

Class 18 Outline
Business Finance 749
Spring Quarter, 2007

- I. Review of Comprehensive Environmental Response, Compensation and Liability Act (CERCLA or Superfund)**
- A. RCRA regulations cover active but not abandoned waste disposal sites.
 - B. CERCLA was passed to facilitate the cleanup of abandoned or uncontrolled sites containing hazardous substances, including numerous old dump sites.
 - C. The cleanup cost of a single site can range into hundreds of millions of dollars.
 - D. Superfund operates under the “let the polluter pay” funding theory that features retroactive, strict liability.
 - E. Under the legislation, all parties who enjoyed an economic benefit from the waste disposal activities or ownership of the site are referred to as “potentially responsible parties” (PRP’s) who could be held legally responsible for the costs of remediating the Superfund site
 - F. PRP’s can include any of the following:
 - 1. The current owners or operators of the site (even if they had no involvement with the original waste disposal activities)
 - 2. Prior owner and operators (again even if they had no involvement with the site during the disposal of hazardous materials)
 - 3. The generators of the waste disposed of at the site
 - 4. The transporters who hauled the waste to the site
 - 5. Anyone who arranged for the disposal of the materials at the site.
 - G. Once liability has been established, the PRP’s or subset of the PRP’s become “responsible parties” (RP’s).
 - H. Superfund liability is harsh:
 - 1. Liability is strict, that is without regard to fault.
 - 2. Liability is retroactive. Many of the disposal sites that ultimately became Superfund sites were permitted, legal operations and the times that the sites were actively accepting waste.
 - 3. Liability is joint and several, meaning any party may be responsible for the entire amount, regardless of its fair share.
 - 4. Assessment of liability can be based on the volume of waste contributed to the site, not the toxicity. A party who contributed a large volume of non-hazardous materials to a Superfund site could be responsible for a large part of the cleanup cost, even though the party contributed no hazardous waste to the site.

Class 18 Outline
Business Finance 749
Spring Quarter, 2007

- I. The passage of CERCLA led to a flood of claims. This was largely responsible for the proliferation of pollution exclusions that exist today in commercial insurance policies, including the CGL and the Business Auto Policy.
- J. There are only three defenses to liability under CERCLA:
 - 1. Acts of God
 - 2. Acts of War
 - 3. Acts of an unrelated third party
 - Third-party defense is narrowly defined and rarely applies. It is limited to such occurrences at the unanticipated acts of vandals.
 - 4. Most of the loss exposures associated with Superfund can now be insured under a combination of various forms of environmental insurance.

II. Legal Foundations of Professional Liability

- A. Professional liability can be based on:
 - 1. Breach of contract
 - 2. Tort principles
 - 3. Statutes or regulations
- B. Distinguishing characteristic of tort actions against professionals
 - Expert testimony is often required to establish the professional's duties.

III. Breach of Contract

- A. Professionals have a duty to perform the services for which they were hired. They also have a duty to perform those services in accordance with appropriate standards of conduct.
- B. The first duty is primarily contractual; the second duty arises from tort principles of law.
- C. The contract between the professional and their client could be a formal written agreement, but even if it is not, the law will assume that a contract exists, based on the relationship between the parties.
- D. If the client suffers harm as a result of breach of contract, the client is entitled to be restored to the position that he or she would have occupied had the contract been performed as promised.
- E. Damages recoverable for breach of contract can be categorized as:
 - 1. Compensatory damages
 - a. Unlike compensatory damages in negligence actions, compensatory damages in breach-of-contract actions do not normally include amounts for intangible general damages such as pain and suffering.

Class 18 Outline
Business Finance 749
Spring Quarter, 2007

- b. Compensatory damages in contract actions are generally limited to monetary loss sustained by the party alleging breach of contract.
 - 2. Consequential damages
 - a. Payments awarded by the court to indemnify an injured party for losses that result indirectly from a civil wrong.
 - b. For example, the court might award damages for loss of profit if the profit loss occurred as a result of the breach of contract.
 - 3. Liquidated damages
 - a. Specified amount of money stipulated in a contract as the amount to be recovered if a breach of contract occurs.
 - b. The amount is set in advance as a reasonable estimation of the actual or anticipated damages.
 - 4. Nominal damages
 - a. Small amount, such as one dollar, awarded to a plaintiff when a breach of contract occurred but without compensable injury.
- F. To recover compensatory damages, the injured party must prove the amount of loss that he or she suffered is a direct result of the breach of contract. Example of no compensable damages
- a. Company A fails to fulfill contract to supply Company B with fuel at a given price.
 - b. Company B is able to buy the fuel in the open market at the same or lower price
 - c. Company A breached the contract.
 - d. However, Company B will not be able to prove any compensatory damages.

IV. Tort Principles - Liability of Professionals

- A. A professional is not liable merely because of an unfavorable outcome.
 - 1. The professional must have failed to perform with reasonable professional care and competence.
 - 2. He or she must have made an error or omission that a reasonably competent professional in the same field would not have made.
 - 3. Failure to maintain the accepted standard of conduct or care will expose the professional to tort liability for damage caused to another person.
- B. Distinction between: Professional liability claims from contract and professional liability claims arising from tort.
 - 1. In contract claims, the allegation is that the defendant failed to do something that was required by the contract.

Class 18 Outline
Business Finance 749
Spring Quarter, 2007

- a. Example: An insurance agent failed to place insurance that he/she agreed to place for the plaintiff.
2. A tort contracts rests on allegations that the performance of the contract did not meet the standards of reasonable professional care.
 - a. Example: The accountant prepared the tax returns as agreed. However, the returns contained errors that a reasonably competent accountant would not have made.
3. As a general rule, if a professional's performance causes bodily injury, the claim is likely to be pursued through a tort action, because breach of contract claims do not permit the injured party.
4. However, different statute of limitations may be apply to contract and tort actions
 - a. Example: Pennsylvania has a two-year statute for tort actions, but a four-year statute of limitations in contract cases.

V. Professional Liability Arising From Statutes and Regulations

- A. Statutes affecting professional liability are of two types:
 1. Statutes with general application
 2. Statutes governing a specific profession
- B. Example: Statute with general application – Racketeer Influence and Corrupt Organizations (RICO)
 1. Defines racketeering to include such offenses as mail fraud, wire fraud, and certain securities violations.
 2. As a result, attorneys, accountants and stockbrokers have been charged under the act for misdeeds that would not be commonly considered racketeering.
- C. Examples of Statutes that apply to specific professions:
 1. Federal securities laws
 2. State securities laws
 3. Regulations of the Securities and Exchange Commission (SEC)
 4. All impose standards on:
 - a. Stockbrokers
 - b. Some financial planning professionals and life agents
 - c. Accountants whose practices include securities-related accounting
 - d. Attorneys whose practices include securities-related law

VI. Need for Expert Testimony

- A. In professional liability suits, the plaintiff bears the burden of proof that the defendant breached a duty by failing to meet the applicable standards of professional conduct.

Class 18 Outline
Business Finance 749
Spring Quarter, 2007

1. In many cases that do not involve professional liability, jurors can evaluate the defendant's conduct in light of their own experience and background.
 2. However, most jurors do not have the specialized knowledge required to determine whether a professional used the required level of skill and care.
 3. Lacking this background and experience, they need to be informed of the standards that apply to the profession.
- B. Typically, the plaintiff calls an expert witness to inform the jury regarding the applicable standard based on:
1. Practice guidelines
 2. Statements of professional organizations and societies
 3. Authoritative texts and treatises
 4. Published articles
- C. In most cases, the defendant will also produce expert testimony to dispute the testimony of the plaintiff's expert witness.
1. An expert witness is allowed to state his or her opinions. Other witnesses are generally limited to testifying on what they have observed or perceived.
 2. Many authorities disapprove of what they call "junk science". This refers to the opinions of some expert witnesses that are not based on generally accepted principles.
 3. In an effort to stop perceived abuses, the U. S. Supreme Court, in *Daubert v. Merrell Dow Pharmaceuticals*, instructed trial courts to act as a gatekeeper for expert testimony.
 4. The court provide four factors for evaluating the reliability of scientific testimony:
 - a. Testing
 - b. Peer review
 - c. Error rates
 - d. Acceptability in the relevant scientific community
- D. Expert testimony is not needed in every professional liability case of negligence or omission
1. Example: Removing the healthy right kidney instead of the diseased kidney
 - a. No special expertise is needed to determine that negligence has occurred.
 2. Res Ipsa Loquitur
 - a. The very fact of the injury or damage establishes a presumption of negligence on behalf of the defendant
 - b. It is then up to the defendant to refute the presumption of negligence
 - c. Example: Vehicular liability
 - ✓ Object being transported by a flatbed truck flies off and strikes the vehicle behind causing damage and injury.
 - ✓ The object would not have flown off if the operator had exercised due care by properly securing the object.
 - d. Example: Professional liability
 - ✓ Surgical sponge left in patient's body after surgery

Class 18 Outline
Business Finance 749
Spring Quarter, 2007

- ✓ The very fact of the injury establishes a presumption of negligence on the part of the surgeon

VII. CGL – Endorsed to Exclude Professional Liability

- A. Some professional liability exposures would be covered under a CGL policy unless an endorsement excluding professional liability was attached to the policy.
- Example: Injury to a healthy organ resulting from a surgeon’s error would be “bodily injury” as defined in the CGL policy.
- B. Consequently, when insuring persons or organizations that render certain professional services, insurers routinely endorse their CGL policies to exclude professional liability.
- For example, a CGL policy covering a physician’s office will cover routine premises liability claims (such as a slip and fall), but will not cover claims arising out of the physician’s professional medical services
- C. ISO’s Commercial Lines Manual states that exclusions should be added to the CGL policy for numerous business classifications, including:
- | | | |
|--|--|--|
| ✓ Ambulance services | ✓ Electronic data processing operations | ✓ Laboratories – research, development or testing |
| ✓ Analytic chemists | ✓ Engineers, architects or surveyors | ✓ Marine appraisers or surveyors |
| ✓ Barber shops | ✓ Fire departments | ✓ Medical offices |
| ✓ Beauty parlors | ✓ Funeral homes or chapels | ✓ Medical or X-ray laboratories |
| ✓ Blood banks | ✓ Healthcare providers | ✓ Optical goods stores |
| ✓ Cemeteries | ✓ Health or exercise clubs | ✓ Spas or personal enhancement facilities |
| ✓ Computer data processing | ✓ Hearing aid stores | ✓ Tannin salons |
| ✓ Computer manufacturing | ✓ Inspection, appraisal and survey companies | ✓ Tattoo parlors |
| ✓ Construction management | ✓ Insurance agents | ✓ Tele-communications equipment or service providers |
| ✓ Contractors engaged in construction operations | ✓ Insurers | ✓ Veterinarians or veterinary hospitals |
| ✓ Cosmetic, hair or skin preparation stores | ✓ Internet service providers and Internet access providers | ✓ Web site designers |
| ✓ Crematories | | |
| ✓ Drugstores | | |
- D. Even without a professional services exclusion, a CGL policy does not cover many professional liability losses.
- E. Lawyer Example:

Class 18 Outline
Business Finance 749
Spring Quarter, 2007

1. Lawyer representing a client in a contract dispute fails to file suit within the time period allowed by applicable state law.
2. If the failure to file suit caused the client financial loss, the lawyer might be held liable.
3. The lawyer's CGL policy would not cover this claim even if no professional services exclusion was attached to the policy.
4. The reason is that the type of injury was not bodily injury, property damage or personal and advertising injury as defined in the CGL policy.

VIII. Accountant's Professional Liability Exposures

- A. Accountant professional liability exposures may arise from duties and requirements imposed by tort, contract or statute
 1. Tort – Accountants are liable for their failure to perform with the degree of care and skill that is appropriate given their specialist expertise.
 - The skills expected of accountants will vary depending on the nature of the work they have been hired to do.
 - For example, if the accountant performed a financial audit, the accountant's work will likely be measured in terms of the standard of professional practices employed in auditing.
 2. Contract – An accountant's contract liability is based on the contractual relationship between the accountant and his or her clients.
 - a. A client can assert breach of contract against an accountant if the client suffers damage because of the accountant's improper or incomplete performance of the accounting engagement.
 - b. Under certain circumstances, third parties can also assert breach of contract if they can prove that they were the intended beneficiaries of the contract between the accountant and the client.
 - c. For example, an investor who relied on a misleading financial statement which included the opinion of an accountant could assert that the accountant breached the contract with the organization whose statement the accountant opined on.
 3. Statute – Primary among the statutory requirements that accountants must comply with are those imposed by federal and state securities laws, such as the Securities Act of 1933, the Securities Act of 1934 and the Sarbanes-Oxley Act of 2002.
- B. Tax services impose unique duties and responsibilities on the accountant. The client can allege that the accountant is liable for the following kinds of alleged errors or omissions:
 1. Late filing of tax returns
 2. Underpayment of estimated tax obligations

Class 18 Outline
Business Finance 749
Spring Quarter, 2007

3. Government disallowance of favorable tax treatment because of mistakes or omissions made the accountant on the tax return
- C. Audit services create to potential liability arising from allegations brought both by the client and by third parties. Third parties have a right of action if they relied on the audit opinion given by the accountant.
- D. An accountant can face liability loss exposures arising from his/her compilation and review work.
 1. This exposure is present even though the accountant confirms that no audit was undertaken.
 2. In performing the compilation and review, the accountant acknowledges that entries were made according to Generally Accepted Accounting Principles (GAAP).
- E. Securities laws create liability exposures for the accountant that could involve significant indemnity and defense costs.
 1. Complaints based on securities statutes may include allegations of violation of rules:
 - a. That prohibit false or misleading statements made intentionally or recklessly in connection with the sale or offer of securities
 - b. That govern registration statements or prospectuses
 - c. That govern documents to be filed with the SEC.
 2. Allegedly false and misleading statements can appear in financial statements, projections or tax opinions.

IX. Insurance Agents' and Brokers' Professional Liability Exposures

- A. Exposures arise primarily out of the failure to obtain either the insurance or the correct coverage requested by the client.
 - Often referred to as "Errors and Omissions" Liability
- B. Insurance agents' and brokers liability can arise out of:
 1. Tort
 - a. Tort actions are brought for the failure to exercise reasonable care in procuring insurance coverage requested.
 - b. Breaching this duty gives rise to a cause of action in negligence
 2. Contract
 - a. Courts may find that the insurance agent or broker was contractually obligated to procure insurance on behalf of the client.
 - b. Failure to fulfill that promise may result in an action for breach of contract.

Class 18 Outline
Business Finance 749
Spring Quarter, 2007

3. Statute

- a. Some states have statutes that require the insurance agent or broker to obtain the insurance coverage requested or inform the client that the insurance coverage cannot be obtained.

- b. Clients can rely on the statute to prove that the agent or broker was negligent per se.