

Executive Acts Becoming Criminal Offenses

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Proposed and enacted legislation in the United States, England and elsewhere characterizes erstwhile corporate management activities as criminal acts, much to the surprise of many directors. These laws increase the importance of the criminal liability protection currently offered in some directors' and officers' liability insurance policies.

U.S. Legislation

U.S. Senate Bill 3014, introduced September 7, 2000 by Senator Arlen Specter, provides that any company employee who grossly deviates from a reasonable standard of care in selling, manufacturing, transferring or assembling a product which that employee knows is defective, is guilty and may be imprisoned if the defective product causes death or serious bodily injury.² The bill is a response to frustration in assigning liability for injuries and deaths connected with allegedly defective Bridgestone/Firestone tires.³

The penalty is imprisonment for up to 15 years in the event of death. Maximum imprisonment is reduced to five years if serious injury results, rather than death, and if the employee did not actually know the product was defective.

English Legislation

The United States is not alone in seeking greater corporate accountability using criminal laws. English law permits executives to be charged with manslaughter, and companies to be charged with corporate manslaughter. Three of six corporate manslaughter cases brought by 2001 resulted in convictions. The difficulty is that, in proving corporate manslaughter, the prosecutor must show that the controlling mind of the company, such as a chairman or some other executive manager, was to blame, which can be difficult.⁴

Revised legislation was proposed in England following fatalities resulting from the sinking of a ferry in the English Channel.⁵ The new bill provides that a company commits the offense of corporate manslaughter if death results from a management failure that falls below what can reasonably be expected. This is a departure from the requirement of proving the involvement of a controlling mind, discussed above. In addition, directors can be prosecuted individually under criminal law if they have substantially contributed to the entity's wrongdoing.

The legislation provides that boards must designate one person who will go to jail on behalf of the company if corporate infractions occur. To ensure designation occurs, the legislation also provides that, if the boards fail select someone, then the entire board may be ordered to go to jail instead. The notion of designation and the proposed legislation has evoked considerable discussion, and has not yet been passed.

Spreading Criminalization

Criminalization of management activities is not unique to product liability. Examples of other laws exposing company executives to criminal penalties include:

- In Venezuela, the Law on Violence Against Women and Family makes sexual harassment a crime and imposes penalties of a prison term from three months to 12 months, and payments to the victim in an amount equal to double the economic damage caused by sexual harassment impacting access to positions, promotions or job performance⁶;
- In Japan, the receipt of benefits due to one's position can result in fines and a maximum of three years' imprisonment⁷;
- In France, statutes deem criminal the failure to call annual company meetings as required, or inadvertently leading a company into bankruptcy⁸;
- In Italy, failure to pay taxes may be deemed criminal⁹;
- In Germany, failure to file tax returns or financial statements, and failure to comply with social security laws may be deemed criminal¹⁰.

Insurance Protection

D&O policies should be carefully reviewed to assess the availability of coverage for ostensibly criminal acts. At a minimum, three areas must be examined:

- ✓ *Insured Persons Definition:* The proposed U.S. legislation applies to "employees". This would include both officers and inside directors, since they are actual employees of the company. Insureds should review the definition of insured persons to be sure that it covers both officers and directors.
- ✓ *Claim Definition:* Proceedings under the new laws are criminal in nature, not civil. Insurance buyers should review the claim definition to ensure that it includes criminal proceedings. Indeed, some directors' and officers' liability policies include criminal proceedings in the definition of claim.
- ✓ *Exclusions:* Buyers must assess the applicability of all exclusions. Some older directors' and officers' liability policy forms exclude criminal acts. This is clearly problematic. Other exclusions may be at issue as well. For example, essentially all directors' and officers' liability policies exclude bodily injury claims, intending those to be covered under a traditional general liability policy. To accomplish this, some directors' and officers' liability policies exclude claims 'for' bodily injury. However, other directors' and officers' liability policies go even farther, excluding all claims 'based upon, arising from, in consequence of, or in any way related to' the bodily injury. Under this construction, the criminal action by the government may be excluded from the directors' and officers' policy because it 'relates' to the bodily injury, but may not be covered under the general liability policy, because the government did not suffer a bodily injury and is not suing 'for' bodily injury. Indeed, it is suing 'for mismanagement – which mismanagement caused the bodily injury. Hence, it is critical that insurance buyers assess which exclusions they are buying.

Summary

Directors and officers must be mindful of the increasing number of criminal statutes applicable to their activities, wherever they and their organization are doing business. Furthermore, they must review their directors' and officers' liability insurance policies to determine the extent of protection afforded by the coverage purchased.

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² Senate Bill 3014, 106th Congress, 2nd Session:

SECTION 1. DEFINITIONS.

Any company employee who manufactures, assembles, sells, produces or transfers a product containing a flaw in the design, manufacture, assembly or instruction which makes the product dangerous to human life beyond the reasonable risk associated with similar products lacking such flaws.

- (a) A "defective" product is one with a flaw in design, manufacture, assembly, or instruction which renders the product dangerous to human life and limb beyond the reasonable and accepted risk associated with such or similar products lacking such a flaw.
- (b) To "introduce" a product into the stream of interstate commerce is to manufacture, assemble, import, sell, or otherwise produce or transfer the product in question.
- (c) "Person" means the employees of any corporation, company, association, firm, partnership, or other business entity.
- (d) "Serious bodily injury" means bodily injury which involves--
 - (1) a substantial risk of death;
 - (2) extreme physical pain; or
 - (3) Protected or impairment of the function of a bodily member, organ, or mental faculty.

SEC. 2. ENACTMENTS.

- (a) A person who in gross deviation from a reasonable standard of care introduces into interstate commerce a product known by that person to be defective which causes the death of any individual shall be guilty of murder in the second degree and shall be imprisoned for a term of up to fifteen years.
- (b) A person who in gross deviation from a reasonable standard of care introduces into interstate commerce a defective product which causes serious bodily injury to any individual shall be imprisoned for a term of up to 5 years.

³ National Underwriter, September 18, 2000, *Criminal Penalties Proposed for Product Liability Violations*, by Steven Brostoff.

⁴ Business Insurance, January 1, 2001, *For the Record* column at p.23; Aberdeen Evening Express, September 26, 2000.

⁵ Financial Times (London), December 19, 1999; The Herald (Glasgow), December 19, 1998, by Anne Simpson; Tort & Ins. L.J. 435; Business Insurance October 27, 1997, *Corporate Killing Idea Opposed*, by Carolyn Aldred; Insurance Day, January 23, 2001, *Corporate Manslaughter and Corporate Killing: a Directors' Nightmare?*, by Charles Boorman.

⁶ National Underwriter, Property & Casualty/Risk & Benefits Management Edition, September 11, 2000, pg. 34, *Harassment, Discrimination Laws Go Global*, by Gerald L. Maatman, Baker & McKenzie.

⁷ AP Worldstream, December 10, 2000, *International News*; Deutsche Presse-Agentor, November 9, 1999; Asahi News Service, July 28, 1992.

⁸ Corporate Officers' and Directors' Liability Reporter, November 22, 1999, *Protecting Your Decision-Makers Abroad*, by Donna Ferrara.

⁹ Id.

¹⁰ Id.