

When Corporate Officers Are Personally Liable

Being an officer of a corporation can be the heady experience of a lifetime. On the upside is the opportunity to be a strategic thinker, a lauded visionary, the captain of a profitable venture and the recipient of compensation beyond one's dreams.

But there is a downside, and it can be equally dramatic.

On a seemingly weekly basis, we see corporate officers handcuffed and police-escorted away, in full glare of the press. They are being charged with corruption and are the subjects of governmental investigations, shareholder lawsuits and the public's unquenchable thirst for payback. And they are receiving harsh sentences and lengthy jail terms. The fears of corporate officers over personal liability for their actions are well-founded.

Why Are Corporate Officers Being Sued Personally?

The courts have not yet provided a bright-line rule governing the personal liability of corporate officers. But there are a number of instances in which officers can be held liable for misconduct.

The courts have consistently held that intentional conduct by a corporate officer will result in personal liability (see *Frances T. v. Village Green Owners Association*).

Similarly, if a corporate officer "authorizes, directs or in some meaningful sense actively participates in the wrongful conduct," personal liability will attach even though the actions were taken by the corporation. In this situation, there is joint liability. Personal liability also enters the equation when a corporate officer engages in fraud.

In deciding liability, courts will consider if an officer's participation in the improper conduct

resulted from direct action or by knowingly consenting to or approving the unlawful acts. This explains the flurry of lawsuits by shareholders, third parties and the government against corporate officers involved in the Wall Street and banking fiascos leading to the financial meltdown over the last several years.

The long-standing explanation officers have relied upon to shield themselves from personal liability is that they acted on behalf of a corporation in performance of their duties. In its ruling in *Granoll v. Yackle*, the court declared that this excuse will not allow the officer to "escape the consequences of his individual wrongdoing."

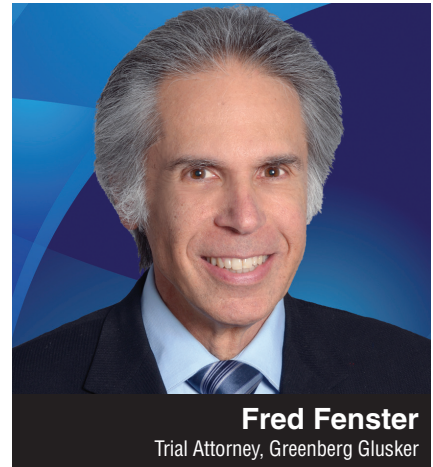
How does the oft-mentioned "business judgment rule" fare as a protective weapon? Not very well lately. A recent appellate ruling determined that California's "business judgment rule" does not insulate corporate officers from liability.

Steps for Officers to Prevent Personal Liability

Will all these recent cases portend the end of corporate officers as their fear of personal financial ruination widens? Probably not.

Courts are far less likely to impose personal liability on a corporate officer when the harm is the result of *negligence* rather than *intentional* conduct—and it is a rare case when corporate officers deliberately engage in conduct whose purpose is to cause damage. Here are a few measures for officers to follow to prevent personal exposure:

1. Ensure the corporation obtains appropriate and sufficient liability insurance coverage.
2. Include a provision in the corporation's bylaws requiring that the officers be indemnified against all losses caused by their negligent conduct.



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3. Tighten corporate governance to ensure that officers have full information regarding their subordinates' ongoing activities. This will lead to better decision-making, lessen the likelihood of mistakes being made and minimize the prospects that future losses will trigger litigation.

4. Establish comprehensive checks and balances within the corporate structure to minimize mistakes and put an end to intentional conduct that could place the corporation and its officers in the direct cross-hairs of a lawsuit.

In all likelihood, this assault on corporate officers can be expected to continue unabated as victims of corporate actions redouble their efforts to find additional sources of recovery for the damages they suffer as a consequence of corporate actions.

While this may result in fewer people agreeing to serve as corporate officers, there is an undeniable benefit to the public, an upside that everyone can enjoy. Those who do serve and follow the recommended procedures can take comfort that *their* actions, and those of the corporation, are above board and in full consonance with the law.

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