Liability
Where Does It Come From
And Where Does It End?

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Abstract

The law measures and appoints responsibility for the harm we do in our private affairs and in our business dealings. Liability - the risk of meeting legal responsibility - is the very substance of the "legal landscape" through which we all must travel as businesspeople and members of a society ruled by law. The law identifies the sources of liability in our contractual and personal relationships, and in our intentional and negligent misconduct. We may assume liability voluntarily, or have it unknowingly imposed by law. In each instance, methods for avoiding, minimizing and shifting liability are available; each has costs and benefits, downside and upside risks. This paper proposes to map the sources and limits of legal liability and offer helpful tips for controlling risk. On the legal landscape, liability cannot always be avoided, but it can be managed, and it helps if you see it coming.

Introduction

Liability (by definition) is legal responsibility, the counterpart to legal right. At least as far back as the Declaration of Independence, our society has evidenced more concern with rights than with responsibilities, and we fought the Revolution when our “petitions for redress” fell on British ears “deaf to the Voice of Justice”. Nowadays, arguably, whether the viewpoint stems from historical roots or not, most people understand their rights better than they do their responsibilities, and only consider their responsibilities when the “rights” of others are pressed upon them. Our bad experience with the rule of King George is emblematic; we can agree that private conscience is an unreliable safeguard to put right a wrong or to obtain payment for a wrong that has been done. In America today, our legal system ensures that each citizen has a judicial avenue to petition for redress, while legal responsibility, or liability, is now the very heart of the law in this country ruled by law.

In the following survey of the sources and limits of legal liability, this talk does not concern private morality, moral obligation, and duty, an altogether more interesting topic which delves deep into religion and philosophy. As the Catholic Encyclopedia states, "Duty and right are two concentric circles. The inner one, duty, embraces all that is to be observed under penalty of failing to live rationally." Our topic, liability, is but a pale shadow of the richer and more mature concept of duty; however, the aforementioned "Voice of Justice" speaks through the collective as well as through the conscience, and we can each of us profit by learning more about liability in the law.

Survey of The Sources of Liability - Contract, Tort and Relationships

Contract Liabilities We Assume by Agreement

A contract, in its true sense, means an agreement enforceable by law, whether written or not, to do something, or not to do something. In this context, "enforceable by law" means that the coercive power of the state can be brought to bear so as to force the contracting parties to live up to their bargain.

Every businessperson will appreciate the concept of contractual liability as something one brings on oneself. In the absence of agreement, a volitional act, there can be no contractual liability. We volunteer for contractual liability, and in this sense the illness suggests its own cure. Mixing metaphors, I would argue that the best way to avoid contractual liability is coincidentally the best way to avoid a punch: don't be where the punch lands. For most of you who work for companies, this will mean avoiding personal liability by always observing corporate formalities, and scrupulously avoiding the impression that you are dealing with anyone in business other than as the agent for a fully disclosed principal. You will remember to sign your name on all documents as John Doe, Vice President, for ABC Company, or as ABC Company by John Doe, V.P. That way, when the lawsuit comes, you are not a proper party to the case, and under the law of agency you avoid liability for breach of contract because you were never a contracting party. First and foremost, avoid contractual liability by avoiding the contract personally.

As a representative, you may want to avoid involving your principal in contracts which extend for long periods of time, since damages in the event of breach will be correspondingly higher, and refuse "evergreen clauses" which automatically extend your contracts in the absence of written withdrawal notice. You may want to provide for withdrawal from the contract on shortened notice at intervals, with "good cause" broadly defined. In other instances, you may be able to negotiate breaking down big contracts into related smaller contracts of limited scope. Since contracts are a means of allocating business risk, it merits serious consideration to raise as little risk as possible on either side. As a practical example, should you be asked to propose terms for a five-year multi-facility maintenance contract, consider a one-year counterproposal, renewable by either side on written notice on stated terms through the fifth year, or separate contracts for each facility with trap doors for quitting on sufficient notice. Since nobody can read the future, prudence sometimes dictates that you avoid the potential

for catastrophic liability inherent in larger contracts.

The Contract Giveth and the Contract Taketh Away

The second best way to avoid contractual liability is to use the contract itself to circumscribe your duties. You can't avoid every type of obligation; such a contract would lack the consideration which evidences a bargained-for exchange of value, and would likely be held by the courts as "illusory" and non-binding.

Still, there is a wealth of contract language out there to limit your liability, many of which were described in last year's speech on "Contract Terms to Watch for and Avoid". When provisions such as waivers, releases or exculpatory clauses are inserted in a contract by the other side, they pose traps for you, but they can greatly improve your own position when you state them in your favor. In addition to contract language which releases you from liability, you can set up an agreement to have the other side indemnify you in the event someone outside the contract sues you on a related matter. You can select the court or location in which disputes will be resolved, and the law which will be applied. You can have the other party waive its right to a jury trial, pre-define damages at a stated rate in your favor as "liquidated damages," select arbitration or some other means of alternative dispute resolution instead of trial, and even shift the risk of insolvency from the person paying you to the person you'll be paying. There are many more time-honored contract clauses your lawyer can suggest, so don't overlook the contract itself as your best way to limit liability you otherwise assume elsewhere in the agreement.

A Word About Insurance

Liability in this field of law can be stated as the superposition of contract outcomes, one of which is realized loss. In order to manage the risk of loss, we traditionally seek to shift and/or to share it through insurance in all of its many forms. An economic loss falls in three directions without insurance: upon the individual suffering the loss; upon the individual causing the loss by his negligence or unlawful conduct; or lastly, upon a particular party who has been allocated the burden by the legislature, such as an employer under a workers' compensation statute.

In any contract whereby you have liability to third persons for the activities of your contracting counterpart, such as where your remodeling contractor sends his workmen onto the roof of your decrepit barn, you do well to insist that the other party carry sufficient insurance against mishaps. Where you have direct liability to another party to the contract, you may shift liability by purchasing errors and omissions insurance, or professional malpractice liability insurance as applicable. This principle applies in reverse, and you may choose to insist upon such coverage as a precondition to contracting with insurable parties, only. Where the law makes you liable regardless of your direct actions, insurance may be your only practical option as a shelter against

legislated risk.

Insurance Is Not the Only Security Out There

In considering the liability of others to you, you must consider the risk that the other guy may not be able to make good on a loss you incur as a legal result of his or his agents' breach, misconduct or mishap. Certainly insurance is your first line of defense, wherever available, since it provides the backup of deep pockets, but the risk of unsatisfied liability can also be lessened with the contractual requirement of other security, such as personal and other third-party guarantees, surety bonds, posted collateral (real and personal), judgment notes, powers of attorney, penalty clauses, and more exotic legal devices to secure the contract performance of the obligee.

Hadley vs. Baxendale - The Limit of Contractual Liability

One hundred and fifty years ago, the English case of Hadley v. Baxendale, 9 Exch. 341, 354-355 (1854), framed the rules for contractual liability in countries across the world from the United States of America to Japan. In that case, the British Court of Exchequer stated:

> "Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally, i.e., according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it. Now, if the special circumstances under which the contract was actually made were communicated by the plaintiffs to the defendants, and thus known to both parties, the damages resulting from the breach of such a contract, which they would reasonably contemplate, would be the amount of injury which would ordinarily follow from a breach of contract under these special circumstances so known and communicated."

Hadley, 9 Exch. at 344. In other words, the decision in Hadley vs. Baxendale differentiated contract damages from other kinds of damages, and limited them generally to those kinds of harm which were reasonably foreseeable by the contracting parties at the time they made their deal. Special damages for loss which arises on account of unusual circumstances affecting the plaintiff are not recoverable unless the defendant was on notice of those special damages at the time of contracting. This important limitation differentiates breach of contract from other kinds of cases, where damages are unlimited so long as they were "proximately" caused by the complained-of misconduct.

To illustrate the rule of Hadley vs. Baxendale, imagine you hired a taxicab to drive you

across town. Should the taxicab break down, you might reasonably sue the driver and collect for the price of the bus ticket you bought to take you the rest of the way. If as a result of the breakdown you missed your own wedding, you could not sue for the related wasted expenditures. Such damages would not be reasonably within what you and the driver had in mind at the time you hired him, unless you laid it all out specifically and told him about your wedding, how necessary it was that you get there, and that you would be looking to him to pay for the wedding if he failed to perform.

Contractual Liability in Evolving Forms of Association

Sometimes contractual liability proceeds onward from the transaction on a continuing basis. In this regard we speak of contractual "relationships" to refer to the whole of the sometimes complex courses of association which may comprise one or many contracts. Such a relationship may grow to signify far more than the original accord, as is the case with a marriage. Most states (still) define marriage as a civil contract between a man and woman to become husband and wife. Even as the law continues to evolve and new forms of association are created, including "domestic partnerships" and "civil unions" for same-sex couples, the new forms remain recognizable as contractual relationships. So, while principles of family law may inform these developing roles, the core liabilities of the members to one another and to the public will be founded upon and initially limited by the contractual principles described here.

Tort Liabilities We Assume by Our Conduct

Unlike the contract liability we voluntarily assume, we take on liability for misconduct willingly or not. When behavior falls short of what society requires, and results in injury or harm, the law recognizes the basis for a tort claim by the injured party. While some torts are also crimes punishable by fine or imprisonment, the primary aim of tort law is to provide relief for the damages incurred. Torts fall into three general categories: (1) negligent torts (such as causing an accident by failing to obey traffic rules); (2) intentional torts (such as intentionally hitting a person); and (3) strict liability torts (such as liability for making and selling defective products).

Back to the Example:

Returning to our broken down taxi, if that same driver then locked the back doors and refused to let you out of the cab, thus committing the tort of false or wrongful imprisonment, you could properly sue to recover the cost of the entire wedding. Tort liability is unlimited so long as the misconduct was the legal cause of the harm alleged. Outside of contract, the foreseeability rule of Hadley vs. Baxendale does not apply.

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Although we opened the topic of insurance in the context of contractual relationships, insurance is more often used to protect against legal liability for unintentional harm to others. Before liability can be found, however, the essential elements for negligence - duty, breach, proximate cause, and resulting damages - must be proved. And, as with any question related to insurance, the terms of the policy control, and issues relating to the date of loss, scope of the harm, causation, and dozens of other issues based on policy provisions and exclusions may be raised by the carrier to avoid or limit coverage.

Negligence is generally considered to be the failure to do something which an "ordinarily reasonable and prudent man" would do under similar circumstances; conversely, it is the act of doing something which a reasonable and prudent man would not do. The standard used to determine negligence then, is the behavior of an "ordinarily reasonable and prudent man," or as my college insurance and risk management teacher introduced him, “Orpman.”

As a simple rule of thumb in guarding against liability for negligent misconduct, consider first and always, “what would an ordinarily reasonable and prudent person do in this circumstance?” Then, do exactly that. Ninety-nine times out of one hundred, this will keep you clear of trouble, since in court, it is this hypothetical "reasonable man" against whom your actions will be measured. When it comes time to determine if you have acted in agreement with this standard, if the jury can decide that your behavior does not measure up to that action expected of a reasonable man under similar circumstances, you will almost certainly be held liable.

Be comforted, though, that negligence is further gauged by one's ability to anticipate danger. Thus, the foreseeability of danger is an important factor in determining liability. Again, we turn to Orpman for the standard, and find that if an unintentional injury is the result of a danger which could be foreseen by an ordinarily reasonable and prudent man, and thus avoided, the defendant who failed to see the danger or failed to act may be held liable for damages resulting from his negligence. When a jury decides that an injury could neither have been foreseen nor prevented by reasonable precautions, the defendant will not be held liable, since unavoidable accidents do not form the basis for legal action.
Remember, liability is not pinned to a personal standard, but to the standard set by the entirely hypothetical Orpman. Even where you have taken careful consideration and precautions in conformity with your own best judgment, you can still be held liable for negligence if the jury finds that your judgment fell short of what Orpman would have done under similar circumstances. In such a case you may still be held liable for resulting harm.

Intentional Misconduct

Examples of intentional torts include assault, battery, intentional infliction of emotional distress, trespass, spoliation of evidence, and an ever-expanding host of “business

torts" starting with unfair competition and interference with contract. Although, as a general rule, you cannot buy insurance against liability for your own intentional misconduct, you may in certain circumstances find coverage under parts of your policy which the courts have interpreted broadly. A good example is the recognized coverage under the "advertising injury" section of a business owner's policy for slander by the insured.

While you may more readily be able to buy insurance against loss or liability caused by the intentional misconduct of others, it pays to read the fine print in your policy. I heard the story from a landlord the other day, about how his soon-to-be-evicted "tenants from hell" stripped the sheetrock from his rental unit to steal the copper pipes in the wall, and tore out the windows to sell the aluminum for scrap. In such a case his resulting loss was altogether uninsured, even though had the property been vandalized by strangers, the damage would have been covered.

Strict Liability in Tort

Under the legal theory of strict liability, if the defendant engages in an abnormally hazardous activity, then he will be absolutely liable for any harm he causes as a result of his participation, regardless of how careful he was. For instance, a lion tamer may be liable for any harm caused by the accidental escape of his lion. Even if he were as careful as possible and took all reasonable precautions, locking the cage and double locking it, the defendant lion tamer will still be liable for any damages or injury caused by the escaped lion. A lion is an extreme example, but the principle also holds for any domesticated pet known by its owner to be dangerous. Even if the owner takes all reasonable precautions to ensure that the dog will not bite, if it does, then the owner, even if she is not negligent because she was careful, is nevertheless liable for any injury caused.

Products liability is also generally considered a strict liability offense. When a manufacturer, assembler, wholesaler, or retailer places a defective or unreasonably dangerous product in the marketplace and that product causes an injury, that defendant may be strictly liable for such injury when it is shown that the product is defective. It is irrelevant whether the manufacturer or supplier exercised great care; if there is a defect in the product that causes harm, he or she will be liable for it.

Liabilities We Assume by Our Relationships

Our relationships give rise to legal responsibility of two kinds: (1) liability within the relationship and (2) liability to those outside the relationship for the acts of another within it, also known as vicarious liability.

Family Law

Any discussion of personal liability deriving from family law must come with a warning,

that the laws regarding marriage, parenthood, separation, or divorce change and vary from one state to another, so that blanket answers must be very general, and in a particular jurisdiction may not apply.

Parental Liability To and For Children

Solely by virtue of the parent-child relationship, both parents, married or not, are legally responsible for the support of their children until they reach the age of majority (usually eighteen), marry, or leave home to support themselves. At minimum, this means food, shelter, clothing, medical care and education. In some states, divorced parents may be obliged to pay for a child's college education or trade school. In addition, a parent's duty to support a disabled child might continue for the child's entire life. If a father refuses to support his child, a court may garnish his wages, seize his property or bank accounts, revoke his driver's license or professional license, and perhaps even send him to jail.

As with same-sex unions discussed above, the law is also evolving with respect to the liability of stepparents to support their stepchildren. Originally, under the common law, the relationship of stepparent and stepchild did not impose any obligation of support, and a stepparent had no duty to financially support a stepchild during the marriage to the child's natural parent merely by reason of the marriage. In modern times, a stepparent can become liable for the support of a stepchild during the marriage where (1) the stepparent undertakes to act “in loco parentis” to the child, meaning the stepparent has been treated as a parent by the child and has formed a meaningful parental relationship with the child for a substantial period of time, or (2) there is a statute imposing such a duty, which twenty (20) states now have.

According to the National Education Association, various types of legislation mandating a minimum level of parental responsibility have been a part of this nation's history since its inception. The objective of these laws is to impose affirmative duties on parents to provide necessities for the youth in their custody and to ensure they do not abuse or abandon their children. Other related efforts to establish a minimum standard of parenting include compulsory school attendance laws and criminal nonsupport laws.

In the last several years, growing concern about juvenile crime and the state of America's families has prompted nearly every state to enact a new type of parental responsibility laws, making parents in some form ultimately liable for the delinquent acts of their children. These laws hold that a custodial parent has a duty to properly supervise his or her child, and the breach of this societal duty gives rise to tort liability for damages caused by the delinquent unsupervised youth. Tort law varies from state to state regarding the monetary thresholds on damages collected, the age limit of the child, and the inclusion of personal injury in the tort claim against the accountable parents.

Spousal Liability

Depending upon state law but in general, as soon as you marry, you are legally responsible for financially supporting your husband or wife, if that support is needed.

(Support might be needed for any number of reasons - because one of you stayed home to look after the children, for example). One spouse may bring a lawsuit against the other spouse for his or her failure to provide support, and obtain an order by the court to the other spouse to pay support. In addition, if a charitable institution such as a hospital furnishes support to a spouse, the provider may seek a court order to obtain reimbursement for support furnished, continuing support and for attorney fees incurred in the action.

Some states and provinces extend this liability to unmarried couples in common-law relationships (opposite- or same-sex), in which the partners have the same legal responsibility to support the other spouse, but it takes effect at a different time, after the partners have been living together for at least the specified number of years. If the partners decide to separate before they have been living together for the specified number of years, they have no further liability to one another, but if they live together more than the requisite period, however, then they are legally responsible for financially supporting their former spouse, if that support is needed.

The answer to whether a husband or wife is responsible for debts incurred by the other depends on where they live and the reason for which the debt was incurred. In most states, neither spouse is responsible for debts the other spouse brought into the marriage, but in community property states, a spouse may, under special circumstances, become liable for the other spouse's premarital debts. Ten states - Alaska, Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin, as well as Puerto Rico - use the community property system, which holds that husband and wife share equally the income earned and property acquired during a marriage, and may likewise be responsible for debts incurred by the other. In any state, if both husband and wife have co-signed for the debt, both will be liable for paying it. Some states recognize a “family expense obligation” by common law or by statute, and hold a wife or husband liable for bills incurred for the benefit of the family, even if the other spouse did not approve the expense beforehand. The family expense obligation is limited as the name implies, and with the possible exception of community property states, unless a spouse co-signs, he or she normally will not be liable for business debts incurred by the other spouse.

Vicarious Liability in Business Relationships

Agency Liability

As described above, an employee or other agent of a corporation or a limited liability company is not normally liable for the contract obligations of the company, so long as the other party to the contract is not misled into thinking otherwise. General partners, on the other hand, are treated differently. All general partners are liable jointly and severally for all obligations of the partnership unless otherwise agreed by the plaintiff/claimant or provided by law. Each general partner is considered the agent of the other while on partnership business. This has immediate practical application for everyone who enters a general partnership. For example, if married brothers and their

wives go in together on an investment rental property, and if one brother drives over a pedestrian on the way to buy paint for the new unit, both families may lose their houses to satisfy the victim's judgment against the partnership.

In any business, the legal doctrine of "respondeat superior" holds principals legally responsible for the actions of their agents. Under this doctrine, as an employer, you are liable for the conduct of your employee while the employee is acting within the scope of his/her employment.

Another way that an employer can become liable for his employee is under a theory of negligent hiring, where an employer is held responsible for the conduct of an employee if the employer failed to use due care in hiring and retaining the employee. The classic example of a circumstance involving negligent hiring is where an employer hires a driver and fails to check the driving record where it would have revealed a poor driving history.

Alter Ego Liability

The phrases "piercing the corporate veil" and "alter ego liability" embody concepts which represent serious concerns for any businessperson who must rely on the corporate liability shield which normally protects him or her from liability for debts incurred by the corporation. Alter ego liability extends in other directions as well, to any individual or corporate entity, such as an owner, partner, or principal in an agency relationship, closely identified with the affairs of another corporation, who may be found liable for the corporation's conduct and debts. The equitable doctrine of piercing the corporate veil under an alter ego theory can be described by the following two-part test: (i) was there such unity of interest and lack of respect given to the separate identity of the corporation by its shareholders that the personalities and assets of the corporation and the individual are indistinct, and (ii) would adherence to the corporate fiction sanction a fraud, promote injustice, or lead to an evasion of legal obligations. In a similar way, a member of an LLC may also be held liable for the LLC's debts if the court imposes alter ego liability.

Successor Liability

Traditionally, the buyer of a business does not assume the seller's liabilities if he bought only the assets, and not the corporate shares, unless he has agreed to assume the liabilities. Under certain conditions, though, the buyer may be liable for loss events that predate the purchase, as where the purchase can be considered a de facto consolidation or merger, or the transaction was fraudulently entered into to escape liability, or the transaction was not for reasonably equivalent value in exchange, or the case involves a products liability claim arising out of a product line continued by the buyer, or the buyer is in fact the mere continuation of the seller (when just one corporation exists after the sale and the buyer and seller have directors and managers in common). The trend has been to expand successor liability to include a successor that is a "substantial continuation" of the old company. Courts will consider whether the buyer keeps the employees, supervisors, production facilities, products, and some version of the name, and whether it holds itself out as a continuation of the seller. Apart from the common sense steps to avoid looking like a successor, successor liability

insurance is available to address the exposures arising out of mergers, acquisitions and business discontinuations.

Conclusion

The law measures and appoints responsibility for the harm we do in our private affairs and in our business dealings. Liability - the risk of meeting legal responsibility - is the very substance of the "legal landscape" through which we all must travel as businesspeople and members of a society ruled by law. The law identifies the sources of liability in our contractual and personal relationships, and in our intentional and negligent misconduct. We may assume liability voluntarily, or have it unknowingly imposed by law. In each instance, methods for avoiding, minimizing and shifting liability are available; each has costs and benefits, downside and upside risks. As this paper has sought to demonstrate, on the legal landscape, liability cannot always be avoided, but it can be managed if you understand its sources and limits, and know a few helpful tips for controlling risk.