

# When Things Go South: A Corporate Director's or Officer's Personal Liability to Third Parties for Corporate Misdeeds

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Generally, corporate officers and directors do not have a special relationship of trust (i.e., a fiduciary relationship) with third persons or creditors transacting business with the corporation. Moreover, unless they sign in an individual capacity, corporate officers and directors who negotiate and execute a contract on behalf of the corporation are not personally accountable on the contract, even if the corporation later defaults or otherwise breaches the contract. Likewise, corporate officers and directors will not be personally liable for the debts of the corporation, even if involved as an agent of the corporation in undertaking the debt.

## Personal Liability for Directing or Participating in Actionable Wrongs

One of the major exceptions to this general rule of no personal liability is if the officer or director knew of and committed (or directed) an actionable wrong, such as a tort or fraud, that directly damaged a third person or creditor.

Though simply holding a corporate office does not expose an officer or director to personal liability for corporate misdeeds, it also does not necessarily shield the officer or director. An individual is not protected from personal liability simply because an actionable wrong was committed within the scope and course of (or pertained to) the duties of employment.

A corporate officer or director may be held personally liable if he or she had actual knowledge (or should have known) of the actionable wrong and participated in the actionable wrong. In Missouri, even if the officer or director did not actively participate in the wrongful action, but knew of it and directed the action, he or she can be held personally liable.

An officer or director is generally not responsible to third persons for inattention, negligence, or other mismanagement of the corporation that may impact a third person or creditor. But, if the officer or director actively participated in malfeasance in the management of the corporation to the detriment of the third person or creditor, there may be personal liability.

## Common Claims Against Directors and Officers

For example, if an officer or director knew of (or should have known of) and participated in such acts that would constitute the following, he or she could be held personally liable for:

- defamation;
- conversion (i.e., stealing or misappropriating personal property that another person has the right of possession in);
- unfair competition;
- inducing the corporation to breach a contract (usually requires a personal benefit to the officer or director and bad faith); or
- fraud or misrepresentation.

Even if acting for a corporate purpose, every officer and director has an obligation to act with honesty and good faith when transacting business on behalf of the corporation. If an officer or director were to intentionally misrepresent a material fact when transacting business with a third party on behalf of the corporation, the officer or director can be held personally liable for fraud.

## Duty to Disclose Material Facts

Parties to a contract are generally under no duty to disclose every fact relating to the transaction or history of the company, but concealment of a fact material to the contract that there was a duty to disclose may be considered fraud.

There may, for example, be a duty to disclose information material to the transaction:

- when directly asked about the subject matter;
- when there is a partial disclosure regarding the subject matter;
- when one party has superior knowledge regarding the subject matter;
- when the knowledge regarding the subject matter is not equally available to both parties; or
- when one party expressly or by clear implication places a special trust in the other to disclose all facts regarding the subject matter.

Under Missouri law, when negotiating and executing a settlement agreement or release of liability there is a duty to fully disclose all material facts. Courts hold these contracts to a higher standard of disclosure.

An officer or director can be held personally liable for misrepresenting the financial health of the corporation when negotiating and executing a contract on behalf of the corporation if the financial health of the corporation is an important factor in the contract. Moreover, officers and directors are presumed to have accurate knowledge of the financial affairs of the corporation when making such statements, and thus, should not make inaccurate statements.

#### Concluding Thoughts

In light of a corporate director's or officer's potential liability to third parties, special care must be taken to be aware of applicable law and to stay within it. Generally speaking, acting with honesty and in good faith when transacting business on behalf of the corporation will help an officer or director avoid pitfalls, especially if something later goes south despite his or her best intentions and practices.