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OFFICERS AND DIRECTORS

Officers and Directors Face Personal Liability Under the Responsible Corporate Officer Doctrine

BY MARCO QUAZZO

A fertilizer plant explodes, damaging neighboring properties, and causing injury and death to bystanders. A manufacturing facility releases a toxic substance into the air causing harm to a nearby community. A vessel spills petroleum into a waterway.

Such incidents often are headline news. Corporations have to grapple with the legal consequences, especially when they find they have insufficient assets to survive setbacks. Often overlooked is the potential personal liability of corporate officers and directors for corporate misdeeds under the Responsible Corporate Officer (RCO) doctrine. This doctrine can impose personal liability even when an officer or director does not personally engage in any misconduct.

Holding officers and directors responsible for corporate *criminal* activity is not a new practice. In 1943, the U.S. Supreme Court applied the RCO doctrine to hold a pharmaceutical company's president criminally responsible for shipping misbranded drugs in violation of a federal statute, even though the corporate officer was unaware of the violation.[1]

Marco Quazzo is a partner at Barg Coffin Lewis & Trapp, LLP in San Francisco with more than 25 years of experience. He regularly advises corporate officers, directors and shareholders on issues of fiduciary duty and corporate governance. Quazzo can be reached at mquazzo@bcltlaw.com, or via the firm's website at http://www.bcltlaw.com.

In 1975, the U.S. Supreme Court applied the RCO doctrine to hold the CEO of a national grocery chain criminally responsible for storing food in conditions that violated federal law.[2] Corporate officers and directors have historically faced potential criminal liability for corporate violations of "public welfare" statutes.

A new trend in the law, however, is to hold officers and directors liable for corporate misdeeds in *civil* cases. For example, officers and directors can be held jointly responsible with the corporation for paying civil fines and penalties arising from environmental violations.

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In a California case, county environmental regulators imposed civil penalties of $2.5 million against a family-owned corporation for owning a leaking underground storage tank, in violation of California's Health and Safety Code sections 25280 *et seq*.[3] The California court applied the RCO doctrine to hold two corporate officers and directors personally liable for paying the civil penalties. The officers and directors were held liable without any evidence that they were aware of, or participated in, the corporate wrongdoing. What instead mattered under the RCO doctrine was that the underlying

[1] *United States v. Dotterweich*, 320 U.S. 277 (1943).
[2] *United States v. Park*, 421 U.S. 658 (1975).
[3] *People v. Roscoe*, 169 Cal.App.4th 829 (2008).

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statute constituted ''public welfare legislation and . . . imposed strict liability.'' [4]

Further, the court found that ''three essential elements'' were met: (1) the individual defendants were corporate managers capable of influencing its policies or activities; (2) a nexus existed between the individuals' corporate positions and the statutory violations in question; and (3) the individuals' actions or inactions facilitated the violations.[5] Courts in other jurisdictions, including the Supreme Courts in Indiana and Connecticut, have also applied the RCO doctrine in civil cases.[6]

The trend of holding officers and directors liable in civil cases under the RCO doctrine is problematic on several levels. First, private individuals are typically responsible legally only for their personal actions, not the actions of others. Under the RCO doctrine, however, corporate officers and directors are potentially liable for the misconduct of any corporate employees or agents, regardless of whether the officer/director participated in or knew of the misconduct.

Second, although courts currently apply the RCO doctrine most often in environmental cases, courts have or could apply the doctrine to violations of food and drug laws, securities laws, and even tax laws. If application of the RCO doctrine in the civil context expands beyond public welfare statutes, it will raise such questions as whether a corporation's chief financial officer should be personally liable for paying the corporation's taxes.

Third, the law encourages small business enterprises to adopt a corporate form in order to limit the personal liability of business owners, who often also serve as the enterprise's officers and directors. Owners may intend and believe that incorporation will protect them from personal liability, but the RCO doctrine creates a potentially broad exception to the general rule of limited liability.

Finally, it is difficult to insure against a corporate officer or director's potential personal liability under the RCO doctrine. Most director and officer liability policies have an exclusion for payment of fines or penalties. To promote responsible corporate governance, more and more corporations are now including independent directors on their boards, and empowering independent directors to act as a ''check and balance'' on management decision-making. Boards with independent directors typically act more quickly to replace management when appropriate. These positive trends in corporate governance are undermined by the RCO doctrine. In particular, the unavailability of D&O coverage for civil fines and penalties is a deterrent for qualified individuals to serve as independent directors or officers for corporations that have potential legacy liabilities.

Until and unless the courts in California and elsewhere rethink the wisdom of extending the RCO doctrine to civil cases, corporate officers and directors must heed the increased risks they face for personal liability. Directors and officers of all corporations, including those that are private and closely held, can reduce their potential personal liability by adopting strict policies for complying with government regulations, and by ensuring that senior officers promptly address any reported or potential violations. Corporations should also try to secure the broadest insurance coverage available for director and officer liability.

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[4] 169 Cal.App.4th at 835.

[5] *Id.* at 839.

[6] *See Commr., Ind. Dept. of Envtl. Mgmt. v. RLG, Inc.*, 755 N.E.2d 556 (Ind. 2001); *BEC Corp. v. Dept. of Envtl. Prot.*, 775 A.2d 928 (Conn. 2001).

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