and liability they should accept

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[34]Ibid., 1202.

[35]Ibid.

[36]Ibid.

[37]Ibid.

[38]Ibid.

personally for mistakes, whether genuine risks resulting in losses or actual intentions to deceive or defraud.

Current Trends

Further legislative action to control wrongful behavior of executives and managers is an approach many proponents of corporate governance reform believe has proven ineffective.[39] The need for improving the standards by which executives and managers must abide is unmistakable. However, the methods to successfully ensure ethical behavior of decision-making corporate representatives are unclear. Allowing the legislature to create government documents has been eliminated as an option for reform, but creating standards for director independence from executive positions has been supported.[40]

The debate topic recently, after the collapse of Enron, has been corporate governance and how to fairly place blame where it is due. Decision-making individuals have reason to become concerned for personal liability after seeing the effects of Enron executives, but also recognize the need for corporate governance reform without sacrificing entrepreneurship and risk-taking activities.[41]

Proposals have been developed to attempt to strengthen the independence of directors outside of executive roles.[42] Incorporating an independent director policy will

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[39]"Under the Board Talk," The Economist, 18 June 2002.

[40]"Designed by Committee," The Economist, 15 June 2002.

[41]"Under the Board Talk," The Economist, 18 June 2002.

[42]Ibid.

address some of the problems contributing to wrongful behavior and will create a stronger checks and balances system. The most common proposal is to divide the role of the CEO from the Chairperson of the Board.[43] By dividing the roles, duties will also be divided, resulting in a stronger decision-making team. This proposal will eliminate much of the spinelessness cultivated from bully CEOs.[44] However, many do not support this notion based on the apprehension of conflict in the boardroom, such as losing the cohesiveness and collegiality.[45]

The NYSE (New York Stock Exchange) has also done their fair share of creating proposals to standards for director independence, thereby strengthening boards and limiting liability. Although most American boards consist of non-executive members, the NYSE is providing an escape to the dangers of groupthink and spinelessness of "yes-men."[46] Part of the proposal is to give shareholders a more active role in the selection of board members, and monitor and participate in corporate governance by voting on stock and stock-options benefits for executives and managers.[47] As part of this proposal, companies would be obligated to publish codes of ethics and conduct on their websites.[48]

The next sections will demonstrate how many of the trends of executive and managerial personal liability have progressed and how courts have interpreted them

[43] "Designed by Committee," The Economist, 15 June 2002.

[44] Ibid.

[45] Ibid.

[46] Ibid.

[47] Ibid.

[48] Ibid.

within each area of law covered in this thesis. Depending on the area of law, and the time span in which the situation occurred, the cases provided in this thesis may have different outcomes than what would be considered reflective of current norms and trends. This is due to the persistent attempt of involved persons to find a fair balance of justice concerning executive and managerial personal liability.

Section III

Financial Crimes

The financial services industry is a unique area of business in which more people within organizations are susceptible to personal liability. Most employees, generally excluding clerical employees, have increased access to resources facilitating monetary transactions. In this section, executives, managers, and employees excluded from the TMT alike confront similar degrees of risk in the financial services industry. For the purposes of this section, the term 'employees' will be used to include all those who are susceptible to personal liability.

The risk of personal liability is greater when the employee is aware of the wrongdoing, as opposed to cases in which the employee is ignorant of the wrongfulness of the action. A first condition needs to be established arguing for the increased likelihood of personal accountability when individuals are aware of the illegality of their actions. Cases involving financial crimes are solid examples in which the likelihood of employees' knowledge of the breach of the law is high, yielding a higher probability of liability.

The person committing the crime is often employed in the financial industry and has access to the trading mediums. Employees who understand such readily available technology also understand the laws and regulations of trading securities and will likely comprehend the severity of any crime committed. Concealing awareness in this industry is more difficult, especially with cases involving insider trading, conspiracy, and embezzlement. Cases involving financial crimes have demonstrated the principle that employees aware of the illegality and severity of their crimes will likely be held accountable in their professional capacities. The consequences of committing these crimes with full awareness of their wrongfulness may be forced relinquishment of any licenses necessary to conduct business, barring from the industry, monetary fines, and imprisonment.

Legislation

PSLRA

The Private Securities Litigation Reform Act of 1995 was passed attempting to curtail abusive litigation of cases claiming misdeeds in the securities industry. Congress passed the PSLRA in response to many of the issues arising from securities fraud lawsuits. A major purpose of passing the PSLRA was to curb extraordinary amount of lawsuits flooding the judicial system.[49] The first problem was a seeming rise in unsubstantiated cases claiming securities fraud. Lawsuits, many without merit, began absorbing and wasting the court's time with unjustified claims.[50] Secondly, many unscrupulous attorneys abused securities litigation by trying to take advantage of windfall damages, resulting in the decreased quality of investor representation.[51] Lastly, the amount of time the attorneys spent in the discovery process and the threat of personal

[49]Terrence G Stolly, "Scienter Under the Pnvate Securıtıes Lıtıgatıon Reform Act of 1995: Unexpected Implıcatıons on Dırector and Officer Lıabılıty and D&O Insurance," *Capıtal Unıversıty Law Revıew* 29 (2001): 545, 545-599.

[50]Ibıd.

[51]Eugene P. Caıola, "Comment: Retroactıve Legislative History: Scienter Under the Unıform Securıty Lıtıgatıon Standards Act of 1998," *Albany Law Revıew* 64 (2000): 315, 309-360.

liability hindered the recruitment of many qualified persons to serve on corporate boards.[52]

The PSLRA was specifically tailored to focus on a particular area of law: financial crimes. There are several purposes for the PSLRA, and several goals Congress attempted to accomplish by its passage. The initial goals of the act were to prevent cases lacking substantial complaints and limit the opportunity claimants have to take legal action against executives, managers, and employees.[53] In order to deter private plaintiffs from bringing frivolous claims against financial representatives, the act intended to reduce lawsuits lacking merit and provide consistent federal pleading standards.[54] However, legislators sought to ensure that passing an act curtailing the limits on which a plaintiff may sue claiming securities fraud did not risk excluding legitimate claims filed by fraud victims. Legislators realized that the PSLRA could obstruct legitimate claimants from pursuing justified remedies, and development of legislation to curtail abusive litigation should not exclude plaintiffs with legitimate claims from using the judicial system to justly receive remedy.[55]

Congress also used the PSLRA to change the proportionate liability for wrongdoers.[56] Before the PSLRA, executives violating the securities laws were held

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[52]Ibid., 316.

[53]Terrence G. Stolly, "Scienter Under the Private Securities Litigation Reform Act of 1995: Unexpected Implications on Director and Officer Liability and D&O Insurance," *Capital University Law Review* 29 (2001): 558, 545-599.

[54]Ibid., 547.

[55]Ibid., 558.

[56]Ronald A. Dabrowski, "Proportionate Liability in 10b-5 Reckless Cases," *Duke Law Journal* 44 (1994): 574, 571-611.

jointly and severally liable for damages caused by the wrongdoing.[57] This means that one party could be forced to pay the damages, even if the injury was caused by another party. The traditional rule resulted in forcing payments from innocent parties.[58] However, the PSLRA changed the provision to hold those accountable only partially responsible, and parties acting with non-knowing conduct may not be held accountable. This revision helped guard the accused against meritless litigation. The new provision of partial liability allows that each responsible party is only ordered to pay a portion of the entire judgment. The percentage of liability is allocated to each defendant, in which they will be ordered to pay the corresponding liability.

The third element of the PSLRA helped to reduce the amount of lawsuits claiming securities fraud by encouraging early settlement of class action lawsuits.[59] Specifically, settling defendants are released from liability if a non-settling defendant attempts to recover any amount of contribution.[60] For example, if two defendants are involved in a case in which they may be ordered to pay the plaintiff a remedy, and one defendant settles while the other does not, the non-settling defendant is disallowed from bringing suit against the settling defendant for a contribution of the remedy.[61]

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[57]Terrence G. Stolly, "Scienter Under the Private Securities Litigation Reform Act of 1995: Unexpected Implications on Director and Officer Liability and D&O Insurance," *Capital University Law Review* 29 (2001). 558, 545-599.

[58]Eugene P. Caiola, "Comment: Retroactive Legislative History: Scienter Under the Uniform Security Litigation Standards Act of 1998," *Albany Law Review* 64 (2000): 318, 309-360.

[59]Ibid.

[60]Terrence G. Stolly, "Scienter Under the Private Securities Litigation Reform Act of 1995: Unexpected Implications on Director and Officer Liability and D&O Insurance," *Capital University Law Review* 29 (2001): 559, 545-599.

[61]Ibid.

Lastly, the PSLRA included a clause protecting executives and managers from liability involving forward looking statements. This clause made it more difficult for plaintiffs to bring suit against executives if the firm did not perform to the high standards expected in the forward looking statements, provided there is a meaningful cautionary statement included.[62] Not only is the company's TMT protected from forward looking statements in the financial documents, but they are also protected from any liability arising from oral statements.[63]

Congressional legislators understand the facets of business where it is unwise and uncommon for a company to disclose problems, threats, and losses to the firm in the financial statements. Any company announcing losses or poor performance will inevitably lose capital and shareholder confidence, ultimately weakening the organization's financial position. The PSLRA designates liability only in a situation in which a plaintiff can prove the person making the statements intentionally mislead or had knowledge that the information disclosed was false.[64]

The intention of the PSLRA was to rectify many of the problems occurring with securities litigation. Despite efforts to resolve these issues, lawmakers quickly identified many flaws. Analysis of the PSLRA concludes the act inconsistently provides guidelines by which courts should follow. The different circuit court systems have interpreted the PSLRA differently. Considering the different parts of the United States have different cultures, it is not uncommon for courts to interpret laws differently, as in the case of the

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[62]Ibid.

[63]Ibid.

[64]Terrence G. Stolly, "Scienter Under the Private Securities Litigation Reform Act of 1995: Unexpected Implications on Director and Officer Liability and D&O Insurance," *Capital University Law Review* 29 (2001): 559, 545-599.

Second and Third Circuit Courts. Both have relaxed the standards by which a defendant may be found liable. A plaintiff can substantiate her claims by showing that there is "a strong inference the defendant had a motive and opportunity to commit fraud, or by setting forth facts that constitute circumstantial evidence of either reckless or conscious misbehavior."[65] However, the Ninth Circuit has interpreted the PSLRA differently by making it more difficult for plaintiffs to hold the defendant liable in cases under their jurisdiction. This court requires stricter inference, making it more difficult to hold the defendant liable for misdeeds.[66]

In light of these differences, two general concerns regarding the act's effectiveness have arisen. The first questionable element is (1) what qualifies as the required state of mind under the PSLRA, and (2) whether the "motive and opportunity" test the Second Circuit uses is adequate to determine that state of mind.[67]

Scienter

Scienter is the component of the PSLRA that provides a standard by which all federal courts could used to determine if a case contains enough merit to continue in the legal process.[68] Scienter is simply the intent to commit a crime.[69] The Supreme Court ruling established in *Ernst & Ernst v. Hochfelder* that a plaintiff cannot attempt to collect

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[65]Ibid., 548.

[66]Ibid.

[67]Ibid., 590.

[68]Ibid., 548.

[69]Ibid.

damages without alleging scienter. This case was before the PSLRA was passed, but determined

> ...that an action for civil damages could not be maintained under 10(b) of the Securities Exchange Act of 1934 and Securities and Exchange Commission Rule 10b-5, in the absence of an allegation of intent to deceive, manipulate, or defraud on the defendant's part, since some element of scienter was necessary and liability could not be imposed for negligent conduct alone.[70]

Edward Brodsky in his article in the *New York Law Journal* further writes, "...mere negligence is insufficient to show scienter."[71] In the past, scienter was generally only used in criminal law cases to indicate that the defendant had intent to commit the crime. However, the term has been extended to the PSLRA. The act determined that a case must, "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind."[72]

The PSLRA contains a provision allowing courts to scrutinize the degree of merit cases have which claim financial crime. It also served to increase the standards by which a case meets the standards to be allowed through the system. Because a person cannot be prosecuted or sued simply for scienter, it is a minimum standard useful for determining which cases are substantial enough to proceed in the legal system. The PSLRA allows courts to discriminate among cases and hear only those which have merit. Courts only consider cases to have merit if scienter can be shown, and only cases will be admitted that can prove the required state of mind. Three situations must be proven to

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[70]Ernst & Ernst v. Hochfelder, 96 S. Ct. 2194 (1976).

[71]Edward Brodsky, "Scienter Under the Reform act of 1995," *New York Law Journal,* 217, no. 5 (1997): 3.

[72]Ibid.

demonstrate scienter: whether the executive committed the illegal act, the percentage of responsibility and whether the accused knowingly violated the securities law.

Current Pending Bills

The Corporate and Criminal Fraud Accountability Act of 2002

Senator Patrick Leahy from Vermont is currently proposing a bill containing principles to hold corporate wrongdoers accountable. Leahy's bill, The Corporate and Criminal Fraud Accountability Act of 2002 will instate more penalties for violations of securities fraud, possibly penalizing offenders with a maximum of 10 years in prison.[73] The bill also extends protection to whistleblowers.[74] Employees have often been afraid to be the one to blow the whistle on others engaging in misdeeds within their company. Insider awareness does not usually lead to the prevention of wrongdoing because of repercussions commonly encountered by whistle blowing. The added protection supporting employees who report wrongdoings in good faith will add a much needed, but small fraction of encouragement for executives to perform work-related duties as they are expected.

An extension of the statute of limitations is incorporated into Leahy's bill, giving legitimate securities fraud victims more time to pursue justice.[75] The destruction document feature included in Leahy's bill is an attempt to prevent problems similar to

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[73]Ibid.

[74]Ibid

[75]Ibid.

Enron's, and was likely prompted by Enron's collapse and unscrupulousness with destroying their pertinent documents.[76] The bill will include two new features making document destruction a felony.[77] Under these features, companies will be forbidden to shred audit papers and preservation of them will be mandatory. The provision requires these audit papers to be kept for five years.[78]

President Bush's 10-point Plan

The wake of the Enron scandal left investors, companies, and politicians unsure of how they can provide assistance to those who suffered a loss as well as penalize those who were responsible. The loss of many families' life savings because of the collapse of one company deservedly increased the care that should be taken when investing. To try to prevent future unexpected and unforeseen damage, President George W. Bush is currently developing a plan to increase the accountability of corporate officers who mislead investors.[79] Currently, President Bush has only specified a few features of the bill. It is designed to take away bonus payments and prevent individuals from managing an organization if found guilty of misleading investors.[80] President Bush's plan relies on

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[76]Ibid.

[77]"US Democrats Unveil Securities Fraud Bill Granting Whistleblower Protection," *AFX* (Asia). 12 March 2002.

[78]Ibid.

[79]"Bush/Congress Proposals for Securities Law Reforms Get Mixed Response," *AFX* (Asia), 12 March 2002.

[80]Kathy M. Kristoff, "SEC Seeks to Take Exec's Stock Options; Regulator: Lawsuit against Former COO of IGI, Alleging Fraudulent Financial Statements, is Precedent-setting," *Los Angeles Times*. 14 March 2002, sec. BUSINESS, part 3, p 1.

the SEC to handle new methods of enforcement.[81] The SEC would not only begin requiring companies to release more accurate financial information, but to do so faster, and use better accounting standards.[82]

Effects of Financial Crimes

Employees working in this industry should take extra precaution when conducting business. The financial industry is one area of business where employees excluded from executive and managerial status in which financial transaction resources has been entrusted to them may be found liable when they fail to conform to security laws. Employees facilitating transactions in the financial markets must be licensed to perform the transaction specific to the security. Crimes most common in this area of business with which an employee may be charged includes securities fraud, insider trading, conspiracy, mail fraud, tax evasion, and money laundering.

As previously mentioned, executives, managers, and employees may be found liable in their personal capacities for crimes committed in violation of the SEC. An individual committing these crimes may be forced to pay extraordinary fines and may possibly be imprisoned. A recent case demonstrates the SEC's intolerance of such violations. David Fitzgerald, a broker from Pacific Genesis Group, Inc. was fined $300,000 for a securities fraud violation in connection with the municipal bond market.[83]

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[81]"Bush/Congress Proposals for Securities Law Reforms Get Mixed Response," *AFX* (Asia), 12 March 2002.

[82]Ibid.

[83]Lynn Hume, "Fitzgerald Accepts SEC Settlement: To Pay $300,000, Be Barred," *Bond Buyer*, 14 March 2002, p. 1.

He was also banned from the brokerage industry for a minimum of five years with the right to reapply after five years, as part of his settlement with the SEC.[84]

Robert Hibbs, a businessman from Minneapolis, involved in a securities fraud cases was severely penalized when he pled guilty to four counts of insider trading, three counts of tax evasion, and one count of conspiracy.[85] Hibbs was ordered to pay a fine of $250,000 and forfeit cash received from the sale of his home in the amount of $1.2 million.[86] The court also ordered him to relinquish 139,600 shares of stock in Rimage Corporation, cash in the amount of $450,000 from the sale of stock.[87] Finally, the court ordered a personal money judgment against him in the amount of $350,000, and most importantly, Hibbs was sentenced to four years in prison for the violations.[88] Three other business colleagues of Hibbs, George Kline and his sons, Erich and Christian, also pled guilty to counts of securities fraud and have agreed to pay more than $9 million to the government, resulting in totals more than twice their illegal profits.[89]

Several class action lawsuit against Chuck Conaway, the former CEO of Kmart have been filed since the company declared Chapter 11 in January. One of the cases filed in Detroit in March of 2002, accuses Conaway of making misleading statements about Kmart's financial statements to the public in the company's announcements of monthly

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[84]Ibid.

[85]"Businessman Sentenced for Insider Trading," *Associated Press State and Local Wire.* 21 March 2002, sec. BUSINESS NEWS.

[86]Ibid.

[87]Ibid.

[88]Ibid.

[89]Ibid.

sales and quarterly earnings.[90] The class action claims the nondisclosure caused an artificially inflated stock price.[91] This case has yet to be resolved.

Ralph Whitmore, chairman of Alaska Statebank, engaged in conspiracy with fellow bankers, including H. Derrell Smith president, and three directors: Robert C. Ely, Thomas J. Miklautsch, and William A. Swain. The three intended to obtain funds from Statebank to buy stock in another bank, Alaska National Bank of the North (ANBN).[92] All were criminally charged with several counts of conspiracy and bank fraud.[93] The indictment stated the defendants declared dividends of $2.7 million in 1987 while the bank was suffering devastating losses.[94] The conspiracy was initiated in 1984 when Statebank gave four separate loans of $500,000 to Ely and his other colleagues.[95] The books reflected false entries of repayment of the loans, planned by Ely and the others.[96] The Ninth Circuit reinstated charges after the Alaska district court dismissed the charges of conspiracy to deprive the bank of property.[97] The Circuit reasoned the defendants indeed deprived the bank of property. The court stated rationalized the decision by determining that property deprivation occurs when the collection of debts is prevented or,

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[90]Lorene Yue, "More Investors Sue Former Kmart CEO," *Detroit Free Press,* 14 March 2002.

[91]Ibid.

[92]"Ninth Circuit Reinstates Criminal Bank Fraud Charges Against Former D&Os," *Bank Lawyer Liability,* November, 1997, sec. CRIMINAL LIABILITY, vol. 6, no. 9.

[93]Ibid.

[94]Ibid.

[95]United States of America v. Robert S. Ely et. al., 142 F.3d 1113 (1997).

[96]Ibid.

[97]"Ninth Circuit Reinstates Criminal Bank Fraud Charges Against Former D&Os," *Bank Lawyer Liability,* November, 1997, sec. CRIMINAL LIABILITY, vol 6, no. 9.

in the case of the defendants, when they arranged to be credited the payments they did not in fact make.[98]

Executives, managers, and even employees employed in the securities industry should exercise caution and abide by acceptable standards of conduct. It is especially important in this area of business because most employees licensed to perform monetary transactions and have various sources by which to implement questionable activities. It is likely an executive or manager of a business dealing with such transactions to be civilly liable for a licensed employee's misdeed. All employees of such businesses should remain knowledgeable in their area of expertise and maintain corporate codes of conduct.

[98]United States of America v. Robert S. Ely et. al. 142 F.3d 1113 (1997).

Section IV

Environmental Law

A second condition should be established arguing that an employee may be held legally accountable for negligent acts or failing to perform a duty which he or she as a responsible corporate officer is legally obligated to perform. Executives and managers have been found personally liable in many cases for refusing to abide by environmental laws, and failing to correct a problem, of which they are fully aware. However, proving awareness may not be necessary for liability to be imputed to the executive or manager in their individual capacity. Environmental cases represent the principal that it is possible for executives and managers to be held individually liable for failing to perform a duty, instead of actively pursuing performance of misdeeds.

Legislation

Clean Water Act

To address the increasing environmental concerns in the 1970s, Congress passed The Clean Water Act (CWA) in 1972 to preserve and protect our air and water resources.[99] Several of our nation's rivers and monumental lakes, such as Lake Erie and

[99] "Clean Water Act: A Brief History." (Accessed 28 April 2002); available from http://www.epa.gov/owow/cwa/history.htm; Internet.

the Potomac River, were polluted with sewage and algae.[100] Not only was this pollution unsightly, but unsafe and dangerous to public health.[101]

The CWA was passed to accommodate public concerns and protect our water resources, such as lakes, rivers, and coasts.[102] In order to minimize the effects of water pollution, the CWA seeks to eliminate pollution discharges, prohibit emission of toxic pollutants, and provide federal assistance to publicly-owned wastewater treatment facilities.[103]

The CWA sought to minimize pollutants in the water caused by hazardous discharges, often released from organizations.[104] The CWA states the "discharge of any pollutant by any person shall be unlawful," except in situations which the pollution is in compliance with the CWA.[105] Pollution, although limited, continues to be allowed under the CWA, and companies can obtain permits allowing them to emit a specified amount of pollutants.[106] The CWA imposes criminal penalties for organizations or entities failing to abide by regulations prohibiting the discharge of pollutants, failing to abide by a permit, or failing to follow statutory notification and record keeping requirements.[107]

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[100]Ibid.

[101]Ibid.

[102]Ibid.

[103]Jason Blacksberg, F. Joseph Dausch, Elaine K Inman, and Craig J. Gabriel, "Environmental Crimes," *American Criminal Law Review* 38 (2001): 628, 607-692.

[104]"EPA Proposes Enhanced Approach to Cleaning Up America's Waters," *US Newswire*. (May, 2002).

[105]"Clean Water Act: A Brief History." (Accessed 28 April 2002); available from http://www.epa.gov/owow/cwa/history.htm; Internet.

[106]Margaret A. Johnston, "Clean Water Act – The Supreme Court Scales Back the Army Corps of Engineers' Jurisdiction over 'Navigable Waters' Under the Clean Water Act," *University of Arkansas at Little Rock Law Review* 24 (2002): 341, 329-358

Clean Air Act

The Clean Air Act (CAA) was first passed in 1970 to improve the quality of the United States' air resources and set air quality standards.[108] It was amended in 1990 to give new enforcement powers to the EPA, and sets deadlines for businesses and governments to meet pollution reduction requirements.[109] The amended 1990 CAA also gives the public more opportunities for participation in deciding how the laws will be enforced, and gives the public opportunities to request the EPA or local government to take action against violators of the CAA.[110]

Companies are required to obtain permits to be legally allowed to discharge pollutants in the air.[111] Permit programs were implemented in the amended act to allow the control programs to collect money for permits from more sources than those specified in the previous version.[112] Instead of only stationary sources, such as plants and factories, paying for permits, mobile sources, such as cars, trucks, and airplanes, must also obtain permits.[113] Permit programs allow for local governments to close facilities

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[107]Jason Blacksberg, F. Joseph Dausch, Elaine K Inman, and Craig J. Gabriel, "Environmental Crimes," *American Criminal Law Review* 38 (2001): 630-631, 607-692.

[108]Cary Coglianese, "The Constitution and the Costs of Clean Air: Is the Clean Air Act Unconstitutional?" *Environment* 42 no. 9 (2000): 32.

[109]"The Plain English Guide to the Clean Air Act," (Office of Air Quality Planning and Standards, 2001, accessed 28 April 2002); available http://www.epa.gov/oar/oaqps/peg_caa/pegcaa02.html#topic2; Internet.

[110]Ibid.

[111]Ibid.

[112]Ibid.

[113]Ibid.

who fail to meet the permit requirements, and can monitor more easily than federal enforcement agencies.[114] Organizations themselves must measure the amount of pollution released in the air and what steps they are taking to reduce pollution to obtain the permit.[115] Obligations the business has for air pollution clean up and reduction is also specified in the permit.[116] These fees assist the government in paying for pollution control programs and clean up activities.[117] Lastly, the revised CAA includes provisions for the clean up of air pollution efficient and inexpensively by allowing businesses to choose their own methods to clean up pollution.[118]

The CAA is a federal law applying to all regions in the United States. The Supremacy Clause, the theory that federal law will always supersede state law, allows states to have stricter air pollution control programs, but states cannot have weaker control plans than the CAA.[119] The act was designed to include states in all decision making regarding keeping the local environment safe and clean.[120] Plans to control pollution require understanding of the unique local infrastructure, such as industries, geography and residential areas, which may require special knowledge and attention.[121]

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[114]Arnold, W. Reitze, Jr., "The Legislative History of U.S. Air Pollution Control," *Houston Law Review* 36 (1999): 695, 679-741.

[115]"The Plain English Guide to the Clean Air Act," (Office of Air Quality Planning and Standards, 2001, accessed 28 April 2002); available http://www.epa.gov/oar/oaqps/peg_caa/pegcaa02.html#topic2; Internet.

[116]Ibid.

[117]Ibid.

[118]Ibid.

[119]Ibid.

[120]Ibid.

[121]Ibid.

Therefore, the act delegates the enforcement responsibility to the states.[122] Although the EPA limits the amount of pollution discharged into the air, the states must develop state implementation plans (SIPs) detailing how each state intends to abide by the CAA, which must retain EPA approval.[123] The CAA gives the EPA the authority to reject a state's SIP and take over enforcing the Act in that state, if the state is unsatisfactory according to EPA standards.[124] The states are not alone in ensuring environmental cleanliness and safety. States do receive assistance from the federal government with scientific research and money to help clean up pollution and enforce programs.[125]

Effects of Green Crimes

Courts made an example of a recent case in 2001, *BEC Corporation v. Department of Environmental Protection*, involved violations of the Clean Water Act and set a precedent for green crime penalties. The two sole owners and shareholders of BEC Corporation (BEC), Irvin and Michael Shiner, a father and son team, owned an oil tank farm in New Haven Harbour, Connecticut.[126] The property became contaminated from oil leaks and spills, in which thousands of gallons of spilled oil was ignored for more than

[122]Ibid.

[123]Ibid

[124]Ibid.

[125]Ibid.

[126]Charles K. Campbell, Jr., "New Liability Concerns for Corporate Officers, Officers May Be Personally Liable for the Costs of Environmental Remediation," *Connecticut Law Tribune*, 22 October 2001, sec ENVIRONMENTAL LAW, vol. 27, no. 43, p. 7.

twenty years.[127] The contamination resulted in a violation of the Connecticut Water Pollution Control Act (the "Water Act"). The Connecticut Department of Environmental Protection (DEP) ordered the business owners in their personal capacities to tend to the contamination. DEP ordered the owners to immediately take steps to prevent further contamination and ordered an evaluation of the land to determine the extent of the existing pollution and development of a plan to bring the land into current compliance with environmental laws.[128]

This case set a precedent because the Supreme Court of Connecticut not only did the DEP order the BEC to come into compliance with the law, but the order placed the responsibility on the Shiners in their personal capacities. The orders made BEC and the Shiners personally, jointly and severally liable for compliance of the orders.[129]

The Shiners appealed the case to the Supreme Court of Connecticut.[130] The questions of the case were whether the executives could be held personally liable for violations of the Water Act.[131] The court used the "responsible corporate officer" doctrine, established in the 1943 case involving drug contamination, *United States v. Dotterweich*.[132] This case involved the misbranding of drugs into commerce. The hallmark of this case was the court's decision, holding that Park's (the CEO of Acme Markets) personal engagement in wrongful activity was unnecessary for holding him

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[127]Ibid.

[128]Ibid.

[129]Ibid.

[130]Ibid.

[131]Ibid.

[132]Ibid.

liable.[133] His position and responsibility within the corporation allowed him access and authority to prevent or correct any violations.

The responsible corporate officer doctrine specifies three provisions that must be present in order for a corporate agent to be held personally liable. First, the agent is in a position to accept responsibility and has substantial influence over the organization's policies and activities.[134] Second, there must be a nexus between the agent's acts or omissions in his corporate position so that the officer has substantial influence over the actions committed to violate the act.[135] Lastly, the violation resulted because of the agent's actions or inactions.[136]

The Shiners argued that they could only be held personally liable if they actually spilled the oil, or refused to abide by orders to rectify effects of the spill.[137] The court contended that individuals may be held liable for failing to act and intentional acts, and supported the argument by declaring the pollution a nuisance.[138]

The Connecticut Supreme Court determined in the case *BEC Corporation v. Department of Environmental Protection* that an executive or manager is not shielded from personal liability when violating pollution laws. The issue in this case was whether individuals may be held personally liable for violations of the Clean Water Act. The

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[133]Ethan H Jessup, Environmental Crimes and Corporate Liability: The Evolution of the Protection of "Green" Crimes by Corporate Entities, *New England Law Review* 33 (1999): 736, 721-742

[134] Charles K. Campbell, Jr., "New Liability Concerns for Corporate Officers, Officers May Be Personally Liable for the Costs of Environmental Remediation," *Connecticut Law Tribune*, 22 October 2001, sec. ENVIRONMENTAL LAW, vol. 27, no. 43, p. 7.

[135]Ibid.

[136]Ibid.

[137]Ibid.

[138]Ibid.

court concluded by stating officers are not exempt from liability of his or her acts or omissions simply because a corporate officer is the individual responsible for polluting.[139] The court responded to the issue at hand by using the responsible corporate officer doctrine.[140]

Owners are also accountable for pollution, and face similar degrees of risk as executives and managers who are not private owners of organizations. Lawrence Roseman, sole corporate officer of RLG, was the sole owner-operator of the Spring Valley Landfill in Wabash, Indiana, from 1988 to 1991.[141] The Indiana Department of Environmental Management (IDEM) filed action against RLG pursuing permanent and preliminary injunctive relief and civil penalties for violations of state environmental laws at Spring Valley.[142] RLG agreed to remedy the violations by closing the landfill and developing a closure plan, in which actions in the plan would be accomplished by specified dates.[143] The IDEM agreed to drop charges for other relief including the civil penalties previously sought.[144]

In March of 1994, inspection of the property was ordered to evaluate compliance and progress of cleaning up the land.[145] The scientist evaluating the land determined that the RLG failed to remedy the initial violations, and, at this point, the company breached

[139]Ibid

[140]Ibid.

[141]Commissioner, Indiana Department of Environmental Management v. RLG, Inc. and Lawrence Roseman d/b/a/ Spring Landfill and Lawrence Roseman, et al. 755 N.E.2d 556 (2001).

[142]Ibid.

[143]Ibid.

[144]Ibid.

[145]Ibid.

successive agreements. A trial court found RLG to have failed to comply with the arranged agreements in May of 1994.[146] The company was found in contempt and ordered to pay $5,000 per day in civil penalties until the violations were remedied and the company complied with the agreements.[147] The following July, IDEM filed an amended complaint against RLG with an additional cause for imputing personal liability on Roseman based upon his role in the organization as the sole corporate officer of RLG for failing to comply with previous agreements and continuing to violate the CWA.[148]

IDEM was allowed access to the property cared for by Roseman through the Clean Water Act to begin resolving the landfill's environmental violations. In June of 1999, a trial court ruled in favor of Roseman regarding his personal liability for civil penalties.[149] The court concluded liability should not be imposed on Roseman's because of the lack of evidence of acting in a personal capacity regarding the activities undertaken to manage or operate RLG or activities involving environmental compliance.[150] The court determined Roseman is not responsible for acts executed in a professional capacity as a corporate officer, nor is he personally responsible for debts of the defendant.[151] The

[146] "Sole Corporate Officer Can Be Held Liable for Violations, Ind. Sup. Ct. Rules," *Hazardous Waste Litigation Reporter* 22, no. 1 (2001): 11.

[147] Commissioner, Indiana Department of Environmental Management v. RLG, Inc. and Lawrence Roseman d/b/a/ Spring Landfill and Lawrence Roseman, et al., 755 N.E.2d 556 (2001).

[148] Ibid.

[149] Ibid.

[150] Ibid.

[151] Ibid.

commissioner of the IDEM appealed, in which the appellate court agreed with the lower court's decision.[152]

The case was appealed, once again, to the Indiana Supreme Court, who ultimately reversed the lower court's decision. The Indiana Supreme Court reinstated civil penalties on Roseman in the amount of $3,175,000.[153] The higher court concluded that Roseman had both the responsibility and authority as the sole corporate officer to prevent the environmental violations and to remedy them once he became aware of the noncompliance.[154] The court reasoned the appropriateness of holding an officer personally responsible for actions taken in a professional capacity when the institution of a corporate entity is solely for the purpose of an individual conducting his or her own business, and the misuse of the entity "constitutes fraud or promotes injustice."[155]

Owners of small businesses risk a same degree of personal liability for violations of environmental laws. Consider the case in which two restaurant directors were sentenced for illegal dumping, in violation of the CWA. Warren Spielman the president and treasurer, and an employee, Rush Templeton, ran a restaurant named "The Tavern on the Rand," which was once a tow vessel, and was permanently anchored on the Mississippi River.[156] The restaurant representatives used this to their advantage and,

[152]Ibid.

[153]Ibid.

[154]Ibid.

[155]"Sole Corporate Officer Can Be Held Liable for Violations, Ind. Sup. Ct. Rules," *Hazardous Waste Litigation Reporter* 22, no. 1 (2001): 11.

[156]"Missouri Restaurant, 2 Individuals Sentenced for Dumping," *Real Estate/Environmental Liability News* 13, no. 8 (2002).

instead of paying for sewage disposal, dumped it into the Mississippi River.[157] Spielman was imprisoned for 90 days, fined $90,000, and ordered to serve 100 hours of community service, and his colleague, Templeton, was imprisoned for 30 days, sentenced to one year of home confinement and penalized $10,000 in fines.[158]

Managers, executives, owners, and other decision-making individuals representing organizations should consistently be aware of the daily operations and physical conditions of the business. With the evolving environmental legislative initiatives and revisions to current Acts, it is important for key organizational individuals to remain conscientious of the conditions of the facility as well as the environmental effects the business has on the community. This is a situation in which key individuals may be found guilty for an act they failed to perform, regardless of their intention. Remaining knowledgeable about the facility's condition and abiding by EPA's requirements will help executives and managers avoid liability.

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[157]Ibid

[158]Ibid

Section V

Occupational Safety and Health Administration

The third and final condition which executives and managers should be aware is the possibility of personal liability when the individual is unaware of the violation and took no action to purposefully violate any laws. Many managers, owners, and executives have been found liable in their personal capacities for violating OSHA statutes, often when they have either not been aware of the violations, or when they failed to correct a problem when they had a duty to remedy a known violation. Often, they have been ordered to pay extraordinary amounts for these violations, regardless of their level of awareness. Understanding this principle should encourage executives to correct any problems they might recognize, as well as implement management team objectives to facilitate increased awareness of violations and problems that may cause problems with violating OSHA regulations.

Penalties incurred by executives, managers, and owners should demonstrate to all employees the likelihood of personal liability when violating OSHA regulations. Many executives and managers choose not to rectify dangerous situations because of the costs involved. However, employees need to evaluate which would be a worse sacrifice: sacrificing more money than they would like to in order to comply with OSHA regulations, or sacrifice their freedom for noncompliance.

Legislation

The Occupational Safety and Health Act (The OSH Act)

The Occupational Safety and Health Administration (OSHA) was created in 1971 and sought to create a plan to ensure safe workplaces and reduce workplace fatalities and injuries.[159] OSHA is a part of the Department of Labor and has developed the following mission statement:

> The mission of the Occupational Safety and Health Administration (OSHA) is to save lives, prevent injuries and protect the health of America's workers. To accomplish this, federal and state governments must work in partnership with the more than 100 million working men and women and their six and a half million employers who are covered by the Occupational Safety and Health Act of 1970.[160]

The OSH Act specifies the main objectives and the methods used to implement the main objective in its introduction:

> To assure safe and healthful working conditions for working men and women; by authorizing enforcement of the standards developed under the Act; by assisting and encouraging the States in their efforts to assure safe and healthful working conditions; by providing for research, information, education, and training in the field of occupational safety and health; and for other purposes.[161]

It is beyond the scope of this paper to discuss all details concerning the intricacies of the OSH Act. However, generally, the OSH Act specifically states that criminal indictment may occur if the violation of OSHA provisions were willfully violated and

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[159]*The OSH Act U S Code.* vol. 84, sec. 1 (1970).

[160]Ibid

[161]Ibid

resulted in a death.[162] Pertaining to an employee death, it is likely the government would have to demonstrate the defendant's awareness of a dangerous situation where the defendant refused to correct the violation in order for the defendant to be convicted.[163] However, demonstrating awareness may not be necessary for other OSHA violations. The information as to which the executive has the knowledge is important for a large company; it determines exactly who will be convicted and sentenced to jail.[164] Using this method of accountability is an attempt to encourage compliance of the entire management team for a company.

Executives and managers are subject to a higher degree of risk when they possess awareness of OSHA violations. Nonetheless, they are also subjected to risk when they do not possess awareness. Organizations in which there is more than one executive, or in organizations which the safety of employees is inherently compromised are two situations in which an executive or manager may be held accountable. OSHA attempts to prosecute the highest officials possible, who likely condoned subordinate activities thereby constituting the offense, but not necessarily.[165] In order to fairly prosecute those responsible, enforcement agencies will prosecute the executive or manager, rather than the employees who performed the violation.[166]

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[162] William A. Hancock, *Small Business Legal Advisor* (New York: McGraw-Hill Book Company, 1982), 233.

[163] Ibid., 234.

[164] Ibid.

[165] Ibid.

[166] Ibid.

Effects of OSHA Violations

The TMT of an organization has a fundamental duty to protect the employees from danger while they perform their job functions. A large portion of the OSH Act is dedicated to demanding that companies comply with safety standards and avoid on the job accidents. Despite all attempts made by safety laws, employers often refuse to abide by regulations, often resulting in an employee's death or serious injury.

The owner of a packaging manufacturing company, Lawrence Mardon, was indicted with reckless homicide and criminally convicted when an employee was killed in an explosion at his plant.[167] The indictment charged that Mardon "recklessly caused the death of Paul Bierly by failing to perceive the substantial and justifiable risk of explosion which constituted a gross deviation from the standard of care that a reasonable person would observe in the situation as it then existed."[168] Mardon was also ordered to pay $28,000 in civil penalties.[169]

Organizations may also be found guilty of criminal charges themselves. The United States Postal Service contracted with Hyman/Power, who then subcontracted with Pitt – Des Moines (PDM) to build a general mail facility.[170] PDM failed to abide by OSHA regulations while constructing the building. OSHA regulations mandate two bolts to hold steel beams in place, while the company was only using one, and continued to use

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[167]Greenebaum, Doll, and McDonald, PLLC. "Manufacturer Hit with KOSHA Fines, Possible Criminal Liability." *Kentucky Employment Law Letter* 10, no. 8 (2000).

[168]Ibid.

[169]Ibid.

[170]US v. Pitt-Des Moines, Inc., 168 F.3d 976 (1999).

only one after notice of noncompliance by Hyman/Power.[171] Several months later, the steel structure collapsed, resulting in the deaths of two ironworkers.[172] PDM was indicted and found guilty by a federal grand jury.[173] The court imposed a civil penalty on the company of $1 million.[174] However, the grand jury also held the company criminally liable.[175] Because an executive or manager was not found guilty, and the company was the entity serving the sentence, instead of imprisoning an executive, the company was sentenced to five years probation.[176]

OSHA and the Department of Justice sought to impute criminal and civil penalties to an owner of an Indiana company for OSHA safety violations. Roy Stoops, owner of C&S Erectors, Inc. owned a company in which Brian Smith, an employee fatally fell thirty-five feet while laying steel decking on a roof.[177] Stoops plead guilty to violating OSHA safety standards, and was imprisoned for four months.[178] The District Court also instituted a $6,000 civil penalty, and ordered probation for one year.[179]

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[171]Ibid.

[172]Ibid.

[173]"Subcontractor Loses Appeal of OSHA Criminal Violations Before 7TH Circuit," *White-Collar Crime Reporter* 13, no. 4 (1999): 18.

[174]Ibid.

[175]Ibid.

[176]Ibid.

[177]"Indiana Employer Sentenced to Prison for OSHA Violations," *Workers' Compensation Monitor* 12, no. 3 (1998).

[178]Ibid.

[179]Ibid.

OSHA requirements may be the most difficult regulations by which to abide. In this case, it is possible for a key organizational individual to be held liable for an occurrence in which the individual had no intention of harm, nor failed to correct any mistakes of which he was aware. An executive may be liable for employee's injuries while performing job duties, although he was unaware of any risks or potential threats to safety. OSHA has many requirements to reduce workplace injuries, increase safety, and provide a safe working environment. Executives and managers should minimally be aware that by failing to abide by OSHA regulations not only puts the employees at risk for injury, but also increases the executive and manager's risk for personal liability.

Section VI

Liability Protection

This thesis has been devoted to illuminating the extreme likelihood of personal accountability as an executive, manager, and sometimes as an employee of a company. Realizing the possibility, managers susceptible to personal liability risk have an option to seek protection through indemnification or insurance. I will provide a few methods available for protection against personal liability. However, this paper is not a comprehensive list of all offenses in which an executive, manager, or employee may find herself in legal predicaments. It is always best to refer to your attorney concerning the questionability of any activities.

Executives and managers should be aware of all intricacies relating to liability, to arm them with appropriate knowledge when searching for protection. First, liability refers to the damages and criminal penalties incurred after an unsuccessful defense against an action.[180] Accountability is the expectation placed on organizational management of conducting corporate affairs prudently.[181] The following is a list of consequences occurring when an action is filed against an executive or manager. The following list is organized in ascending order of importance and descending order of frequency:

1. The expenditure of time needed to consult with lawyers, to review documents, to prepare affidavits, to give testimony, and so on.
2. The expense of conducting a defense. Then, if the director is held liable –
3. The expense of paying the judgment for damages, if any.

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[180]J.M. Juran, and J. Keith Louden, *The Corporate Director* (New York: American Management Association, Inc., 1966), 299.

[181]Ibid.

4. The expense of paying for punitive damages, if any.
5. The criminal penalties involved, if any.[182]

Two protection methods are commonly used to indemnify corporate agents. A corporation may provide indemnification by reimbursing expenses to the executive. Executives and managers may also be indemnified by acquiring an insurance policy.[183] The purpose of the insurance is to provide more monetary assistance than indemnification if action is filed against an executive.

Indemnification Protection

Indemnification is a simple concept in which companies provide protection against personal liability for its executives and managers. Essentially, indemnification is provided to protect highly ranking corporate representatives financially against actions filed against them while performing the duties of the job. Experienced officers and directors with proven success records often forego offers to sit on corporate boards for apprehensions related to liability risks.[184] To compensate for these shortcomings, corporations can recruit attractive board members if they agree to minimize liability risks. Companies attempt to enhance the attractiveness of board positions by protecting board members from potential personal liability through indemnification. Robert Mueller, in his book, *The Director's and Officer's Guide to Advisory Boards* defines indemnification as "to save harmless or to secure against loss or damage that may occur in the future, or

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[182]Ibid.

[183]Ibid., 310.

[184]Robert K. Mueller, *The Director's and Officer's Guide to Advisory Boards* (New York: Quorum Books, 1990), 127.

to compensate for loss or damage already suffered."[185] He further explains the three categories in which indemnification falls:

1. Indemnification is a matter of right,
2. Indemnification is allowed,
3. Indemnification is prohibited because of public policy or specific situation, such as bankruptcy.[186]

Indemnification may be mandated by statutes in particular states, or if a corporation chooses to offer it, it may be stated in the charter or by-laws.[187] States' statutes concerning indemnification have been inconsistent; while some state's statutes provide for mandatory indemnification in certain circumstances, others only allow the executives and managers to have a right to indemnification if it is in the company's charter or bylaws.[188] Unlike insurance, in order to be indemnified by the corporation, the burden is placed on the executive to show that the questionable behavior benefited the corporation or the act was to protect some aspect of the corporation that was threatened.[189]

Insurance Protection

Companies provide insurance as part of pecuniary benefits to protect representatives risking personal liability from more serious problems, such as severe

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185Ibid.

186Ibid.

187Marc J. Lane, *Legal Handbook for Nonprofit Organizations* (New York: AMACOM, 1980), 93.

188Ibid

189Robert K Mueller, *Director's and Officer's Guide to Advisory Boards* (New York. Quorum Books, 1990), 127 injuries caused by mismanagement or poor decision making. An insurance policy provides more extensive protection. Insurance is especially important and may be more useful when the company is prohibited from indemnifying the executives, when the company chooses not to indemnify the executives or managers, or to reimburse the company if they choose to indemnify them.[190]

Insurance protection may not provide coverage for various situations specified in the contract. Many policies do not cover criminal penalties and the insured may be required to pay all penalties or damages without the help of the insurance, although the reason for seeking the policy was precisely to protect them from these situations.[191] This was the case with Daniel Gonzales, Vice President of SabreTech, Inc, an Orlando based company specializing in airline maintenance. SabreTech was the company responsible for maintaining ValuJet airplanes and ensuring their safety for flying.[192] Gonzales was not present when the oxygen tanks were mislabeled and loaded into the cargo area, which ultimately caused Flight 592 to crash.[193] However, Gonzales was charged with 110 counts of manslaughter, unlawful transportation of hazardous waste, conspiracy, and falsifying records, although he was not present, due to his position with the company.[194] If Gonzales was convicted, he also faced imprisonment for up to 55 years and $2.7

[190]Steven J. Gladstone, "Due Diligence Wards Off D&O Disaster," *Business Insurance* 34 (2000): 13.

[191]Ibid.

[192]Ibid.

[193]Ibid.

[194]Ibid.

million in fines.[195] Luckily for Gonzales, he was acquitted by a jury, but SabreTech was found guilty of the criminal charges, ultimately resulting in the company's collapse.[196]

What to Look for in a Policy

Gonzales' case immediately spelled out the loopholes in insurance coverage, where a executives and managers may find that they were not as well protected as they once thought. The case of Gonzales led executives and managers to be more cautious about the protections enumerated in their policy and the understanding of the nomenclature of these agreements. The following are a brief, but not exclusive, description and explanation of clauses that executives should understand and make sure are included in their policies.

Definition of "Claim"

Minimally, the insurance policy needs to define what constitutes a claim.[197] Insureds should know exactly for which situations they have coverage. It is beneficial for employees exposed to personal liability risk if criminal proceedings are also included under the claims clause. Some insurance policies allow formal investigations to be considered a claim, apart from an official lawsuit.[198] The insurance policy may define

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[195]Ibid.

[196]Ibid.

[197]Ibid.

[198]Ibid.

"claim" in extremely broad terms, which may exclude coverage for criminal proceedings, or limit other types of claims.[199] If the policy fails to define "claim," it will ultimately be left to the courts, which may or may not interpret the policy in favor of the accused.[200] Insureds need to fully understand the extent of coverage and what constitutes a claim before binding themselves to the contract.

Pollution Exclusion

Executive insurance policies commonly exclude claims in which the insured was charged with pollution offenses.[201] The exclusion clause usually includes prefatory language to exclude pollution from coverage, such as "arising from," "based upon," or "directly or indirectly resulting from."[202] Other policies use "for" language, which is a narrower approach to only exclude those claims for pollution.[203] Coverage may still exist for pollution of particular substances, such as natural gas and asbestos.[204]

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[199]Ibid.

[200]Ibid.

[201]Stacey Kalberman, "Director and Officer Liability: An Overview of Corporate and Insurance Indemnification," *Securities Litigation & Regulation Reporter* 7, no. 4 (2001): 17.

[202]Steven J. Gladstone, "Due Diligence Wards Off D&O Disaster," *Business Insurance* 34 (2000): 13.

[203]Ibid.

[204]"Pollution Exclusion Precludes Coverage for Release of Asbestos," *Insurance Coverage Litigation Reporter* 11, no. 43 (2001): 967,

Dishonesty Exclusion

Policies often exclude claims involving dishonesty, or claims arising from executive or manager fraudulent or criminal activity, and any expenses paid in advance on behalf of the accused must be reimbursed to the corporation.[205] However, policies may also exclude claims in which a mere allegation of dishonesty is made, regardless of actual proven dishonesty or evidence of the allegation.[206] The exclusion provision prohibits coverage for any losses in which an executive or manager contributed to the dishonesty or fraudulent activity.[207] Under a clause of this type, the insured will immediately lose any coverage if any allegations of dishonesty are made.[208] Other claims only exclude those in which a judgment establishing that dishonesty, or fraudulent or criminal activity did occur.[209] The latter claims are more beneficial for executives because protection continues despite probable false allegations.

Insured v. Insured Exclusion

Certain types of clauses are in place to prevent an insured from filing action against another insured under the same policy, and perhaps, of the same company.[210]

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[205]Stacey Kalberman, "Director and Officer Liability: An Overview of Corporate and Insurance Indemnification," Securities Litigation & Regulation Reporter 7, no. 4 (2001): 17.

[206] Steven J. Gladstone, "Due Diligence Wards Off D&O Disaster," *Business Insurance* 34 (2000): 13.

[207]Ibid.

[208]Ibid.

[209]Ibid.

Insurance companies enforce these clauses to prevent the covered individuals from taking advantage of insurance policy proceeds.[211] Otherwise, the insurance policies may be viewed as a savings account to draw from when the company needs cash.[212] The drawback to this exclusion is when a bankruptcy trustee or conservator makes a claim against insureds for legitimate purposes.[213] A consensus among courts concerning the fairness of this type of clause does not exist.[214] Insurance companies recently began adding language covering action against executives and managers filed by bankruptcy trustees and conservators.[215]

Imputation Wording

It is possible that a plaintiff files a lawsuit against more than one executive or manager for the same injury. In this case, defendants will prefer to keep their pleas independent of the other defendant's plea, to ensure each individual is treated fairly and justly. Simply because one defendant pleads guilty does not inherently proves the other's guilt. To compensate for these differences, insurance contracts may include wording to prevent another executive's guilty plea from voiding another executive or manager's insurance coverage, especially one that is wrongfully accused or innocent of the

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[210]Stacey Kalberman, "Director and Officer Liability: An Overview of Corporate and Insurance Indemnification," Securities Litigation & Regulation Reporter 7, no. 4 (2001): 17.
[211] Steven J. Gladstone, "Due Diligence Wards Off D&O Disaster," *Business Insurance* 34 (2000): 13.

[212]Ibid.

[213]Ibid.

[214]Ibid.

[215]Ibid.

allegations.[216] Those seeking insurance coverage should look for policies with language stating that the activities of one officer will not be imputed to another.

Although this is not an exhaustive list of preferred features of an executive and managerial protection policy, one should always thoroughly review and understand the terms and conditions of the policy before binding to the agreement. Any individual seeking indemnification insurance should consult legal counsel if the terms and conditions are unclear to avoid any further problems associated with executive coverage.

[216]Ibid.

Indemnification Example Case

Executives and managers are not always entitled to organizational indemnification. A case which demonstrates the limitation of entitlement to indemnification protection is *Baker v. Siegel,* in which a corporation refused to reimburse a CFO for litigation fees.[217] The Second Circuit was asked to clarify whether Health Management Systems (HMS), the company for which Phil Siegel served as CFO, is obligated to reimburse him for fees incurred during his defense in a case alleging securities fraud.[218] Phil Siegel was named in the suit alongside other officers and directors for making statements the shareholders believed were calculated to inflate the company's stock price while the company was experiencing financial difficulty.[219] The former CFO was named in the case despite his absence from the company during the alleged incident.[220] Cases of this nature are becoming more common as the contracts for insurance are becoming more specific to which offenses are covered.

Siegel hired his own representation when the shareholder suit was filed, in which he spent $67,000.[221] The company attempted to withhold expenses which would provide for his legal counsel through indemnification, arguing that the expenses incurred was needless and excessive because he hired an attorney from a prestigious New York law

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[217]"Indemnification: Baker v. Siegel," *Corporate Officers and Directors Liability Litigation Reporter* 16, no. 24 (2001): 3.

[218]Ibid.

[219]Ibid.

[220]Ibid.

[221]Ibid.

firm.[222] Siegel immediately filed suit in the Second Circuit against HMS to recover expenses for defending himself against accusations of securities fraud.[223] The court held for the company to indemnify Siegel for the costs of defending himself in the successful shareholder fraud suit, but did not award Siegel the additional $17,000 he was requesting for costs incurred to acquire judgment for indemnification.[224]

Executives and managers seeking protection from activities while performing the functions of their positions should be aware that the protection they may find through insurance or corporate indemnification is not guaranteed. It is equally important for them to primarily understand the contract into which they are entering, as well as understanding coverage, exemptions, and unwritten limitations. Opening the personal pocketbook when liability situations arise may not be optional. Although companies attempt to attract successful individuals by including personal liability protection, there is never a risk-free element to accepting these positions. The highly sought after position on the corporate ladder does not come without a price.

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[222]Ibid.

[223]Ibid.

[224]Ibid.

Conclusion

The purpose of this thesis is to warn executives and managers of the threats of personal liability they may encounter while performing duties within a professional capacity. The most general, but essential, tool these professionals have is awareness, which is key to avoiding liability. Increasing awareness will help understand the businesses needs, allow for careful implementation of governmental requirements within financial limitations, and, perhaps most importantly, minimizing personal liability.

The three conditions outlined in the prior sections were intended to increase awareness of the prevalence and likelihood of legal accountability for those affected by personal liability risk. This thesis stresses caution to those individuals to find appropriate protection and make all efforts to understand rights and entitlements. Perhaps more importantly, all employees should attempt to behave with as much integrity as possible to avoid questionability of liability.

Corporate employees at all levels should be aware of the three general conditions when they may find themselves liable. Executives, managers, and sometimes employees may equally risk personal liability in all three situations:

1. When the executive or manager commits an act known to be a crime,
2. When the executive or manager is aware of the violation, but takes no action to correct the offense,

3. When the executive or manager is unaware of the violation, and took no action to purposefully commit a crime, nor were they aware of failing to correct a violation.

This list includes situations in which a professional is acting on behalf of the organization. There is no guarantee of protection against a lawsuit being filed against any professional, nor is avoiding liability foolproof. It is crucial that the TMT not only takes responsibility for their actions and behaves with the utmost integrity, but also seeks protection from situations that may arise from repercussions of wrongdoings, however unintentional.

It is important for executives and managers to find as much protection as possible with their available resources. They should also be aware that it is not only their careers they risk losing. The least of their worries would be to lose professional integrity, and the worst situation possible is to lose their entire livelihood and freedom.

Although the controversy over the fairness of holding corporate heads responsible for their actions continues, it does not lessen the realities and possibilities of potential personal liability. This paper contained a small percentage of all the judicial interpretations concerning executive liability, and similarly contained a miniscule proportion of cases dealing with professional liability. The law is an ever changing entity continuously changing to find the correct balance of fairness and justice. The equal balance of fairness and justice appears to be a moving target for lawmakers, victims, and, even executives and managers.

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VITA

Katherine Lynn DeRossitt was born in Lawrence, Kansas, on August 6, 1977, daughter of Michael Joseph and Deborah Ann Mulvany. After graduating from Clear Lake High School in 1995, she began taking courses at local community colleges. She quickly exhausted the courses at these colleges, after which she began steps to complete a Bachelors of Arts from the University of Texas at Austin in December, 1999. Katherine entered the Graduate School of Southwest Texas State University in San Marcos, Texas in August of 2000 to earn a Master of Business Administration degree. During her work at SWT, she has been awarded the J.C. Kellam Memorial Scholarship for academic excellence, as well as inducted into Beta Gamma Sigma, the honor society for graduate business students.

Since graduation from University of Texas, Katherine has participated in several community service activities. Court Appointed Special Advocate program is a children's organization devoted to supporting the rights and interests of abused and neglected children, in which she spent time advocating for the best interests of abused and neglected children in a district court.

Katherine is an active member Capital City Toastmasters, one of the many clubs developed in Austin of Toastmasters International. This is an organization devoted to improving public speaking skills. She has been a member since August of 2001, and she is currently working toward her Competent Toastmaster (CTM) certification.

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