

Business Enterprise Exclusions Preclude Coverage for Claim "Arising Out Of" Ownership Interest Where Alleged Legal Malpractice Began Prior to Ownership

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The United States District Court for the Western District of Washington has held that a policy's business enterprise exclusions precluded coverage for a legal malpractice claim "arising out of" an ownership interest where the alleged malpractice began prior to, but continued after, the acceptance of that interest. *Corbello v. Moore*, No. C10-5357BHS (W.D. Wash. Apr. 20, 2011). Wiley Rein LLP represented the insurer in this case.

The insured attorney formed an attorney-client relationship with an investor and two individuals to assist in the formation of an LLC and then accepted a 25% ownership interest in the business. After one of the individuals fraudulently withdrew the vast majority of the investment, the investor filed a legal malpractice action in state court alleging that the attorney had acted negligently by (1) failing to warn or obtain waivers of the potential conflict between the interests of the investor and the other members of the business, and (2) preparing deficient organizational documents in the formation of the LLC, which failed to protect the investor's interests. The insurer denied coverage pursuant to the policy's business enterprise exclusions. Thereafter, the state court entered judgment against the attorney, and the investor filed a writ of garnishment against the insurer. The insurer removed the garnishment action to federal court, and the insurer and investor filed cross-motions for summary judgment.

The court denied the motion for summary judgment filed by the investor and granted summary judgment in favor of the insurer. The court held that coverage was precluded by both of the policy's business enterprise exclusions: Exclusion F, which precluded coverage for "any claim based on or arising out of an Insured's capacity as . . . a former, existing or prospective . . . shareholder," and Exclusion H, which barred coverage for "any claim based on or arising out of legal services performed for any existing or prospective . . . business enterprise . . . if at the time of the act or omission giving rise to such claim . . . any Insured was . . . more than a 10% shareholder . . . of such enterprise." The court rejected the argument that the business enterprise exclusions did not apply because the alleged malpractice began prior to the attorney's acceptance of an ownership interest in the LLC. Rather, the court held that Exclusion F precluded coverage because the attorney "wore different hats at different times" and refused to "separate out" those actions by the attorney that

occurred prior to his acceptance of the ownership interest. The court also held that Exclusion H applied because the claim included malpractice that occurred after the attorney became a shareholder of the LLC.