



By Kenneth G. Anspach
and Betty K. Goldberg
Anspach & Associates
Attorneys at Law
Chicago

When Corporate Directors and Professionals Are Held Liable as Individuals

American corporations are continuously held responsible for conduct that affects the environment. Federal, state and local laws and regulations require compliance to established environmental standards. Responsibility for these compliance requirements rests not only on the corporation as an entity but also on those individuals within the corporation who have decision-making authority and full knowledge of environmental issues and consequences.

Although, in general, an individual employed by a corporation is not liable when acting responsibly within her scope of authority, a director or officer, or one of the professional advisory staff, can become personally liable for the corporation's environmental conduct if certain statutory requirements are violated, or the individual has acted negligently outside the scope of her authority.

This article examines the nature of an individual's environmental liability within a corporation and the liability insurance specifically available to protect the individual in this situation.

Directors, Officers and Professional Consultants

Directors and officers can be held liable as individuals for a corporation's environmental conduct under several environmental statutes, such as CERCLA, RCRA, the Occupational Safety and Health Act, the Clean Water Act, the Federal Water Pollution Control Act, and the Toxic Substances Control Act. These statutes impose liability upon those persons who are in charge or who have the ultimate authority to control the operations of a corporation that have an impact on the environment.

One representative case interpreting this area was *Kelley ex rel. Michigan Natural Resources Commission vs. Arco*

Industries Corp., 723 F. Supp. 1214 (W.D. Mich. 1989). This case set forth a legal standard by which corporate directors and officers could be held personally liable under CERCLA.

Imposing personal liability on a corporate individual is a serious matter.

The court recognized that imposing personal liability on a corporate individual is a serious matter and such liability should be imposed only after careful scrutiny of

- an individual's authority to control the corporate practices at issue,
- the responsibility undertaken by the individual and the degree to which that responsibility was neglected, and
- whether the individual could have prevented or did prevent or significantly abate the environmental damage that is the basis of the claim.

Another group of individuals who are faced with personal liability are those professionals consulted by the corporation for its legal, financial, engineering and environmental concerns. As with the corporate directors and officers, the recommendations and decisions that affect environmental matters made by these professionals may expose them to personal liability.

Breach of duty, negligence and fraud are the typical theories under which an attorney can become liable. When an attorney is consulted about an environmental concern that could have potential economic consequences, failure to advise the corporation to act in a timely manner, or in a manner in keeping with

statutory requirements, can result in personal liability and unfavorable consequences.

An attorney's duties include a fiduciary duty not to act in her own interest to the detriment of the corporation. Negligence and fraud are measured against a professional standard of care that requires an attorney to possess the requisite knowledge and deal fairly in matters concerning her client.

Similar duties and standards of care apply also to accountants who prepare financial statements and disclosure documents. Courts have debated the extent to which an accountant can be held liable. One approach has been to hold the accountant responsible for all those persons she might reasonably foresee as relying upon her work product. The New Jersey and Wisconsin Supreme Courts have allowed actions against an accountant on this reasonable foreseeability principle in *H. Rosenblum, Inc. vs. Adler*, 93 N.J. 324, 461 A.2d 138 (1983), and *Citizens State Bank vs. Timm Schmidt & Co.*, 113 Wis.2d 376, 335 N.W.2d 361 (1983).

Because the foreseeability approach can open an accountant to virtually unlimited liability, a more popular approach has been to hold the professional liable to that group of persons to whom she intends to supply the information and for whose benefit she has prepared her work product.

The accountant has been held liable for negligent misrepresentation under this intended beneficiary approach in *Bily vs. Arthur Young & Co.*, 3 Cal.4th 370, 11 Cal. Rptr.2d 51, 834 P.2d 745 (1992). Thus, an accountant can be liable not only to the persons with whom she contracted but to those for whose benefit she has intended to supply the information and, in extreme cases, all persons who might rely upon her work product.

Engineering and laboratory contractors and consultants who regularly deal with hazardous substances also can be personally liable for environmental contamination resulting in failure to follow accepted scientific procedures in analyzing, monitoring and documenting environmental conditions. The economic repercussions of inadequate environmental analysis are enormous. Individuals entrusted with the environmental and financial auditing need to know for whose benefit these reports are being prepared and who will rely on the information.

In another aspect, the directors, officers and professionals may be liable under Rule 10b-5 of the Securities and Exchange Act of 1934, 17 C.F.R. Section 240.10b-5. The annual reports of many corporations are representations of a company's financial stability. Potential environmental liability that is not adequately stated in these reports can be misleading to the shareholders.

The repercussions of a misrepresented violation of environmental regulations and the ensuing cleanup and penalty costs could have a drastic effect on the value of the corporation's stock. Under such circumstances, shareholders could bring a class-action suit against the directors, officers and professionals of the corporation for misrepresentation.

Imposing personal liability on an officer or consultant of a corporation for the financial consequences of his decision or misrepresentation is a serious matter. The statutes and regulations that impose this liability recognize the crucial role that certain individuals have to influence a corporation's environmental conduct, thus making them responsible for their actions.

Professional Liability Insurance

The liability for violation of an environmental statute can come in the form of remedial or cleanup costs of an environmental contamination. The corporation and individual who approved or ordered the activity that led to the

contamination can be held jointly and severally liable. To protect against these types of losses that might be incurred, specialized individual liability insurance is available.

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Director's and officer's (D&O) liability insurance usually either covers the individual if found personally liable for a nonwillful breach of duty or indemnifies the corporation for any costs incurred as a consequence of the individual's conduct. As with other individual liability policies that will be discussed here, coverage for environmental claims has often been curtailed because of the "claims made" basis underlying these types of policies. The insurer is only required to pay those claims that arise during the policy's required reporting period. Yet environmental consequences are often not manifested until years after the decision-maker's conduct, and a claim may not be made until after the policy has terminated.

Another issue is the exclusionary clause that denies coverage for environmental damage that results in a violation of a statute, regulation or ordinance. One possible avenue of coverage, however, is a securities-fraud derivative action by shareholders.

If the corporation becomes liable for extensive remedial costs that threaten its financial viability and the value of its stock declines, the shareholders could bring a class-action suit against the directors and officers for breach of duty. This claim would not necessarily come under the exclusionary environmental clause, and coverage would be possible.

Individual liability insurance for attorneys is available for breach of

professional standard of care, or breach of a contract. An attorney is held to a standard of care that is often referred to as possessing the knowledge and skill ordinarily held by other attorneys in the specific field of practice.

If an attorney's recommendations are made without full competence in his field of expertise, or if he acts in conflict of his client's interest without full disclosure, he is liable to his client for the ensuing damages. Although the attorney's primary obligation is to his client, recent case law has allowed a third-party nonclient to recover on a breach-of-contract action in which the third party must show that he was an intended beneficiary of the attorney/client relationship.

Professional liability insurance for accountants is available for breach of contract or negligent performance of duty. The coverage could extend to beyond the client with whom the accountant contracted. Recovery is possible for claims from the third-party nonclient who relied on the ac-

countant's representation, especially if intentional misrepresentation or fraud was involved.

In *Bily vs. Arthur Young & Co.*, 11 Cal. Rptr.2d 73, 834 P.2d 767 (1992), the court recognized that in addition to contractual privity, an accountant can be liable for negligent misrepresentation to specifically intended beneficiaries of the report whom the accountant knows will benefit or rely on his work product. The court in *Bily* stated that the person injured by the report must prove that the contract was for his benefit.

There is also liability insurance available for the other professionals who are consulted by the corporation for its environmental concerns. All of these insurance policies cover claims for personal injury, property damage and any economic loss resulting from an

individual's negligent and nonwillful act while performing his professional services.

In Conclusion

Federal, state and local environmental laws and regulations have increased corporate responsibility and ensuing liability for violations that have an impact on the environment. Although a corporation is liable for its employees' actions, these new legal requirements also impose personal liability on those individuals who, because of their decision-making authority or professional knowledge and expertise, have great influence in the environmental conduct of the business entity.

Professional liability insurance policies are available to protect the director, officer, attorney, accountant or

other professional from nonwillful conduct that results in financial detriment to the corporation. Recovery under these policies is possible but only after careful analysis of the employee's responsibilities and the impact of his actions that led toward the environmental damage. ●ASI

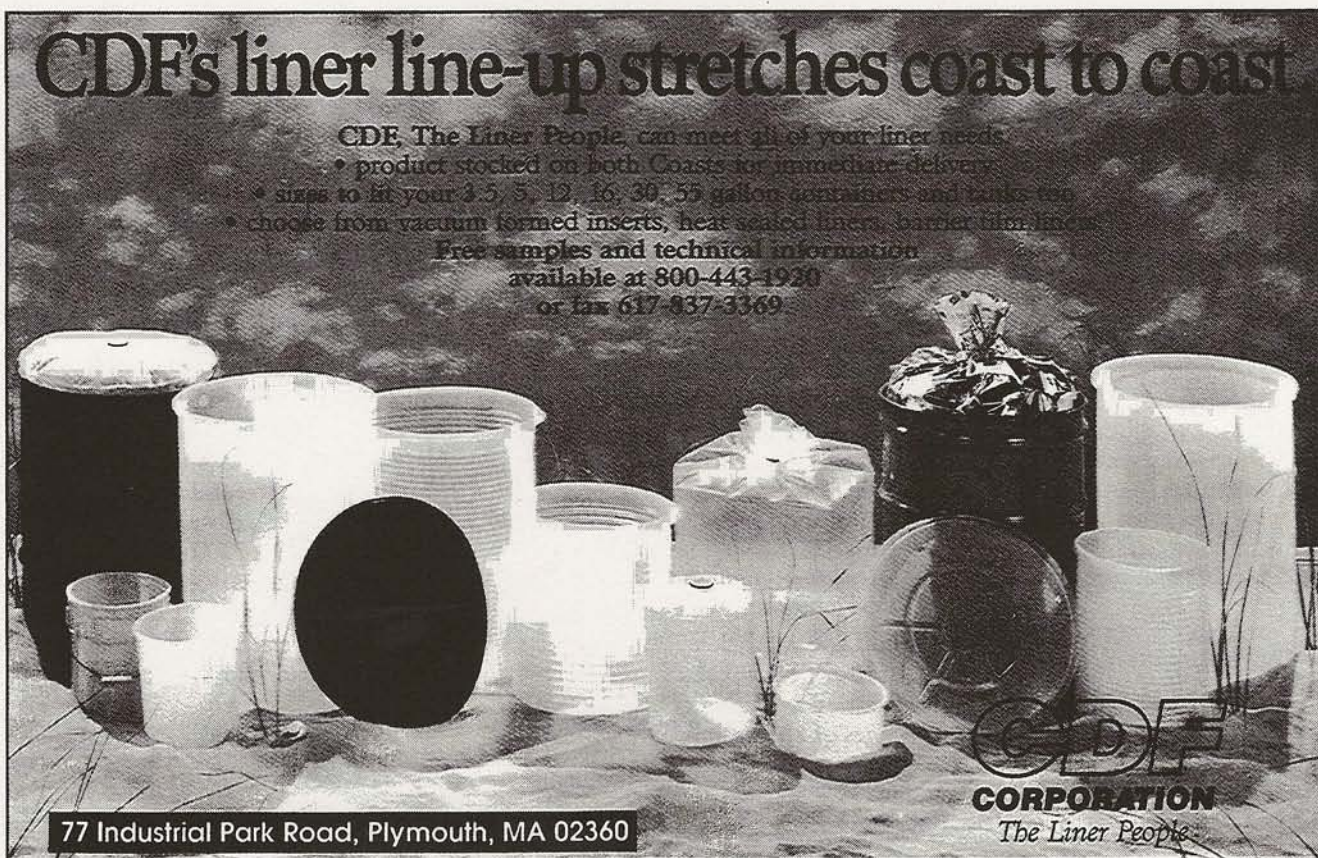
Kenneth G. Anspach is a Chicago attorney (Anspach & Associates, Suite 1435, 111 W. Washington St., Chicago, IL 60602; 312-407-7888) concentrating in environmental and commercial law and litigation. He represents banks, manufacturers, insurance companies and industrial-property owners. Mr. Anspach is a hearing officer for the Illinois Pollution Control Board and a former Illinois Assistant Attorney General in the Environmental Control Division. **Betty K. Goldberg** is a member of the Illinois bar and is a graduate of Chicago's Loyola University School of Law. This article is not to be interpreted as a substitute for an attorney's competent legal analysis and advice.

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