Greetings and welcome to our fall edition of the PODL Newsletter.

This edition will be dedicated to the 2013 ABA Annual Meeting, which was very well attended by members of our Committee. As you may have heard, we ran several events that were all well received.

The activities began Friday morning when our own Ari Magedoff and Andrew Oldis participated in a panel sponsored by the Young Lawyers Division entitled: “Insurance Claims: From Notice to Resolution.” Although I was unable to attend, due to an airline delay, I heard from several attendees that the program was outstanding and that the speakers were very engaging and informative.

Thereafter, we held our quarterly PODL business meeting and hosted a record crowd! In fact, we had to change conference rooms to accommodate all the attendees. Several excellent ideas were exchanged, including creating a regular column in our newsletter, dedicated to new legal developments in the area of Professional Liability. This will hopefully be introduced in the next issue and will certainly add value to the Committee, by serving to keep our members informed of new case law and other developments within our practice group. Under the direction of our Co - Editors Janice Hugener and Dan Strict, I intend our newsletter to be the source of cutting edge information for the professional liability insurance bar.

The business meeting also focused on the PODL Strategic Plan, which is being spearheaded by John Rogers. This has been a major undertaking and John has devoted considerable energy in forming an able subcommittee that has put together a thoughtful plan, which will be the blueprint of our Committee’s success for years to come. For more information on our strategic plan, I invite you to view our Committee’s website, which can be accessed through the ABA TIPS website.

After a highly energized business meeting, we walked over to the law offices of Lieff, Cabraser, Heimann &
Bernstein to attend a joint program, co-sponsored by PODL and The San Francisco Bar Association, entitled: “Large Damage Models and the Court’s Gatekeeper Role Regarding the Admissibility of Expert Testimony.” The program, which was chaired by our own Glen Olson, was a spirited and engaging debate among the panelists that included Judge Mark Simons, of the California Court of Appeals, and two highly respected California lawyers, Richard Heimann and Joseph McMonigle. Thereafter, the meeting adjourned and we reconvened at Palio D’Asti, a nearby trendy establishment, for hors d’oeuvres and drinks. Finally a large group of us met for dinner and libations at BIX, a San Francisco institution, and good times were had by all.

The next morning, bright and early, the PODL Sponsored CLE Program entitled; “Lawyers as Corporate Directors” convened. Although the program was scheduled for an early Saturday morning slot there was a credible showing of attendees, who anticipated seeing a formidable panel comprised of Glen Olson, Janet Hugener, Tom Whalen and Carol Zacharias. Unfortunately, I sat in for Carol who suffered from an acute case of poison ivy, and had to cancel her trip. Although I may have ably filled in for Carol, her absence was certainly felt by the audience and panelists alike. Thankfully, the Committee will have the benefit of reading the companion article that Carol and the other CLE panel members put together, and which can be found below. The Committee will also have the good fortune of hearing Carol’s insight into topical legal issues in forthcoming programs that we will produce in 2014 and beyond.

The Annual Meeting was capped with PODL winning the Outstanding Achievement Award, “for exceptional achievement and effectiveness in promoting and achieving greater participation and involvement by committee members in the activities of the Committee and the Section.” Of course this is a special honor and could not have been made possible without all the hard work and dedication by the many members of our committee who have contributed so much to the Committee’s success. I won’t try to name them all for fear of missing some critical Committee members’ names. But, a special thanks goes to my very able Chair Elect Barbara Costello.

As we move on to the 2013 - 2014 fiscal year, we have several exciting plans. We, along with the ADR Committee, will Co-Chair a “Day at Lloyd’s II” event scheduled for January 27th which will once again be venued at St. John’s University School of Risk Management and Insurance. We have also submitted a proposal for a MPL program to be held during the 2014 Annual Meeting. More on this will be discussed in future Committee meetings and conference calls, as we learn whether our proposal has been accepted as an annual CLE event.

In between these events, we are planning several informative CLE’s including an update webinar on Failed Financial institutions, a webinar focused on reading and evaluating financial statements, and a webinar on corporate crime, to name a few.

As I have previously commented, this is your Committee. Our success or failure is dependent on your involvement. Fortunately, we have had a number of new members, who have become actively involved in our Committee, who have complemented the fine work undertaken by our more senior members. Still, there is plenty of work to be undertaken to make our Committee the go to source of the professional liability insurance bar. So, let’s forge ahead! 🇺🇸

Perry S. Granof

P.S. We now have 125 Members that have signed up for the LinkedIn PODL Committee sight. If you haven’t already done so, please sign-up to received the most current updates.
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PODL Committee Members at the Minneapolis Marriot City Center for the Fall 2013 ABA TIPS Meeting.

From left to right: Blaise Chow, Andrew Oldis, Ari Magedoff, Gregory Monaco, Barbara Costello, John Rogers, and Cecelia Lockner.
LAWYERS AS CORPORATE DIRECTORS: ISSUES TO CONSIDER, PART I

By: Glen R. Olson, Esq., Thomas J. Whalen, Esq., Carol A.N. Zacharias, Esq., and Janice Rourke Hugener, Esq.¹

Introduction

Attorney service on a client’s board of directors is becoming increasingly common and is an issue that raises both business and legal questions. While attorneys should not be dissuaded from seeking such service, they should make the choice with a full recognition of the advantages and disadvantages of being on a board of directors and how director status interacts with an attorney’s ethical responsibilities to the client. Moreover, issues related to lawyer’s exposure to suits brought against the client, how board service will impact her firm, and the extent to which exposures can be covered by insurance are all important issues to consider as well.

This article is the first in a two part series addressing those issues. This article addresses the fundamental question of why serve as a director when requested to do so by the client, the standards for outside director liability generally, and exposures lawyers face on the board from both an ethics and malpractice perspective. The second article in the series will address the insurance market and insurance coverage, available to mitigate the risks attendant to attorney board service.

We conclude that, in many instances, attorneys and the corporations which they serve will benefit from having attorneys on their corporate boards. In entering into these relationships, however, both parties should do so with their eyes open. While certain ethical issues need to be addressed and are not insurmountable, the nature of the attorney’s role should be clarified before service begins and it is important to understand how insurance applies to board service. Moreover, it is important for attorneys to understand the law of outside directors’ liability when they agree to join a board.

I. Why Serve on a Board?

There are myriad reasons why attorneys may wish to join a board of directors on invitation from a client. First, and perhaps foremost, it is an honor to be asked to join. The client may believe that the attorney possesses not only significant legal skills in relationship to the client’s business but an in-depth understanding of the business. The client may wish to provide the attorney with an even deeper familiarity with how the business operates and the challenges it faces.

Second, and this harkens back to the pre-Enron days of multi-disciplinary practice issues, but clients and attorneys may wish to decrease the communications “distance” between the client and its counsel. The thought may be that service on the board of directors will provide the client with immediate feedback from the lawyer and the lawyer more immediate access to the critical information she needs to advise about the client’s business. As we all know from the events concerning Enron, WorldCom, and other corporate entities subject to litigation government scrutiny, however, there can be a significant exposures arising from blurring the parties’ respective business, legal and accounting roles. Professional independence is in many instances good for both the client and the attorneys it hires.

Third, the attorney’s expectation may also be that the volume of business he receives will increase through board service, if only by deepening the relationship with the client. Certainly, no attorney joins a board of directors with the expectation that his work with the client will decrease. If there is a potential for creating conflicts of interest, however, that aspect of board service may need to be vetted with the attorney’s law firm. The client may be able to accomplish the desired result of an in-depth knowledge by the attorney through hiring his firm as outside general counsel.

While the advantages to the lawyer of board service may seem apparent, it is very important to understand the client’s motives and desires in some detail. Is the client hoping to make the attorney more familiar with its business? Is the client seeking to obtain more real time...
legal advice as challenges arise in his business? Is the client hoping to bring legal expertise that it ordinarily pays for by the hour onboard and available at board meetings or before board meetings? As discussed below, that latter motive may prove problematic in terms of protecting the attorney-client privilege and discerning the lawyer board member’s standard of care as to certain board actions.

One other possible motive for the client securing attorney service on the board is the potential to improve corporate governance. In this era of heightened scrutiny of corporations and the manner in which they conduct business this may be a logical reason to add lawyers to corporate boards. Again, however, issues of roles and responsibilities, privilege(s) and exposures need to be identified and carefully considered.

Once the client’s and lawyer’s motives for board service are understood, the attorney needs an understanding of the specific duties her board service will entail. Does she believe that her role will be indistinguishable from other outside directors who serve on the board? Or does she believe that she will be opining on legal issues only now in the context of board participation? Does she believe that she will be called upon to advise on legal strategy including how outside attorneys are supervised and deployed in representing the company in its business transactions and in litigation? All of these issues should be discussed with the client in some detail.

In joining the board, it also is useful to ask whether the law firm’s role as counsel will change. Will service on the board make the company more hesitant to refer matters to the firm? Has the lawyer reviewed all of the relevant issues with the partners or shareholders of his firm? Could the attorney be called upon to either review or comment on the services provided by his firm, or recuse himself if called upon to do so? If so, what will that mean for the relationship with the client?

Finally, the lawyer joining a board of directors needs to review the legal standards to which he will be held as an outside director, addressed immediately below. It is important to determine whether a higher standard of care will attach to the lawyer’s conduct by virtue of his status as both an attorney and a board member. Moreover, the law on the exercise of business judgment needs to be reviewed for the jurisdiction in which the lawyer will serve. The attorney should also review her jurisdiction’s rules of professional responsibility to determine which, if any, potentially conflict with the lawyer’s board service.

II. Outside Director Liability

The lawyer director as outside director has the same duty of care and loyalty as any other outside director and the same exposure to liability. Any director is obligated to bring his skill and knowledge to the boardroom in the interest of the corporation he serves. This applies to the lawyer director whose skills and knowledge should be made available to the board and the corporation. Not exercising such skill exposes the lawyer director to liability for breach of his duty of care.

As outside director, the lawyer director must inform herself about the business of the corporation and the particular transaction at issue and, and where the occasion arises, and advise her fellow board members about the legality or legal implications of a transaction as well as the wisdom of a transaction.

She cannot remain silent. Where the legality or the exposure of the corporation to liability is at stake, the outside director should consult counsel, and this is a proper role the lawyer director to play. However, when she gives this advice as director, the corporation may not be protected by the attorney-client privilege but there are steps the lawyer director can take to protect the privilege.

The ABA Rules of Professional Conduct, as addressed in Formal Opinion 98-410 concerning the issue of attorney-client privilege, make a distinction between giving business advice (voicing an opinion on the wisdom of a proposed transaction such as acquiring a company) and giving legal advice either to other directors at board meetings or to management. No attorney-client privilege attaches to business advice, but the attorney-client privilege could be preserved, if carefully limited to legal advice, and disclosed as such to the other directors and management.

The line between business advice and legal advice is often not clear where the lawyer director, for example, objects to a proposal on the grounds that it would violate law and expose the corporation to liability. His views to the other directors may not be privileged. Some commentators would disagree, arguing that any legal advice to fellow directors, properly framed as such, should be privileged. To protect the privilege in important transactions, the more prudent course is to obtain the advice of outside counsel. Not protecting the privilege by obtaining separating legal advice from business advice could lead to a waiver of privilege. For the same reason, if the legal advice is reported in the meeting minutes, the privilege may be considered waived.
The lawyer director’s first loyalty as a director is to the corporation, not to his law firm. As noted above, some corporations want lawyer directors on the board to obtain free legal advice. There is nothing unethical about this, but there is a risk that the attorney-client privilege may be waived, unless confined to legal advice. A good practice would be to put any legal advice in writing and designate it as privileged.

On the issue of giving legal advice and business advice, the lawyer director, at the outset, should inform management which seeks to appoint him as director of the ethical consideration of his dual role, including conflicts of interest issues, and the circumstances when his legal advice may not be privileged and subject to discovery in litigation.

One area of risk for lawyer-directors is a breach of the duty of loyalty through self-dealing and conflict of interest. A lawyer-director of a corporation which is a client of his law firm must be careful not to place the interests of his law firm before the interests of the corporation. This is not to say that a lawyer-director from a law firm should disqualify his law firm from doing business with the corporation. Years ago, marketing experts advised that lawyers should try to get seats on boards to obtain business from the company for his firm. This is a questionable practice today as the lawyer director, out of loyalty to the corporation, should not be involved in decisions, on the appointment of counsel, especially the appointment of his own law firm. The Association of the Bar of the City of New York has taken the position that a lawyer director may not participate in a board decision to engage that lawyer director’s firm for legal services. The ABA Professional Rule is less absolute, but the New York rule is the most appropriate course to take. It is more consistent with the director’s duty to avoid “self-dealing” and “conflict of interest” and the appearance of same.

Thus, the lawyer director’s firm is not disqualified from acting as general counsel for the corporation or doing the legal work for the corporation. However, the lawyer director should abstain from participating in the consideration of law firms to be engaged for legal advice to the corporation.

This duty of loyalty also means that confidential information about the corporation, for example, corporation information which might affect the value of stock, cannot be shared with the law firm. If the information affects litigation his firm is handling, he should advise the board that the corporation’s counsel should be informed.

A lawyer director must avoid conflicts of interest. This means that the lawyer/director’s law firm or a lawyer of that firm cannot represent clients adverse to the corporation. Similarly, the lawyer director should not favor other clients of his law firm seeking to do business with the corporation. The lawyer director’s law firm or the lawyer director himself should not render a legal opinion on board actions in which the lawyer director participated. This may be a conflict because he or his firm may not possess the requisite independent professional judgment. In such case, the corporation should seek the advice of outside counsel.

In litigation brought against the corporation, its directors and officers, including the lawyer director, a possible ethical conflict precludes the lawyer director’s law firm from representing any of the defendant parties, and independent counsel is called for.

Sometimes the lawyer director is asked to perform legal service such as drafting contracts or amendments to the charter or bylaws. There is nothing wrong with that, and this work, compensated or not, may be considered pure legal advice or service. Without minimizing the issue of conflicts of interest, it must also be said that lawyers in general are probably the most sensitive professionals regarding issues of conflict of interests, which arise often in the private practice of law. Recognizing such conflicts or potential conflicts is easier than giving up potential business and benefit to himself or his law firm, but his fiduciary duty to the corporation requires it.

Violation of established ethical rules or guidance applicable to lawyer directors does not usually constitute illegality or a basis for a personal liability, but in a litigation context where directors are sued for self-dealing, such violations are harmful as evidence.

Where the lawyer director acts contrary to law or in breach of any of his duties to the corporation, the lawyer risks exposing his law firm to liability as well as himself, so both the professional director’s liability policy of the director and the malpractice policy of the firm should be constituted. Depending upon the facts, the lawyer director may implicate his law firm as an agent of his firm.

In sum, the liability of the lawyer director is essentially the same as it is for other outside directors. The lawyer director remains exposed for breaches of fiduciary duties of loyalty and due care, self-dealing or approving such self-dealing and conflicts of interests.

In the present environment of good corporate governance, neither corporations nor lawyers should discount the value of an experienced lawyer on a corporate
board and his insights in considering corporate actions. His legal and business perspective and appreciation of developing practices of good corporate governance will go a long way in protecting the corporation and the board from exposure to liability.

III. Malpractice and Ethics Exposures of Attorney-Directors

As referenced above, several interesting issues are raised concerning malpractice and ethics exposures for attorney-directors. First, most jurisdictions provide basic rule of attorney competence that may impact such service.

In California, this rule is expressed in California Rules of Professional Responsibility (CRPC) Rule 3-110 providing that a member shall not intentionally, recklessly, or repeatedly fail to perform legal services with competence. Competence in providing legal services in turn means to apply the (1) diligence, (2) learning and skill, and (3) mental, emotional and physical ability reasonably necessary for the performance of such service. CRPC Rule 3-110(B). This rule can be implicated if, by reason of the lawyer’s role as director, her ability to provide legal services competently is somehow hampered.

As to attorney board service lawyers should ask whether the dual lawyers/board member role compromises the lawyer’s independence of professional judgment. This issue was addressed in American Bar Association Formal Opinion 98-410. In that paper, the ABA Standing Committee on Ethics and Professional Responsibility commented that if there is a material risk that the dual role will compromise the lawyer’s independent professional judgment, the lawyer should not serve as a director or should cease to act as the corporation’s lawyer when conflicts of interest arise.

How are these conflicts likely to manifest? Opinion 98-410 observes that conflicts may arise when an attorney is called upon to advise the corporation in matters involving actions of the directors. In other words, the lawyer’s duty to advise the client of its legal obligations may require the attorney provide advice as to decisions previously made or currently being made by the lawyer’s contemporaries on the board. The attorney should ensure that, to the extent she may be placed in that situation, she can satisfy her professional responsibilities (and that includes providing that the client is aware of how that issue will be handled).

Lawyers need to consider the frequency with which these situations may arise, the potential intensity/ importance of such conflict(s), the impact that the lawyer resigning from the board would have on the client and whether the client can seek the required legal advice from another lawyers if necessary. The client needs to know the potential implications of the dual role in situations in which the lawyer may have to suggest another course of action if the dual role will compromise the attorney’s exercise of his independent professional judgment.

As to this disclosure issue, in 2002, the ABA Ethics 2000 Commission added a sentence to Paragraph 35 of the comment to Rule 1.7 to emphasize that a lawyer should warn the client about the potential conflicts that can arise if the lawyer were to agree to act as director of a corporate client. That sentence provides:

This comment maintains current comment [14] with modifications designed to reflect that, when problems arise with a lawyer-director, the lawyer may either resign as director or cease acting as the corporation’s lawyer, and to advise the lawyer of the possible consequences of discussing matters at board meetings while the lawyer is present in the capacity of director. See also ABA Opinion 98-410 in which the Committee stated that the Rules of Professional Conduct do not prohibit a lawyer from serving as director but there are several ethical issues that the lawyer should keep in mind if he decides to do so.

The effect of board service on the attorney-client privilege also needs to be considered. The client may be under the (often mistaken) impression that the mere fact that a lawyer has joined the board of directors will shield discussions under the attorney-client privilege and perhaps the attorney work product doctrine as well. As noted above, there are concerns as to whether such discussions could be considered privileged in the first instance and, if so, whether the privilege might be deemed waived.

However, even assuming privileges could apply, casting a wide net over discussions about the board’s exercise of its business judgment could also seriously disadvantage the corporation should it need to explain what it did on a particular issue and why. Introducing privilege into general business discussions can also become problematic with regard to create a dividing line between communications that the corporation
contends are not subject to privilege in the first instance and communications as to which the corporation will maintain privilege. In litigation as well courts may also be reluctant to grant partial or limited waivers of privilege, risking broader disclosure than desired.4

For purposes of addressing privilege issues, a typical statutory formulation of the attorney-client privilege is as follows: “confidential communication between client and lawyer” means information transmitted between a client and his or her lawyer in the course of that relationship and in confidence by a means which, so far as the client is aware, discloses the information to no third parties other than those who are present to further the interest of the client in the consultation or those to whom disclosure is reasonably necessary for the transmission of the information or the accomplishment of the purpose for which the lawyer is consulted, and includes a legal opinion formed and the advice given by the lawyer in the course of that relationship.”5 Generally, except as to waiver and other privilege exceptions, the client, whether or not a party, has the privilege to refuse to disclose and to prevent another from disclosing a confidential communication between client and lawyer if the privilege is claimed by the holder of the privilege.6 The law also commonly affords protection for confidential communications between attorney and client whether the communications relate to “factual information” or “legal advice.”7

Were the attorney not a board member, her communications with agents and employees of a client would generally be considered privileged. At least in California, in representing a corporation, the agent with whom an attorney is communicating need not be a member of a “control group” for the privilege to attach.8 While the law is generally very protective of confidential communications between lawyer and clients, including corporate clients, there are privilege issues to be considered in terms of board service. One is the potential that the advice given will take place before third parties, creating the potential for waiver. The more serious concern is that the advice is given in a role other than as counsel for the client. If the issues addressed by the board will more frequently involve the exercise of business judgment than provision of legal advice per se the client may need to be disabused of the notion that such generalized discussions of business issues by the board are privileged.

A basic element of the attorney-client privilege is that the attorney is in fact acting as legal counsel rather than in a business advisor role. In certain instances, communications from a lawyer/director that involve business issues as opposed to the rendition of legal advice have been held not protected by the attorney-client privilege. The commentary to ABA Model Rule 1.7 thus provides that the lawyer needs to warn a corporate client that the attorney-client privilege may not attach when the lawyer is also a board member.

With respect to the issue of conflict of interest, the lawyer also needs to be aware that in his role as director he may be called upon to review the services of his own law firm. Attorney should generally avoid situations in which there will be an obvious conflict of interest and should anticipate how those situations might be handled in discussions with the client. The lawyer also needs to be mindful that he owes a duty as a director to the corporation and that information that he or she learns that is confidential cannot be used to the detriment of the client. That could conceivably preclude the lawyer or the lawyer’s law firm from being adverse to the organization, as in the situation where the firm pursues a matter adverse to the client.9

Conclusion

There are definite advantages associated with attorney service on a client’s board of directors. However, no attorney should accept such an invitation to serve without carefully thinking through the pros and cons and what board service will entail for the lawyer and mean for her firm. With careful identification of the issues that may arise during board service many, and perhaps all, of the relevant risks can be managed effectively.10

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3 See Paragraph 35 of the comment to Rule 1.7 of the ABA Model Rules of Professional Conduct (Conflicts of Interest involving current clients).

4 See In Re Ouest Comm’ns Int’l, Inc., Sec. Litig., 450 F.3d 1179, 1187-88 (10th Cir. 2006).


7 Centro Wholesale Corp. v. Superior Court (Randall), 47 Cal. 4th, 725, 734 (2009).


9 See Berry v. Saline Mem’l Hosp., 907 S.W.2d 736 (Ark. 1995) (Arkansas Supreme Court upholds disqualification of a law firm that sued the hospital on which a lawyer in the firm was a former trustee.)
A Day at Lloyd’s of London Part II and Alternative Dispute Resolution

Monday, January 27, 2014
12:00 pm - 5:30 pm
St. John’s School of Risk Management
101 Murray Street
New York, NY

This is the second program in the TIPS’ Professionals’ Officers’ and Directors’ Liability Committee’s series of panel events, which have been designed to encourage a greater understanding between the U.S. and international insurance market of how the Corporation of Lloyd’s of London works and the practical issues that arise.

The first part of the afternoon will concentrate on Lloyd’s of London itself- what is it, how it works, how the new claims process is playing out, and the coverage issues that Lloyd’s is increasingly dealing with. The second part of the afternoon will discuss the practical ways that Lloyd’s and its participants are addressing disputes and the differences between arbitration, litigation and other forms of ADR, which Lloyd’s is embracing. The panel is made up of a number of well-known individuals in the London, U.S., South America and Asia/Pacific insurance markets who work with Lloyd’s and come up against the issues constantly.

We hope you will find the sessions of interest and look forward to seeing you at the program!

Keynote Speaker
Maurice “Hank” Greenberg, Former Chairman and CEO of American International Group (AIG) and current Chair and CEO of C.V. Starr & Co., Inc.

Moderators
Perry Granof, Granof International Group LLC, Glencoe, IL
Hon. Angela G. Iannacci, Associate Justice of the Appellate Term, Second Department Supreme Court, Nassau County, Mineola, NY
David Zarfes, Associate Dean and Clinical Professor of Law, University of Chicago Law School, Chicago, IL

Faculty
Theodore A. Boundas, Esq., Boundas, Skarzynski, Walsh & Black LLC, Chicago, IL

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CLE Credit Requested: Please visit the program website for more information at www.ambar.org/tips.

Scholarships are available for this program. For more information, please contact Ninah Moore at ninah.moore@americanbar.org

Register Online at www.ambar.org/tips
Introduction

Attorney service on a client’s board of directors is becoming increasingly common and is an issue that raises both business and legal questions. While attorneys should not be dissuaded from seeking such service, they should make the choice with a full recognition of the advantages and disadvantages of being on a board of directors and how director status interacts with an attorney’s ethical responsibilities to the client. Moreover, issues related to lawyer’s exposure to suits brought against the client, how board service will impact her firm and the extent to which exposures can be covered by insurance are all important issues to consider as well.

This article is the second in a two part series addressing those issues. The first article addressed the fundamental question of why serve as a director when requested to do so by the client, the standards for outside director liability generally, and exposures lawyers face on the board from both an ethics and malpractice perspective. This article addresses the insurance market, and insurance coverage, available to mitigate the risks attendant to attorney board service.

We conclude that, in many instances, attorneys and the corporations which they serve will benefit from having attorneys on their corporate boards. In entering into these relationships, however, both parties should do so with their eyes open. While certain ethical issues need to be addressed and are not insurmountable, the nature of the attorney’s role should be clarified before service begins and it is important to understand how insurance applies to board service. Moreover, it is important for attorneys to understand the law of outside directors’ liability when they agree to join a board.

I. Types of Actions

Before discussing specific insurance policies and their application to an attorney’s service as a corporate director, a review of the types of suits that might be brought is in order. First, who are the claimants that might pursue an attorney and the corporation that she is serving as a board member? Second, what are the types of claims that might be brought against the lawyer in her capacity as a corporate director? While there are a wide variety of claims that potentially could be brought some of the general categories can be described as follows.

The first concerns investor actions broadly arising from fluctuations in the price of a corporation’s shares due to a variety of causes. Some of these actions concern the manner in which the day-to-day operation of the enterprise is managed. Shareholders may complain of merger decisions that were made, how corporate finances are handled, and expense issues such as staffing levels and layoffs, and senior management compensation. These actions can be brought as derivative suits naming the corporations and its directors and officers.

Second, former employees or corporate officers may pursue employment- related litigation against the corporation and its board. These can be suits related to the hiring of new employees (such as promises to provide certain compensation packages) with which the corporation allegedly did not comply. These suits may also relate to employment discrimination or alleged wrongful terminations. Corporations may, for instance, face suits against their directors and officers for setting policy leading to discrimination on the basis of age, sex or gender orientation in their employment decisions.

A third class of suits may be brought by competitors or governmental entities related to a company’s competitive practices or policies. These actions may allege violation of state blue sky laws or federal antitrust laws, unfair competition or business practice statutes or similar laws governing the manner in which the corporation’s business is conducted.

A final category of potential claims relates to intellectual property disputes, an increasingly important area of corporate exposure. The business may be sued for infringing the patent of another company, invading a copyright or misappropriating another person or entity’s style of doing business. In electronics and biotechnology companies these risks can represent litigation that must be managed on a day-to-day basis by the corporation.

While not all of these suits will result in the inclusion of board members in litigation, an attorney joining a board should look at the nature of business, the risks that it faces and the insurance his firm or the business carries to cover those exposures. How various policies might respond to such suits is discussed below.
II. Lawyers Professional Liability Insurance

We assume for purposes of this article that the lawyer who has joined a board of directors is a partner who will remain in that capacity with her law firm. The law firm would typically cover itself for professional liability exposures by purchasing an errors and omissions/lawyers professional liability (LPL) insurance policy. The LPL policy would in turn be written on a claims-made basis containing standard features such as prior acts coverage, an extended reporting period and the opportunity to report incidents that might give rise to claims at a later date. The limits of such a policy would also likely be eroded by defense expense associated with defending claims. The limits of the policy can be an important issue with respect to the size of an exposure a lawyer director might face (assuming other coverage requirements can be satisfied).

Another important feature of LPL insurance is the insuring clause. Typically, such policies apply to the rendering or failure to render “Professional Services.” This generally is defined to mean services that were rendered or should have been rendered by the insured in his capacity as a lawyer, notary, or administrator of an estate or similar fiduciary capacity. We emphasize the issue of the insuring clause because there may be a significant hurdle associated with satisfying the Professional Services requirement as to service on a board of directors.

This scope of professional services issue was addressed in Jensen v. Snellings. The court addressed a securities action brought by a husband and wife related to investment losses. They sued their attorney, his firm, their broker, his brokerage firm and the company in which they had invested. The district court granted summary judgment for three professional liability insurers on four separate grounds, one of which was that the services provided by the attorney were not professional legal services.

In Jensen, the insured attorney had advised the clients to adopt certain investment strategies. When the strategies fared poorly and the clients lost their invested funds they filed suit. They asserted violations of the Securities Act, section 17(a) and section 10(b) and Rule 10B-5 of the Securities Exchange Act, along with violations of Investment Advisors Act and Civil RICO. The district court concluded that the asserted claims of misconduct concerned the lawyer’s performance as an investment manager or advisor and not his performance as an attorney.

The Court of Appeals adopted a broad definition of professional services, i.e., such services are those performed by one in the ordinary course of the practice of one’s profession. The Court noted that in addition to the investment-related allegations, the complaint also contained allegations related to tax advice the attorney provided and, therefore, any doubt as to whether professional services had been alleged had to resolved in the insured lawyer’s favor.

Jensen is interesting in adopting a broader construction of professional services to find coverage for activities potentially outside a lawyer’s ordinary professional work. However, in that case, the attorney appears to have been occupying his ordinary practice as a tax attorney, also providing services as an investment advisor. The “professional services” issue may become decidedly more complex where the nature of the decision being challenged is one far removed from an attorney’s ordinary practice and more closely resembles the business policy and management decisions made in the corporate setting.

It is conceivable that an attorney may be able through endorsement to add coverage to an LPL policy for service on a board of directors. Typically, policies provide, for instance, for coverage when the attorney acts as an officer, director or member of a legal professional association. However, that truly is a discrete risk that is closely related to the practice of law. In contrast, operating in a corporate director capacity for a client is a further step removed from the ordinary focus of an LPL policy and would need to be closely vetted with the lawyer’s broker and insurer as to the scope of coverage.

There are also exclusions in LPL policies that may be potentially applicable to board service assuming that the relevant claim is within the insuring clause. For instance, LPL policies uniformly exclude fraudulent or criminal acts of the insured. Thus, if securities law violations, civil RICO violations (such as those addressed in Jensen) or similar allegations are made against the lawyer there is a possibility that the allegations may not be covered. Policies may also exclude services rendered to a business enterprise that is owned or controlled by the insured lawyer or law firm or services that the insured renders as a fiduciary under the ERISA Act of 1974.

An example of the application of such exclusions is Blumberg v. Guarantee Insurance Company. Blumberg involved a suit by one attorney against another following the dissolution of their law partnership. The partner who was sued, Blumberg, was alleged to have fraudulently
misrepresented the status of particular cases the firm was handling upon its dissolution. He tendered his defense to his professional liability insurer, Guarantee, which denied coverage.

The California Court of Appeal in Blumberg noted that, while the policy contained fiduciary coverage provisions, they did not provide coverage for alleged misrepresentations and breach of duties owed by one partner to another partner. The Court limited the scope of fiduciary coverage to Court-appointed positions which lawyers typically accept in conjunction with their lawyering duties.9

The Court also noted that the LPL policy excluded any claim arising out of or in conjunction or connection with the conduct of any business enterprise in which the insured is a partner or which is directly or indirectly controlled, operated or managed by any insured either individually or in a fiduciary capacity. While exclusions are interpreted narrowly against the insurer, the Blumberg court noted that the risks involved in the case before it were endemic to any business and were not outside the scope of this business enterprise exclusion even though they concerned the liquidation rather than the ongoing operation of the law firm.10

Similarly, in Coregis Insurance Company v. Larocca,11 the court considered coverage for an attorney involved in a “botched real estate investment scheme.” After tendering his claim to his LPL insurer, Coregis, the insurance carrier filed a declaratory relief action to which the insured responded with a counterclaim seeking a declaration of coverage and alleging breach of contract and breach of the duty of good faith and fair dealing.

The Coregis policy excluded any claim arising out of the insured’s activities as an officer, director, partner, manager or employee of any company, corporation, operation, organization or association other than the named insured law firm. It also excluded any claim arising out of or in connection with the conduct of any business enterprise other than the named insured law firm in which the insured was a partner or which he directly or indirectly controlled, operated or managed.

The Coregis Insurance court noted that the policy at issue covered claims arising out of the conduct of the insured’s profession as a lawyer.12 The Court concluded that reasonable persons could not differ as to the meaning of the relevant policy exclusions, which were clear and unambiguous. As to the insured’s conduct, the underlying malpractice claims against the lawyer, while critical of his legal representation, were not based solely on that representation, but instead were closely intertwined with his role in the corporation as both a partner and trustee. Thus, because the underlying legal malpractice claim simultaneously involved business decisions by the lawyer they were within the scope of the exclusion.13

Similarly, the court concluded that the business enterprise exclusion applied. The court noted that was axiomatic that a suit against a lawyer for services he provided to a business enterprise in which he was a partner is a suit that “arises out of and in connection with that business enterprise.”14

As a result of the basic scope insuring clause scope of an LPL policy coupled with business enterprise exclusions, lawyers should be very wary of assuming that an LPL policy, without endorsement, will cover exposures arising from board membership. At a minimum, close scrutiny of the policy and discussions with the insured’s broker are in order.

III. Commercial General Liability Insurance

Generally, the Commercial General Liability (CGL) insurance policies issued to either the law firm or the corporate client are not designed to respond to the types of suits that board members may face. Such policies basically cover suits for bodily injury or property damage arising from an “occurrence,” often combined with additional coverages for “personal injury” and “advertising injury.” It seems unlikely that directors and officers will be faced with bodily injury and property damage claims although their corporations may routinely be sued for accidental injuries implicating such coverages.

Claims potentially implicating personal injury and advertising injury coverages might be brought against board members, however, and a review of those coverages is in order.

Personal injury coverage encompasses certain intentional torts such as false arrest, detention or imprisonment, malicious prosecution, slander or libel or oral or written publication of material that violates a person’s right of privacy. Similarly, advertising injury coverage also applies to specified torts including violation of the right of privacy, libel, slander or defamation, with additional coverage for unfair competition or misappropriation of advertising ideas or style of doing business. Advertising injury coverage also extends to infringement of copyright, title or slogan.
Suits implicating the corporation’s competitive practices could potentially implicate personal injury or advertising injury coverage. These coverages also contain exclusion for, inter alia, knowing violations of the rights of other persons, material published with knowledge of falsity, criminal acts, contractual liability, and breach of contract and infringement of copyright, patent, trademark or trade secret for insureds in internet type businesses. It is also possible that a policy may contain an exclusion for professional services or professional liability, usually added by endorsement.

IV. Directors’ and Officers’ Insurance Coverage

Directors’ and officers’ (D&O) insurance policies generally have two separate parts, an executive liability coverage (Side A) and a corporate reimbursement coverage (Side B), as well as Side C coverage for the company regarding securities suits against the entity. Side A coverage pays directors and officers directly for loss, including defense costs, in instances where the company does not indemnify them. Side B coverage applies to situations in which the company has indemnified the insured directors and officers, and seeks reimbursement for such indemnification from the insurance carrier. Because these policies are focused on coverage of corporate directors and officers, they provide the best avenue for protection of a lawyer who decides to serve on his client’s board.

However, the coverage provided by the client’s policy should still be reviewed carefully. D&O policies are written on standard policy forms created by each insurer, and, as a result, the forms vary from insurer to insurer. Moreover, many amendments, called endorsements, are added to change the standard terms to suit the needs of a particular client. Hence the policies vary in scope among both insurers and insureds. This variation in the products offered can be both a benefit and a detriment to companies and executives when seeking coverage. It makes the task of comparing the products more difficult but also offers a wider variety of coverage options that can be tailored to the needs of a particular insured. As a result, it is imperative that each insured’s policy be reviewed carefully to understand the extent of coverage.

As to the scope of coverage, in some respects D&O insurance complements other coverages. For example, it typically excludes bodily injury and personal injury, both covered by the CGL form. It usually excludes ERISA, which is covered by ERISA fiduciary policies. It covers acts in one’s capacity as a director or officer, because other policies are more tailored to provide specific coverage for other professions, such as legal malpractice, medical malpractice, and accountant’s errors and omissions policies.

D&O policies typically cover wrongful acts, a key phrase which is defined to include breaches of duty, neglect, misstatements, misleading statements, omissions or acts by directors or officers. Most importantly, coverage is provided to directors and officers for these acts only when committed in their capacity as executives. For this reason, courts have held that outside counsel, albeit serving as an officer of a company, was sued only in his legal capacity and therefore the D&O policy did not apply.15

The capacity limitation is often buttressed by an express professional services exclusion in the D&O policy. The professional liability exclusion precludes coverage for claims against officers and directors alleging, arising out of, based upon or attributable to the performance of professional services. This means that executives are covered only for their managerial acts, not in their capacity as lawyers or doctors providing legal advice or medical advice.

The professional services exclusion is a critical tool in effectively coordinating and maximizing coverage between LPL and D&O insurers in circumstances in which allegations against the lawyer director based upon both legal and management advice given to the corporation during board service. The LPL policy should be looked to for coverage of legal advice allegations, and the D&O policy should be looked to for coverage of mismanagement allegations, subject to the respective policy terms and conditions. Hence, depending on the allegations, either or both of the policies can be triggered, depending on the capacity of the lawyer and application of the exclusion. Seemingly, an adjudication that the professional services exclusion of the D&O policy applied would preclude the LPL insurer from denying coverage on the basis there were no professional services involved.

With respect to exclusions, dishonest, fraudulent or criminal acts are excluded, but typically the exclusion applies only after there is a final adjudication of dishonesty, fraud or criminal acts. A mere allegation does not trigger the exclusion and defense costs would be covered while the case is pending, subject to the policy terms and conditions. Some policies also exclude willful wrongful acts, and, even without a specific exclusion, coverage may be barred under relevant state law. In addition, D&O policies commonly exclude...
losses arising out of gaining personal profit or advantage to which the insured person was not legally entitled. However, typically this exclusion does not apply until the underlying facts establish the improper personal gain. A mere allegation will not trigger the exclusion and, until it is triggered, defense costs may be covered under the policy, subject to the policy terms and conditions.

Some D&O policies have additional exclusions for specific risks, such as mergers and acquisitions, antitrust liability, copyright, and patent infringement. Coverage may be available, but it must be requested, so that underwriters have an opportunity to review and decide if they wish to insure the risk and, if so, how much premium they need to charge.

V. Non-Profit Board Service and Personal Insurance Policies

In addition to serving on the boards of corporate clients, attorneys commonly volunteer to serve on the boards of local non-profits, including local educational foundations which support neighborhood schools, their children’s youth sports booster clubs, and other 501(c)(3) entities that feed their souls and expand their networking contacts. Although such altruistic board service is “off the clock” the lessons of the preceding discussions should not be ignored: the same fiduciary duties of care and loyalty apply, careful attention must be given to identify potential conflicts of interest, and the attorney should keep her firm apprised of all voluntary board service.

In addition, before an attorney accepts a position on a nonprofit’s board she should confirm that the nonprofit entity has a management liability policy in place that affords full D&O coverage to the attorney for any Claim arising from her board service. If such coverage is in place, best practices dictate that the attorney-director obtain a full copy of the policy and compare the coverage afforded with her own lawyer liability policy to ensure that no gaps in coverage exist.

In the absence of a management liability policy (a frequent occurrence with undercapitalized small nonprofits), the directors frequently assume that their homeowners insurance policies (both primary and umbrella) will afford them a full defense and indemnity in the unlikely event a claim is made or a lawsuit is filed against the nonprofit and its board. Such is not always the case.

Homeowners insurance protects the insured individuals against personal liability for two kinds of risks: (1) Section I provides first party property damage coverage in the event the insureds’ family residence or personal property is damaged as a result of certain perils, such as fire, wind, lightning, hail and theft; and (2) Section II extends third party coverage for the nonbusiness (personal) liability of the insureds that is not otherwise excluded.

One of the most common exclusions to the Section II personal liability coverage grant is the “business pursuits” exclusion, which bars coverage for claims arising out of the insured’s business activities. “The purpose and effect of the ‘business pursuits’ exclusion is to restrict the liability coverage provided by the policy to personal or non-business activities. If a policyholder needs ‘bodily injury’ or ‘property damage’ coverage for business activities, a commercial general liability policy should be procured.”

For the past 20+ years, it has been well settled under California law that the business pursuits exclusion applies whenever an insured’s liability is causally related to a regular business activity. The business engaged in need not be the sole occupation; part time business activities are also included under the exclusion.

The case of Smyth v. USAA Property & Casualty Insurance Company is particularly instructive. There, the insured (Smythe) was sued for “bodily injuries” suffered by hotel guests as a result of a massive fire at a resort owned by a corporation in which he served as an outside director. Although Smythe was sued in his capacity as a corporate director, he tendered the lawsuit to his homeowners insurers (USAA), which denied coverage based upon the policy’s business pursuits exclusion. Smythe sued USAA for bad faith under California law that the business pursuits exclusion applies whenever an insured’s liability is causally related to a regular business activity. The business engaged in need not be the sole occupation; part time business activities are also included under the exclusion.

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the policy.’ [Citation.]” (State Farm Fire & Casualty Co. v. Drasin, supra, 152 Cal.App.3d at p. 868, italics in text.) Because there is no conceivable theory which would raise an issue bringing Smyth’s directorship activities within the ambit of these homeowners policies, USAA had no duty to defend him in the Fire Suit. (Id., at p. 869; Coe v. Farmers New World Life Ins. Co. (1989) 209 Cal.App.3d 600, 608 [257 Cal.Rptr. 411]; Marglen Industries, Inc. v. Aetna Casualty & Surety Co., supra, 4 Cal.App.4th at p. 422 [determination there is no contractual basis for liability under the policy is fatal to bad faith theories].)

Thus, before assuming that nonprofit board service will be covered under a personal lines policy, attorney directors should pull and carefully read the business pursuits exclusion contained in each of their personal lines policies. Some insurers have modified the exclusion to include a carve-out for nonprofit board service; many have not.

Conclusion

There are definite advantages associated with attorney service on a client’s board of directors. However, no attorney should accept such an invitation to serve without carefully thinking through both the liability issues arising from board service as well as managing the liability through careful analysis of insurance protection. With careful identification of the issues that may arise during board service many, and perhaps all, of the relevant risks can be managed effectively. 572

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2 841 F.2d 600 (5th Cir. 1988).
3 841 F.2d at 601-04.
4 Id. at 610.
5 Id. at 613.
6 Id.
7 Id. at 614.
9 192 Cal. App. 3d at 1292.
10 Id. at 1295.
12 Id. at 455.
13 See also, Niagra Fire Ins. Co. v. Pepicelli, 821 F.2d 216, 220-21 (3rd Cir. 1987).
14 Coregis Ins. 80 F. Supp. 2d at 457-58.
17 State Farm v. Drasin, 152 Cal.App.3d at 870.
2014 TIPS CALENDAR

January 2014
16-18 40th Annual Midwinter Symposium on Insurance Employee Benefits
The Driskill
Contact: Ninah F. Moore – 312/988-5498
Austin, TX

21-25 Fidelity & Surety Committee Midwinter Meeting
Waldorf~Astoria Hotel
Contact: Felisha A. Stewart – 312/988-5672
Speaker Contact: Donald Quarles – 312/988-5708
New York, NY

27 A Day at Lloyd’s of London II 2014 and Alternative Dispute Resolution
St. John’s University
Contact: Ninah F. Moore – 312/988-5498
New York, NY

February 2014
5-11 ABA Midyear Meeting
Swissotel Chicago
Contact: Felisha A. Stewart – 312/988-5672
Speaker Contact: Donald Quarles – 312/988-5708
Chicago, IL

20-22 Insurance Coverage Litigation Committee Midyear Meeting
Arizona Biltmore Resort & Spa
Contact: Ninah F. Moore – 312/988-5498
Phoenix, AZ

March 2014
13-15 Workers’ Comp & Labor Law Joint CLE Program
Conrad Chicago Hotel
Contact: Donald Quarles – 312/988-5708
Chicago, IL

20-22 Ethics CLE Program & Golf Tournament
Loews Ventana Canyon Resort
Contact: Donald Quarles – 312/988-5708
Tucson, AZ

April 2014
3-4 Emerging Issues in Motor Vehicle Product Liability Litigation National Program
Arizona Biltmore Resort & Spa
Contact: Donald Quarles- 312/988-5708
Phoenix, AZ