



Serving on Client Boards: Dual Capacity and Dual Dilemma

Serving on the boards of client corporations continues to appeal to lawyers. Lawyer ethics rules do not prohibit the practice outright, and lawyers see benefits from solidifying the connection with the client, demonstrating loyalty, and getting to thoroughly know the client. Clients appreciate that the lawyer has taken a greater interest and personal stake in the business, and appreciate the loyalty and ready access to the lawyer's legal background and knowledge in the boardroom.

But for all the perceived benefits, there are risks – for the lawyers, their firms, and the clients. Whether the risks outweigh the benefits is a matter of personal perception. Whether the risks can be managed is a matter of effort and vigilance.

What Are The Risks?

Conflicts of Interest

An attorney's role and obligations when serving as an outside legal advisor to a corporation differ from an attorney-director's obligations when serving on the board. A corporate director has an obligation to the corporation and its shareholders to exercise judgment about the business affairs of the corporation and to make decisions with an eye toward maximizing the business interests of the corporation. A lawyer's role is to assess the legal ramifications of potential corporate actions to help guide the corporation upon a lawful path. These two points of view may sometimes conflict; in order to manage legal risks, an attorney acting as legal counsel might steer the board away from something that s/he would support as a legitimate business proposal when considering it solely as a director.

The dual role presents potential legal conflicts as well. Rule 1.7 of the Model Rules of Professional Conduct provides in part that a lawyer may not take on a representation that conflicts with his/her responsibilities to another client, a third person or the lawyer's own interests unless "(1) the lawyer reasonably believes the representation will not be adversely affected; and (2)



the client consents after consultation....” As the Restatement (Third) of Law Governing Lawyers notes:

“[S]imultaneous service ... is not forbidden. ... The requirement that a lawyer for an organization serve the interests of the entity ... is generally consistent with the duties of a director or officer. However, when the obligations or personal interests as director are materially adverse to those of the lawyer as corporate counsel, the lawyer may not continue to serve as corporate counsel without the informed consent of the corporate client.”
Section 135, Comment d.

The lawyer-director may have difficulty resolving such conflicts in certain circumstances. For instance, a lawyer-director should not participate in board decisions about hiring the lawyer’s firm to represent the corporation in any particular matter. Likewise, the lawyer-director should not participate in any decisions about choosing a course of action when the outcome could affect fees paid to the lawyer’s firm for services rendered to the corporation. While participating in such a decision is the duty of a board member, lawyers must explain to clients their obligation to recuse themselves from these decisions based on ethics rules about conflicts of interest. The difficulty here is that the lawyer-director has an obligation to participate in discussions about alternative courses of action by the corporation and provide input about the advantages and disadvantages to the corporation of each approach, but must recuse themselves from the decision-making discussion.

Conflicts can also deprive the client corporation of the law firm’s services altogether. If the lawyer-director may be called as a witness in a lawsuit against the corporation, or if the individual board members are sued along with the corporate entity, the law firm will be disqualified from representing the corporation or other board members at a crucial time.

Misunderstanding of Lawyer-Director’s Role by Other Board Members

The fact that other board members likely perceive that the lawyer-director will bring his or her legal knowledge to the table during any discussion heightens the risk that they will interpret the lawyer-director’s advice about a course of action as a tacit opinion that the course is lawful and compliant with applicable regulation when the lawyer may have made no such judgment. The other directors “...may think that the lawyer’s business advice constitutes a legal opinion which they may feel obliged to follow, or... if an attorney-director



votes in favor of a controversial proposition, it may be difficult to convince the other board members that there are nevertheless serious legal consequences relating to the decision.” See, *Dilemma of Counsel Serving on Board of Directors*, PLIREF_CORPLEG sec. 16:5.2 at *16-15. If the board members or the corporation are later sued over the decision, they may blame the lawyer-director and his firm for failing to guide them properly.

To manage risk under such circumstances, the lawyer-director should clearly inform the board members that in discussing courses of action for a corporation, he is fulfilling his role as a director, and that to fully analyze the legal risks and regulatory compliance obligations associated with the activity he will need to perform additional research in his capacity as an attorney prior to providing an opinion on these matters. Board members must understand that a lawyer is not in a position to do this within the context of a board of directors meeting and would be breaching his duty to the corporation as a client by expressing an opinion on legal and regulatory issues without first researching the matter.

The attorney acting as board member may find that other board members are confused about the relationship between them and the attorney, believing that the attorney is also acting as their personal attorney and giving them legal advice when in fact he is not. The attorney can mitigate this risk by clearly informing the board members that he is serving as the attorney to the corporation and as a member of the board of directors and can not provide legal advice to individual board members as it relates to their service on the board. This may be difficult to apply in practice, however. This issue is best addressed when the attorney is first asked to join the board and again at their first board meeting after joining the board. Attorneys should exercise extra caution in this area when the client is a not for profit organization and the board members are unpaid volunteers. Attorneys may perform pro bono work and serve on the boards of such organizations as a public service, but the board members need to understand that to the extent they need individual legal advice regarding their service on the board, they should consult with their own attorney.

Increased Risk for Personal Liability for Regulatory Violations, Business Torts and Criminal Charges

Once a lawyer crosses the threshold from outside counsel to insider-director, they lose the protective shield provided professional advisors by many of the regulatory rules and other laws that apply to corporations and



their individual constituents. For instance, it is arguably easier to support an allegation that a lawyer-director is a person conducting an alleged fraudulent scheme under the Racketeer Influenced and Corrupt Organizations Act (RICO) than to prove that an outside counsel falls under that rubric. Similarly, only lawyers acting as “experts” with respect to parts of registration statements they prepared or certified can be held liable under the Securities Act of 1933, but a lawyer-director can be sued as a director under the same act without need for any such special designations.

Once sued in their capacity as a director, the lawyer-director will likely be held to a higher standard of care than non-lawyer directors. See, e.g., Blakely v. Lisac, 357 F. Supp. 255 (D. Or. 1972) (Because the director was an attorney, he knew or should have known that financial information in the prospectus was misleading). Also see Escott v. BarChris Construction Corp., 283 F. Supp. 643, 690 (SDNY 1968) (Because the director was also the corporation’s attorney, “more was required of him in the way of reasonable investigation than could fairly be expected of a director” who was not an attorney). See also ABA Task Force Report on the Independent Lawyer (ABA 1998) at 54-55. Professional claims against the lawyer-director are generally more difficult to defend because of the appearance of self-dealing and the fact that the lawyer could not easily argue board incompetence or his own failure to know all the facts in defense.

In light of the recent increased scrutiny of corporate boards and their advisors, sitting on a client board heightens risk for attorneys and can create confusion about what the attorney-board member’s role should be in certain circumstances. In the wake of corporate scandals, many shareholders and the public at large have pushed for greater independence of directors, suggesting that they will be quick to question the actions of an attorney for a corporation who also serves as his own client in his capacity as a board member. The advent of the Sarbanes-Oxley Act of 2002 and the attorney advisor’s role under section 307 of the Act makes this unresolved question even murkier; for instance, is an attorney-director who does not practice before the SEC subject to the reporting-up requirements of the section? Is the attorney’s firm required to report suspected violations of the type enumerated in the regulations if the attorney-director learned of them solely in his/her role as a director? So far, these questions have not been addressed in case law, but are likely to arise in the future. See, e.g., The Lawyer as Director of the Corporate Client in the Wake of Sarbanes-Oxley, 23 J. Law & Commerce 53 (Fall 2003).



Increased Vicarious Liability Risk for Lawyer-Director's Firm

Ordinarily, a law firm has no obligation to provide business advice to a corporate client. But the greater the apparent or actual involvement of the lawyer's firm in the client's business decisions, the higher the risk that someone can claim the firm was responsible for the individual attorney-director's business decisions. Muddying the waters between providing legal representation and advice to a client and assuming fiduciary responsibility for the client's business decisions and actions can expose the law firm to claims that the law firm is vicariously liable for the actions of an individual attorney in their capacity as a director.

Law firms that serve clients in such situations should to the extent possible assign attorneys other than the lawyer-director to perform legal services pertaining to the implementation of a course of action (such as a proposed merger) that arose from advice to the company by the lawyer-director in their capacity as a director. In any case, due to these risks to the firm, all legal services rendered by a lawyer-director to the client should be overseen and supervised by other firm principals. If the law firm is large enough, consider establishing a committee to perform this service to minimize conflicts about supervision and to further insulate the firm from allegations that the law firm did not adequately supervise the lawyer-director's activities.

Loss of the Attorney-Client Privilege

Whenever attorneys serve on the boards of clients, there is an increased risk of loss of the attorney-client privilege for communications between the corporation and the lawyer or the lawyer's firm. It is well-established that the privilege only attaches to communications made for the purpose of obtaining legal advice and does not attach to business advice. Since it can be very difficult to compartmentalize the communications an attorney-director has with the corporate representatives or other board members, there is a risk that these conversations may be deemed discoverable, especially since the presumption is against applying the privilege to such conversations. This risk is exacerbated by the fact that an attorney-director arguably has the power to waive the attorney-client privilege on behalf of the corporation, essentially making unavailable any argument that the attorney-director's disclosure of otherwise privileged information was not an intentional waiver of the privilege. Indeed, as one commentator noted, "it is clear that every time an attorney concurrently serves as a director of a corporate client, the attorney-client privilege is put in jeopardy." Straub, ABA Task Force Misses the Mark, 25 Del. J. Corp. L. 261, 268 (2000). See also N.Y. Op. 589 (1988) (Because the risk of



disqualification and loss of privilege is great, the attorney must warn the corporate client and other board members before accepting directorship).

Lack of Insurance Coverage

Typically, professional liability insurance policies for attorneys exclude coverage for claims arising out of activity as a director or officer of a corporation. Additionally, directors and officers insurance policies typically exclude coverage for legal malpractice claims. Consequently, lawyer-directors and their firms may lack insurance coverage for a claim arising out of dual activity by the lawyer-director. Accordingly, attorneys who are considering or already are serving in such roles should consult with their firm's insurance agent on this issue.

Additionally, like other board members, attorneys should ask the corporate client to enter into a hold harmless agreement with them and their law firm with respect to any claims of the corporation or any third party claims arising from their services as a board member as a condition of agreeing to serve on the board. Of course, the attorney and the firm should also confirm that the corporation appears to be financially strong enough to meet any such indemnification obligation. While this won't insulate the lawyer or law firm from attorney malpractice claims (ethics rules prohibit such prospective limitation of malpractice liability), it will help address the uninsured exposure problems.

How to Manage the Risks

These risks can be avoided completely by simply refusing to accept board positions with clients. The client may simply desire the attorney's input at board meetings, which can be satisfied by agreeing instead to attend every board meeting in a capacity as outside counsel. (Firms can consider adjusting hourly rates or charging a set price for attendance at board meetings in order to make such an option more palatable to the corporation.) This allows the board ready access to the attorney's legal expertise without creating confusion about the attorney's role at any given time. This approach keeps the attorney clearly in the role of outside advisor, providing greater protection from claims under RICO or securities laws and significantly lowering the risks of loss of attorney-client privilege. Of course, if the attorney participates only in this way, the client loses the benefit of the attorney's business advice or personal stake in the business of the client.



If declining the position isn't desirable, the attorney and the firm must take steps to ensure that all ethical obligations are met and to mitigate the risks. The American Bar Association's Formal Ethics Opinion 98-410 offers a very thorough consideration of these issues and recommendations for handling them, and any lawyer considering serving as a board member should review it as a first step in the process.

Among the other steps, the attorney must clearly delineate and define his/her roles when interacting with the corporation and the individual board members. Document the risks of this dual role in writing to the corporation and to the individual board members, and be alert to the need to clarify which role is being fulfilled during boardroom discussions. The attorney-director may need to preface statements made in board meetings to clarify whether he is giving legal advice or business advice. Also continuously reinforce to individual board members that the attorney-director is not and can not provide them with legal advice about their own liabilities or legal risks.

A way to try to protect the attorney-client privilege in these circumstances is to always have another attorney from the firm present whenever the corporation seeks legal advice. Because the conversations include someone who is acting solely as an attorney, this strengthens the argument that the client did not intend those conversations to be subject to discovery. Along these same lines, use firm stationery only for communications connected with legal services; the lawyer-director should use his personal stationery for board-related business. Similarly, the lawyer-director should be paid director's fees directly and not through the firm, and all legal fees should be paid only to the firm. It is helpful to avoid delivering firm payments through the individual lawyer-director even when it consists of a check payable to the firm, just to avoid confusion and keep the dividing line as bright as possible.

Additionally, it is important for the individual lawyer-director and the law firm to make sure that the lawyer-director has adequate director's and officer's insurance, either purchased individually or provided by the client corporation. A significant risk of the lawyer-director situation is the lack of legal malpractice or directors and officers insurance coverage, or the existence of applicable insurance but inadequate limits of liability. To the extent insurance coverage exists for legal malpractice claims against the lawyer and law firm and for directors claims made against the individual attorney, it is critical to keep these roles separated as much as possible to preserve coverage under the appropriate policy should the need arise. Lawyers should consider declining to serve on the board of client firms that either have no directors and officers insurance or that maintain inadequate limits of liability. Attorneys should seek



the advice of their firm's insurance agent in these matters. Firms and lawyers that fail to consider these risks may face significant losses that could have been mitigated with better planning.

Finally, if lawyers accept board positions, the firm must enter the information into its conflicts database and remain vigilant to all of the risks outlined above, withdrawing from the representation, having the attorney resign from the board, or both, if and when it may be necessary to do so to address conflicts or confidentiality issues. No such relationship should be undertaken without informing the client and all board members in writing of the downside risks, including potential confidentiality and privilege waivers, and about the different roles and responsibilities of legal counsel and director. The lawyer should obtain written signed consent from the client and other board members before accepting the position.

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