

PERSPECTIVES

An attorney's guide to insurance and risk management

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Serving on Business Boards

By Marcia L. Proctor

The following material is provided for informational purposes only. Before taking any action that could have legal or other important consequences, speak with a qualified professional who can provide guidance that considers your own unique circumstances.

Lawyers may be invited to serve on boards or as officers of community organizations and private businesses, or may contemplate appointment or election to governmental boards or agencies. The opportunity may be a reward for the lawyer's participation in the organization, a reflection of the confidence and esteem with which the lawyer is held, and a recognition that the lawyer's expertise is one that the organization needs at its highest decision-making levels. Some firms consider membership on client boards desirable and encourage their lawyers to cultivate such opportunities.

The law firm should have a policy addressing the circumstances under which firm members may serve on any outside boards or as officers of outside businesses, regardless of whether the organization is a client of the firm. Firm policy should take into account the following aspects of such service.

Liability

The insurance of the law firm may exclude coverage of liability arising from service as director, officers, partners, or similar capacities of businesses other than the firm. Some courts have held lawyer-

officers to a higher standard of care than the non-lawyer officers or directors. *Escott v Bar-Chris Construction Corp*, 283 F Supp 643 (SDNY 1968), higher duty of investigation; *Feit v Leasco Data Processing Equipment Corp*, 332 F Supp 544 (EDNY 1971), higher duty to examine documents readily available.

A lawyer contemplating service should find out the claim history of the organization being considered. Does the organization have directors and officers insurance? What are the policy limits, coverage and deductible? Does the organization pay the deductible when officers and board

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members are sued individually? Is there indemnification? Under the federal Volunteer Protection Act of 1997, 42 USC 14501 et seq, a volunteer of a nonprofit organization will generally be relieved of liability for any harm caused by the act or omission of the volunteer acting within the scope of his/her responsibility. To ensure that the activities would be covered under the Act, the lawyer should verify that the organization is a bona fide IRC 501(C)(6).

Conflicts

A conflict check should be performed at the law firm, as though the organization is a new client. Include not only the name of the entity, but also (a) any subordinate or subsidiary groups, parent entities, etc., (b) names of the executives who are likely to be the spokespersons of the entity, and (C) funding sources, particularly if the organization receives grant or government funding.

Some state ethics rules provide that when a member of a law firm serves on a board, no member of the firm may appear on behalf of a client before that board or any subordinate board. E.g. Michigan Ethics Opinions RI-22 [government board, private petitioners], RI-126 [city council, city attorney, and city housing authority], RI-180 [police commission, criminal practice, city civil practice], RI-236 [of counsel relationships]. These opinions hold that mere disclosure of the board member's connection to the petitioner or petitioner's counsel, abstention by the board member, or disqualification of the board member are not sufficient to dispel the conflict. Where such conflict rules are in place, service on the board may seriously impact the law firm's service to clients.

As an officer or board member, the lawyer may be a witness as disputes arise. ABA Model Rule of Professional Conduct 3.7(a) prohibits a lawyer from serving as advocate at trial when the lawyer will also be a necessary witness about a contested fact. Frequently the lawyer officer or board member is not the only witness available, but the lawyer who serves as legal officer as well as corporate officer or board member may have access to special information that was not distributed to all other fiduciaries. Whether the lawyer's firm is disqualified from serving at trial where the lawyer will be a witness depends upon the impact of the lawyer's testimony on the client's interests. If the testimony is aligned with or consistent with the interests of the law firm client, the firm is not disqualified from appearing at trial.

Written Understanding

Ethics rules do not prohibit a lawyer from sitting on a client board, but ABA Model Rule 1.8(a), business transactions with clients, may be triggered, particularly if there is compensation for service or the organization is a for-profit business. The arrangement should be memorialized in writing as required under the rule. A written description of the responsibilities of the office [scope of authority, duties, attendance requirements, etc.] is advisable, to avoid misunderstandings.

Dual Roles

The lawyer should clarify for personal comfort and/or through discussions with the organization, whether the lawyer may be called upon to serve the organization as a lawyer in addition to the officer/board member role. If that dual role is likely or contemplated, or if the organization is already a firm client, a careful review of ABA Model Rule 1.13 is warranted. It is the responsibility of the lawyer to clarify whether the lawyer is acting as lawyer or as officer/board member, and to make sure everyone understands who is the client [i.e. the organization, not the individual officers and board members]. The fiduciary duties undertaken to the organization are in addition to fiduciary duties to the law firm and ethical duties to clients. A claimant is likely to blur those distinctions in an effort to get whatever relief is desired [money, lawyer disqualification, free legal services, etc.].

Clarifying Roles

The lawyer would have the burden of proving that information disclosed to or reports created by the lawyer serving in an officer or board member capacity are covered by client-attorney privilege, or even by ethics rules protecting secrets. See, e.g. *Georgia-Pacific Corp v GAF Roofing Manufacturing Corp*, 1996 US Dist LEXIS 671, 1996 WL 29392 (SDNY 1996), inside counsel's recommendation and negotiation of clauses for an environmental contract is not privileged as a lawyer function, but is action taken in a business capacity; *Spectrum Systems International Corp v Chemical Bank*, 78 NY2d 371 (1990), outside counsel's report of an internal investigation was not privileged, found to be "assembled in the operation of the business."

Non-Public Information

As a fiduciary of the organization, the lawyer would be privy to information not otherwise available. If the information would be useful to a firm client and cannot be used because of the fiduciary duties owed to an outside board, a conflict may exist under ABA Model Rule 1.7(b).

A conflict might also develop if the lawyer is aware of firm client information that would be useful to the outside board. See also, ABA Model Rule 1.8 (b), a lawyer shall not use information relating to representation of a client to the client's disadvantage without client consent.

Further, the "Insider Trading Sanctions Act," Section 21 of the Securities Exchange Act as amended in 1988 and 1990, imposes liabilities on persons engaging in insider trading and persons or entities in control of inside traders. If the law firm comes into possession of material, inside information concerning a company in the course of its legal practice, and an employee of the firm trades in the company's securities while aware of the information, or discloses it to others who trade on it, two penalties may result:

- The employee may be subject to a civil penalty up to three times the profit gained or loss avoided as a result of a purchase, sale or communication of the inside information.
- The law firm may be subject to a civil penalty up to the greater of \$1 million or three times the profit gained or loss avoided as a result of the employee's violation.

Compensation

A law firm may have a policy providing that when any compensatory service is performed on firm time, the compensation is turned over to the firm. Some firms make an exception for compensation for outside directorships, allowing the firm member to retain the stipend. Having clear guidelines helps avoid misunderstandings.✂

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