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NEWSLETTER

Controlled Enterprise Exclusion in Lawyers Policy Inapplicable

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A federal magistrate judge, applying Maine law, has issued a recommended decision holding that the controlled enterprise exclusion in a lawyer's malpractice policy does not apply to allegations that the attorney engaged in conduct intended to benefit an enterprise in which the lawyer had an interest because the actions by the lawyer were on behalf of a client and therefore were not "based upon or arising out of" work performed on behalf of the controlled enterprise. *Am. Guar. & Liab. Ins. Co. v. Keiter*, No. 02-123-P-C, 2003 WL 1889053 (D. Maine, Apr. 16, 2003).

An insurer issued a malpractice policy to an attorney. The policy contained a controlled enterprise exclusion applicable "to any claim based upon or arising out of the work performed by the Insured, with or without compensation, with respect to any corporation, fund, trust, association, partnership, limited partnership, business enterprise or other venture, be it charitable or otherwise, of any kind or nature in which any Insured has any pecuniary or beneficial interest, irrespective of whether or not an attorney-client relationship exists, unless such entity is named in the Declarations."

The lawyer provided legal advice to an individual in connection with the formation of a corporation in exchange for 25% of the stock in the corporation. The lawyer also advised the individual in connection with a book contract. The individual and the corporation subsequently sued the lawyer for malpractice. One count in the complaint alleged that the lawyer breached his fiduciary duties by recommending that all of the book royalties go to the corporation (in which he had an interest), rather than the standard industry approach in which 80% of the royalties would have gone to the author. The other counts in the complaint alleged various theories of "professional negligence." The insurer filed a lawsuit seeking a declaratory judgment that it had no duty to defend. It then filed a motion for summary judgment, and the magistrate judge recommended that the motion by the insurer be denied.

With respect to the count concerning the book royalties, the magistrate judge reasoned that, according to the allegations in the complaint, the lawyer did not undertake the book negotiations for the corporation. Instead, "he undertook the negotiation for the [the individual client] as an individual and breached his duty to [the individual client] as his individual client by arranging for all of the proceeds to go to [the corporation] in which [the lawyer] had a beneficial or pecuniary interest, rather than to [the individual client]." Accordingly, the magistrate judge reasoned that the alleged liability was not "based upon or [did not] aris[e] out of" work

performed "with respect to" the corporation.

As to the remaining counts, the magistrate judge concluded that the insurer had relied on extrinsic facts and not simply on the allegations in the complaint. Since those facts were in dispute, the court concluded that summary judgment was inappropriate.

For more information, please contact one of WRF's Professional Liability Attorneys at 202.719.7130