Danger: Lawyer on Board

If your client offers you a corporate directorship, just say no

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Malpractice claims in the 1990s increasingly arise out of lawyers’ entrepreneurial involvement in their clients’ business activities. Such claims are brought not by the clients, but by third-party plaintiffs and successors-in-interest to the clients’ assets. One specific area of conflict of interest—easily avoided—occurs when a lawyer elects to sit on a corporate client’s board of directors.

Rule of Professional Conduct 1.7 requires that a lawyer’s exercise of professional judgment on behalf of a client be independent and uninfluenced by other conflicting interests. In a very real sense, the lawyer who serves as a director and continues to act as lawyer for the corporate client has become both client and lawyer. This is hardly an independent and objective posture, and is fraught with risk.

Those who argue that lawyers can serve effectively as both director and counsel contend that a lawyer’s unique professional perspective is invaluable to a corporate board. However, there is no evidence that a lawyer’s “special” talents can’t be used just as well—if not better—by serving as legal counsel to the entire board.

Here are just a few of the problems presented by sitting on your client’s board of directors:

- **Increased risk of malpractice.** All other things being equal, the lawyer who serves as a director is much more likely to be sued for legal malpractice than the lawyer who is not a director.

- **Disqualification.** Once named as a defendant, the director-lawyer and his or her law firm obviously are disqualified from representing the client in the litigation. Even if not sued, the lawyer’s involvement as a participant in the corporate decision-making probably renders the firm disqualified from representing the client in litigation, based on the lawyer-as-witness rule.

Legal malpractice policies never cover director-officer liability.

- **Loss of the attorney-client privilege.** The confidentiality of communications that otherwise would be privileged is jeopardized when the lawyer is involved in discussions in any capacity other than as counsel.

- **Recusal from certain board decisions.** Alternative business decisions by the corporate client often mandate different levels of legal representation. Depending on the fee likely to be involved, the lawyer-director whose firm stands to gain may have to recuse himself or herself from voting on the proposal.

- **Weakened defense to malpractice claims.** Often the obvious defense to a malpractice claim brought by third parties (such as shareholders) is that the client made a bad business decision or failed to follow the proffered legal advice. Both defenses are compromised when a member of the firm sits on the board.

A Loss Prevention Checklist

If you decide to serve as a director despite these concerns, ask these questions:

- **Is the corporation public or private, profit or nonprofit?** In general, service on the boards of private and nonprofit corporations poses significantly less risk than comparable positions with public, for-profit corporations.

- **Does the corporation maintain a director and officer liability policy at adequate levels given the size and complexity of its business decisions?**

Has the corporation engaged in financial services regulated by the federal government? Service on the board of a federally regulated financial institution today is risky, period. Most D&O policies specifically exclude coverage for claims brought by regulatory agencies with jurisdiction over financial institutions. Many legal malpractice policies exclude coverage for legal malpractice claims arising out of circumstances where a lawyer is acting as a director or officer.

In addition, draft and send a letter to the corporation confirming that your future responsibility will be solely as a director. Also confirm that you will be serving as a director in your individual capacity and not as a representative of your law firm. Under some D&O policies, coverage exists only if the individual is serving “solely” as an officer-director.

If, in fact, you will be serving as a director and as counsel to the client company, your letter should disclose to the company’s management that the attorney-client privilege will not apply with respect to any discussions and correspondence in which you are involved in your capacity as a director.

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