



# MALPRACTICE ALERT!

**OBLIC**

Ohio Bar Liability  
Insurance Company

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## *The Hazards of Board Membership*

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For varying reasons, attorneys continue to serve on corporate boards and as corporate officers despite an increase in the frequency of suits against corporate directors and officers, and a decrease in Directors & Officers ("D&O") liability coverage. Some attorneys do so out of a desire to give something back to the community, and serve primarily on non-profit corporate boards. Others do so for such business reasons as believing that board membership will help retain the client, to seek additional business contacts, or maybe a simple inability to say "no."

Board membership and corporate officer status are accompanied by varying D&O liability exposures. Acting as a secretary or assistant secretary of a smaller corporation is less risky than taking an active role in management. Sitting on a non-profit or private for-profit board is far less risky than sitting on a public for-profit board. Sitting only on boards of non-client corporations (not a client of either the lawyer or the lawyer's firm) is less risky than sitting on a client board. Acting exclusively as a director or officer is less risky than acting as both corporate counsel and board member for the same corporation, and here is where the risk is truly significant. Yet, some attorneys continue to rationalize taking the risk, and argue that being both corporate counsel and a board member provides the unique professional perspective that only an attorney acting as counsel and board member can bring to the company. However, this unique professional perspective more

effectively assists the board if it comes from an attorney acting solely as the board's legal counsel. In view of that fact, here are a few issues worth considering before deciding whether to join a corporate board.

**A) Increased Risk of a Malpractice Claim and Firm Disqualification.** Attorney board members face a greater malpractice risk than attorneys who limit themselves to corporate counsel service particularly if the attorney board member is sitting on a client board. The attorney board member often has more power and influence in corporate affairs than do other outside directors. This makes the attorney board member an irresistible target for plaintiffs. Typically, by suing the attorney board member, the plaintiff seeks in part to disqualify the attorney board member and his or her firm from representing the client company. Yet even if she is not sued, the attorney board member (and her firm) may be disqualified from representing the company based upon the "lawyer as witness" rule. In other words, she often becomes a witness because of her participation in corporate decision-making.

**B) Loss of Attorney Client Privilege.** When an attorney attempts to wear the two hats of legal counsel and board member (counsel/board member), it is difficult to determine which hat the attorney is wearing at any given time. Even in situations where the counsel/board member is providing strictly legal advice, the counsel/board member will be considered to have been acting concurrently as a board member. The end result is that when a counsel/board member participates in board conversations, it is likely that her communications will not be privileged.

**C) Inability to Participate in Certain Decisions.** Imagine a situation where the board will consider taking alternative courses of action. One course results in a

significant fee for the attorney's firm and the other course results in no fee for the firm. From a stockholder's perspective, it is difficult to imagine how the attorney acting as both corporate counsel and as a board member could give disinterested advice, or why the counsel/board member should vote on this matter. The counsel/board member should excuse herself from such discussion and voting. This means that there may be times when the company is deprived of the counsel/board member's advice—and perhaps on a critically important issue.

**D) Bankruptcy.** If the corporation for which an attorney is acting as both corporate counsel and board member files for reorganization under the bankruptcy laws, the counsel/board member and her firm may be precluded from acting as corporate counsel under the bankruptcy code. This issue arises if corporate counsel served as a board member within the two-year period preceding the bankruptcy petition. (See 11 U.S.C. Sections 101(14)(D) and 327.) Here again, at a critical time the company may be deprived of its corporate counsel, and the attorney board member and her law firm face the risk of being liable for the costs associated with retaining new counsel.

**E) Malpractice Resulting From Failure to Warn.** If an attorney serves as both corporate counsel and director, she should warn the company's management and the other directors of the above mentioned hazards (A thru D) and, of course, document such warnings. If she doesn't do so, the failure to warn may be sufficient basis for a malpractice claim if the company incurs significant expense, liability or other detriment that could have been avoided if the company was appropriately warned of the above.

**F) Weakened Defense to a Malpractice Claim.** When a corporation's legal counsel is sued by stockholder plaintiffs, often she may defend her position by stating that the board declined to follow her firm's advice, or that the board was incompetent. However, if corporate counsel also is a director, her defense is seriously weakened.

**G) Inadequate D&O Insurance.** Legal malpractice policies typically exclude coverage for director and officer liability. As a result of D&O claim frequency, adequate separate D&O coverage is becoming more

difficult to obtain. Under some D&O policies, the coverage applies only if the officer or director was acting "solely" as an officer or director. Thus an attorney acting as both corporate counsel and board member may not be covered under the D&O policy. Additionally, for those attorneys who serve as board members for banks and savings and loan associations (regardless of whether they also serve as corporate counsel), most D&O policies exclude coverage for claims made by a regulatory agency such as the FDIC, resulting in another insurance coverage gap.

**H) Inadequate Indemnification.** The corporation's bylaws may contain an indemnification provision, but the provision may not protect the board member for all claims. For example, under the corporate laws of many states, indemnification provisions cannot protect the director in successful shareholder derivative suits. Also, the indemnification provisions obviously are meaningless if the company is insolvent.

Before you agree to serve as a corporate director, remember that you never should try to wear two hats. Either serve as a director and never give legal advice, or act as corporate counsel without becoming a director. If you will be acting only as a director, give the corporation a letter stating that you will be acting solely as a director, and that you will do so in your individual capacity and not as a member or representative of your law firm.

If you will be acting as both corporate counsel and director, give the corporation's management a written disclosure of hazards A thru D listed above. Emphasize that the attorney-client privilege will not apply to any discussion or correspondence made in your capacity as a director. Make certain that you have adequate D&O coverage and that the corporate bylaws have appropriate indemnification provisions. Review the corporate finances to ensure that the corporation has sufficient resources to survive an adverse claim.

The decision to serve on a corporate board never should be taken lightly. There are significant risks associated with board memberships. In light of the hazards presented here, give particular consideration to the possibility that both you as the attorney and the corporate client may be better served if you act solely as corporate counsel and refrain from also serving as a

board member. It simply is much cleaner for you and the corporation.

OBLIC wishes to thank Mr. Bassingthwaighte and Attorneys Liability Assurance Society (ALPS) for permission to reprint this article.

### ***OBLIC Board, Department of Insurance Approve Premium Adjustments***

New rates filed by OBLIC were recently approved by the Ohio Department of Insurance. Some lawyers will see their rates decrease by up to 10%, while lawyers with higher limits of liability will see very small increases in premium charges.

Rates for policies with limits of liability of \$200,000 per claim, \$600,000 aggregate per policy year or less will decrease 10%, with all other factors remaining the same for any given policy. The cost of providing limits of liability greater than the \$200,000 per claim \$600,000 policy aggregate (\$200/600) has increased, depending upon the limits of liability purchased. The 10% decrease on the first \$200/600 of limits purchased will offset the increased costs for higher limits of liability. For example, a policy with \$250/750 limits of liability will still have a premium reduction around 5%. For limits of \$1 million/1 million, the premium will increase, but less than 3%.

The proposed effective date of the premium adjustments is July 1, 2002.

### ***OBLIC Loss Prevention Seminar***

Mark you calendar now and plan to attend the OBLIC Loss Prevention Seminar at the OSBA Annual Convention to be held in Columbus on Thursday, May 16, 2002 from 2:00 p.m. – 5:15 p.m. titled “Practice Strategies to Prevent Malpractice.” This seminar will offer tips to help you deal with some of the difficult situations in the practice of law.

CLE Credit has been requested for 1 hour of ethics, 1 hour of professionalism, ½ hour of substance abuse and ½ hour of general instruction.

This seminar will again be co-sponsored by the OSBA Solo Small Firm and General Practice Section Board of Governors, and the OSBA Lawyers’ Assistance Committee. You won’t want to miss this dynamic session!

### ***CLE Coupon Reminder***

As a reminder to OBLIC policyholders, each insured attorney, starting with policies effective September 1, 2001 and thereafter, will receive a coupon good for up to three hours of CLE at any OSBA CLE Institute sponsored CLE program, excluding the OSBA Annual Convention and OSBA District Meetings. If an attorney wishes to enroll in a course exceeding 3 hours, the coupon may be used for \$75.00 off the cost of that course.

This program should give OBLIC insured attorneys flexibility in choosing the time and topic of the CLE program they wish to attend.

The redeemable dates on the coupon will be between the effective date and expiration date of the policy. The coupon must be used between those dates. If a lawyer is added to a policy at any time, that lawyer will receive a coupon. That coupon will expire on the expiration date of the policy. If a lawyer is deleted from a policy two months prior to the expiration date of the policy, the date of his/her deletion shall become the expiration date of that lawyer’s coupon, and not the date originally shown on the coupon issued to that lawyer.

At this time, coupons are not transferable from one lawyer to another. Registration for a CLE program must be made directly with the OSBA CLE Institute. Attorneys wishing to use their coupon must submit the original coupon issued to them to the CLE Institute by mail, or when attending the course.

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