



## **General Principles and Information Director and Officer Liability Info. Checklist**

### **I. General Standard:**

With some exceptions, the general legal standard of care for business actors and agents is “prudence.” In this context “prudence” means to act as an ordinary prudent person would act under the circumstances. But, this standard can be misleading because, at law, prudent people arguably do not make common mistakes, like combing their hair or changing the radio dial while driving, let alone sending texts. So, the prudent standard can be a relatively high standard in its application.

Officers and directors are commonly protected by the “Business Judgment Rule” which holds them harmless from liability as long as certain conditions are met. These are:

#### **A. Loyalty Standard:**

1. Acting for the benefit of the company,
  - (a) reasonable and
  - (b) good faith belief
2. loyalty; fiduciary standard,
  - (a) no self-dealing or conflict of interest;
  - (b) acting without self-interest in the transaction or
    - (i) the conflict of interest is disclosed and approved
    - (ii) not including the vote of the interested officer or director.

#### **B. Competence Standard:**

1. Due diligence (not negligent, i.e. not fail to act as a reasonably prudent officer or director would)
2. Sarbanes-Oxley – Certification of Financial Statements and criminal penalties for alteration or concealment of financial records, etc.
3. Disclosing company as the principal and self as the agent (undisclosed principal -> agent is principal and liable, e.g. business card and letterhead mistake)
4. Ultra Vires Acts: Acting beyond reasonable authority. Act subject to higher authority, e.g. Board of Directors approval?
  - (i) standard resolution procedure
5. Defective Contracts – fail to sign as officer -> possible personal liability
6. Pre-corporate acts – promoter liability.
7. Personal guarantee.

### **C. Misconduct Standard:**

1. Misappropriation: theft, conversion, improper use of company property including intellectual property
2. Self-Dealing - conflict of interest, e.g. breach of corporate opportunity doctrine (torts)
3. Crimes, against company or others, e.g. embezzlement, or fraud (personal liability for torts, like fraud, tortious interference with contracts or business expectancy)

### **D. Statutory Liability:**

1. Personal liability for unpaid 941 payroll taxes, sales taxes, etc.
2. Corp officer responsibility for compliance with OSHA, FDA, other standards. *US v. Park*, 421 U.S. 658 (1975) (President and CEO personally liable for failure to rid food warehouse of rats even though other, local employees in organization were more directly accountable and responsible for the problem.)

## **II. General information:**

This memo is intended to provide general information only and not legal advice on any particular legal issue, because, among other reasons, the change of one or two facts can change the outcome of the case. Also, in defending corporate officers or directors in Arizona, there is some present case law that would support a “gross negligence standard,” in which case officer or director liability could be more difficult to establish.

\*\*\*

**The Law Offices of Donald W. Hudspeth, P.C.**  
**Business Law & Commercial Litigation**  
[www.AZBUSLAW.com](http://www.AZBUSLAW.com) – [TheFirm@azbuslaw.com](mailto:TheFirm@azbuslaw.com)  
**“The Business of Our Firm is Business”**