

No Coverage under Business Enterprise Exclusions

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A federal district court, applying Louisiana law, has held that an insurer was not obligated to provide a defense or coverage to an attorney under a malpractice policy because business enterprise exclusions in the policy excluded coverage for claims arising out of legal services the attorney provided for companies the attorney controlled or intended to control. *Cont'l Cas. Co. v. James E. Smith, Jr. et al.*, No. 02-0282CW01-3625, 2003 U.S. Dist. LEXIS 50 (E.D. La. Jan. 2, 2003).

The insurer issued a legal malpractice policy to the insured attorney. The policy defined a claim as "a demand received by the Insured for money or services arising out of an act or omission, including personal injury, in the rendering of or failure to render legal services." The policy also contained three exclusions relating to work for business enterprises. The first exclusion was a "Specific Person Or Entity Exclusion Endorsement" that excluded coverage for legal services provided to certain specified entities. The second exclusion provided that the policy did not apply "to any claim based on or arising out of an Insured's capacity as: 1. a former, existing or prospective officer, director, shareholder, partner or manager of a business enterprise or charitable organization...." The third exclusion precluded coverage for "any claim based on or arising out of legal services performed for any existing or prospective [business enterprise]..., not named in the Declarations, if at the time of the act or omission giving rise to such claim: 1. any Insured controlled, operated or managed or intended to control or manage such enterprise; or 2. any Insured was: a. a partner or employee of such enterprise...."

The insured attorney had served as counsel to his uncle and father in their joint business ventures and to his uncle individually. These business ventures involved the entities identified in the policy's exclusions. In 1996, the attorney was given responsibilities in the management of the corporations, and in 1999, the attorney assumed the position of president, a position previously held by his uncle. In 2001, the uncle sued the attorney in federal court alleging that the attorney had unlawfully wrested control of the corporation from him. The uncle alleged that the attorney failed to amend the bylaws, diverted profits to other corporations, had a conflict of interest with other companies he managed or that employed him, falsified corporate records and failed to disclose relevant information affecting the uncle's rights in the companies. The uncle asserted various legal theories, including that, in providing legal services, the attorney had operated under an unwaivable

conflict of interest. The uncle also filed an action in state court seeking injunctive relief to restrain the attorney from denying the rights and privileges of the uncle as the CEO of the corporations, from destroying or removing any of the client's files and from undertaking any unethical conduct. After the attorney sought coverage under the policy for both suits, the insurer filed a motion for declaratory judgment.

The court ruled in favor of the insurer. The court found the policy exclusions to be clear and unambiguous and noted that "when an insurance policy excludes coverage for claims 'arising out of' certain conduct, the exclusion is given a broad, general, and comprehensive interpretation." The attorney conceded that there was no coverage for claims brought based on acts or omissions in the performance of legal services for the entities specifically identified in the first exclusion, but argued that claims arising out of representation of the uncle in his individual capacity were not excluded. The court rejected this argument, concluding that none of the claims made against the attorney arose out of representation of the uncle in his individual capacity. Specifically, the court found that the attorney's alleged actions were taken in the attorney's capacity as an officer of the corporations or during the attorney's work for the corporations. The court explained that "all of [the client's] allegations [arose] out of [the attorney's] activities as president of the corporations, in anticipation of his role as president, or from legal services performed for companies that an insured managed, controlled, or intended to control."

The court also found that the policy exclusions barred coverage for the state claims against the attorney because they mirrored the actions in the federal action. The court also held that, because the state court petition sought only injunctive relief, the claim did not make a demand for "money or services," and thus was not a "claim" within the meaning of the policy."

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