

Walking the Legal/Corporate Tightrope: The Risks of Lawyers Serving as a Director of a Corporate Client

The role of lawyers serving as directors of corporate clients involves a variety of risk exposures. While the American Bar Association (ABA) has issued a formal opinion answering “yes” to the general question of whether lawyers may serve as directors of corporate clients, that opinion was tempered with a number of significant caveats. These caveats¹ address risks for the lawyer-director, the lawyer’s firm, as well as the corporate client. Specifically, the opinion advises that lawyers who engage in a lawyer-director relationship with their corporate client must identify and mitigate the following risks:

1. Reasonably assure that management ... understand (i) the different responsibilities of legal counsel and director; (ii) that when acting as legal counsel, the lawyer represents only the corporate entity and not its individual officers and directors; and (iii) that at times conflicts of interest may arise....
2. Reasonably assure that management ... understands that ... the attorney-client evidentiary privilege may not extend to matters ... when the lawyer-director is not acting... [as] corporate counsel
3. Recuse herself as a director from board and committee deliberations when the relationship of the corporation with the lawyer or her firm is under consideration
4. Maintain in practice the independent professional judgment required of a competent lawyer....
5. Perform diligently the duties of counsel once a decision is made by the board ..., even if, as a director, the lawyer disagrees with the decision,
6. Decline any representation as counsel when the lawyer’s interest as a director conflicts with her responsibilities of competent and diligent representation

As a professional who will be held to a heightened standard of care, the lawyer must recognize the risks associated with the lawyer-director relationship and take the requisite steps to manage these vulnerabilities. By identifying and addressing these risks at the outset of the lawyer-director relationship, lawyers may initiate their activities in a manner that will serve the corporate client and mitigate exposures associated with this role. However, lawyers also must remain vigilant in identifying these risks as they arise during their service as both a director and legal counsel to a client. The following four examples illustrate some of the risks encountered during the lawyer-director relationship.

CONFLICTS OF INTEREST RISKS

Generally, ABA Model Rule 1.7 provides the basis for determining whether a conflict of interest exists in the lawyer-director relationship. When considering the potential conflicts of interest risks at the commencement of the lawyer-director relationship, consideration should be given to the:

- Frequency with which such conflict may arise;
- Potential scope or materiality of the conflict;
- Effect on the client of the lawyer’s resignation from the board to avoid the conflict; and,
- Viability of the corporation obtaining legal advice from another lawyer in such situations.²

¹ ABA Formal Ethics Opinion 98-410. See Also ABA Formal Ethics Opinion 00-418 (citing Opinion 98-410 in discussing risks relating to lawyers acquiring ownership in a corporate client) and ABA Formal Opinion 02-426 (citing Opinion 98-410 in discussing risks relating to lawyers serving as fiduciaries for estates or trusts).

² See Comment 35 to ABA Model Rule 1.7.

In addition, the lawyer-director should be diligent in identifying conflicts of interest as they are presented throughout the relationship. For example, an ethical issue arises when a lawyer-director is asked to represent the corporation in an undertaking that he or she, as a director, has unsuccessfully opposed. Another example is where the board of directors addresses a matter that will affect the corporation's retention of legal counsel.

For those lawyers who serve as directors of not-for-profit profit entities such as legal assistance foundations, entities involved in law reform activities, or not-for-profit legal services programs, they should confirm that their activities comply with ABA Model Rules 6.3, 6.4, and 6.5, respectively.³

LOSS OF ATTORNEY-CLIENT PRIVILEGED COMMUNICATIONS

The lawyer-director should inform the corporate client that a court may determine that the company has waived the privilege associated with confidential communications based upon the lawyer-director relationship. Courts have held that the lawyer-director may have waived the privilege on behalf of the corporation.⁴ Throughout the lawyer-director's involvement with the corporate client, the lawyer-director must expressly define the scope of her involvement in a particular matter, whether it be as legal counsel or in the capacity as director. The lawyer-director also must avoid the possibility that other directors and management may be confused as to whether the lawyer-director's views on a matter represent legal advice or a business recommendation of a board member.

Techniques to manage this risk may include references in corporate minutes reflecting consultation in executive session with the lawyer-director on a legal matter. All documentation drafted or reviewed in executive session should then be retained in discrete files labeled as "attorney-client privileged and confidential." These files should be maintained separately from the general corporate minutes.

³ For those lawyers serving on not for profit boards it is recommended that they also review two reports issued by the ABA, namely, *ABA Committee on Corporate Laws, Corporate Director's Guidebook* (3d ed. 2001) and *The Legal Guidebook for Directors Subcomm., ABA Section of Bus. Law, Guidebook for Directors of Nonprofit Corporations* (George W. Overton ed., 1993).

⁴ For example, see *AOC Ltd. Partnership v. Horsham Corp.*, 1992 Del.; *Deutsch v. Logan*, 580 A.2d 100 (Del. Ch. 1990); *Securities and Exchange Commission v. Gulf & Western Ind., Inc.*, 518 F. Supp. 675 (D.D.C. 1981).

VICARIOUS LAW FIRM LIABILITY AND DISQUALIFICATION

A lawyer-director may derive a benefit in the event that the corporate client retains the lawyer's firm for outside legal matters. If the law firm is approached to represent the corporation on a specific matter, the law firm should, of course, run a conflicts check. While lawyers are associated in a law firm, none of them shall knowingly represent a client when any one of them practicing alone would be prohibited from doing so by Model Rules 1.7, 1.8(c), 1.9 or 2.2. If the lawyer-director concludes that under Model Rule 1.7(b) she is personally disqualified from a particular matter, her conflict is imputed to the other lawyers in her firm under Model Rule 1.10(a). Thus, the other firm lawyers are thereby disqualified from the representation.

Ethical issues also may arise when the corporation's directors and its officers find themselves individually named as defendants in litigation and they desire to be defended by the lawyer-director's firm. The lawyer-director probably acquired confidential information during her role as director. Moreover, knowledge of such information may be imputed to the other lawyers in the lawyer-director's firm. Therefore, the files of the law firm may be discoverable in the underlying litigation.

INSURANCE COVERAGE

Traditional professional liability insurance policies provide coverage only for "professional services" provided by an insured lawyer under the policy. As courts tend to draw distinctions between a lawyer's function as a "professional" and as a "director," coverage issues may arise under the lawyer's professional liability policy. Accordingly, lawyers interested in serving on client boards as a director of the corporate client must recognize a potential liability coverage gap and address matters relative to this role with their professional liability insurer and the corporate client.

The lawyer serving as a director must ensure that the corporate client maintains Directors and Officers (D&O) liability insurance for the lawyer's role as a director. This is an especially important question when the corporate client is a not-for-profit or charity, because the chance of this specific insurance being in place is unlikely. If the corporation does not carry a D&O policy, the lawyer-director should discuss purchasing, or having the corporation purchase, an outside director liability insurance policy.

CONCLUSION

In deciding whether to serve on a corporate client's board, the lawyer should address the risks discussed above at the outset of the lawyer-director relationship. In addition, the lawyer should exercise due diligence to identify any potential risks that may arise during the lawyer-director relationship. Sound risk control policies to manage these risks for the lawyer-director include the following:

- Draft a memorandum to the board outlining the potential risks that may arise during the lawyer-director's service on the board;
- Ensure that all directors (including new directors through the years) understand the lawyer-director's distinct dual roles;
- Remain vigilant in identifying and managing any potential conflicts of interest as they arise;
- Take all necessary steps to protect attorney-client privileged communications and documents, including, but not limited to, holding privileged communications in separate executive sessions;
- Recuse oneself from all decisions and votes that may involve a conflict of interest or other ethical considerations.

In addition, law firms also should manage potential liability exposures when a firm lawyer serves as a lawyer-director of a corporate client. Appropriate risk control policies to manage these risks include instituting a law firm policy for lawyers serving as directors of client corporations. The policy should address, at a minimum, the following issues:

- Require that no lawyer accept an invitation to serve as a director without law firm approval (or a committee within the law firm);
- Require that the client corporation has provisions in its Articles of Incorporation or other governing documents for director indemnification;
- Require that the client corporation confirm in writing insurance coverage for the lawyer-director;
- Include the lawyer-director relationship in all conflicts of interest checks within the law firm, including all subsidiaries and related entities to the client corporation;
- Require that all legal matters handled by the law firm for the corporate client be retained and opened with matter specific engagement letters to avoid waiver of any privilege.

Finally, the law firm should advise its professional liability insurance carrier prior to one of its lawyers accepting such a proposal to help minimize any gaps in coverage between the law firm's professional liability insurance and the corporation's D&O insurance.

Distributed By:



800-679-7154 <http://www.locktonrisk.com/iowabar/>
Contact: Michael Schrandt mschrandt@locktonaffinity.com

The purpose of this article is to provide information, rather than advice or opinion. It is accurate to the best of the author's knowledge as of the date of the article. Accordingly, this article should not be viewed as a substitute for the guidance and recommendations of a retained professional and should not be construed as legal or other professional advice. Any references to non-CNA Web sites are provided solely for convenience, and CNA disclaims any responsibility with respect to such Web sites. To the extent this article contains any examples, please note that they are for illustrative purposes only and any similarity to actual individuals, entities, places or situations is unintentional and purely coincidental. In addition, any examples are not intended to establish any standards of care, to serve as legal advice appropriate for any particular factual situations, or to provide an acknowledgement that any given factual situation is covered under any CNA insurance policy. Please remember that only the relevant insurance policy can provide the actual terms, coverages, amounts, conditions and exclusions for an insured. All CNA products and services may not be available in all states and may be subject to change without notice. CNA is a registered trademark of CNA Financial Corporation. Copyright © 2012 CNA.