

Lawyers Mixing Legal Counsel with Business Interests? Not So Fast

AUTHOR: SANDBERG PHOENIX

Introduction

In *Burk & Reedy, LLP v. Am. Guarantee & Liab. Ins. Co.*, 89 F.Supp.3d 1(D.D.C. 2015), the U.S. District Court for the District of Columbia examined a professional liability insurer's duty to defend when the insured attorney is involved in both the legal and business aspects of a failed transaction. The case serves as an apt reminder for attorneys to be mindful of their ethical obligations at all times, and how an alleged failure to follow those ethical obligations may impact the extent of their malpractice insurance coverage.

Factual and Procedural History

This case originated from a transaction involving China Trade and Investments, LLC ("CTI"), an importer and exporter of urea. *Id.* at 3. In October 2008, CTI's managing members, James Burk and Steven Allemang, executed an agreement with Gratian M. Yatsevitch, III. *Id.* Under the agreement, Yatsevitch would be a 32.5% owner of CTI in consideration for his agreement to secure collateral for a loan to CTI that would be used to fund CTI's transactions involving the sale of urea. *Id.* at 3. In December 2008, Yatsevitch secured a \$325,000 loan for CTI from a lender, with Burk providing legal counsel to Yatsevitch in securing the loan. *Id.* Yatsevitch was made a guarantor of the loan; a parcel of real property he owned was encumbered as collateral for the loan. *Id.* After Yatsevitch secured the loan, CTI failed to complete the urea deals and failed to repay the loan. *Id.* The lender foreclosed on Yatsevitch's real property that was used as collateral. *Id.* at 3-4. The property was eventually sold; the loan was repaid. *Id.* at 3. Yatsevitch then sued Burk for a variety of claims. *Id.* at 4.

One of those claims was for legal malpractice. Yatsevitch argued Burk breached his fiduciary duty to Yatsevitch in connection with the loan. *Id.* In support of his legal malpractice claim, Yatsevitch made a variety of allegations against Burk:

- Burk provided advice to Yatsevitch in connection with his decision to invest in CTI;

- Burk knew that Yatsevitch relied upon his advice in connection with all legal issues that arose in connection with the loan and Yatsevitch's agreement to invest in CTI;
- Burk did not act in good faith or with complete candor when he made representations concerning CTI's profitability;
- Burk acted in bad faith because his actions were undertaken to further his own self-interest in creating a possibility that CTI would be able to engage in a transaction that would result in substantial profits to Burk;
- Burk failed to inform Yatsevitch of various false representations in the loan documents;
- Burk failed to negotiate with the lender in a manner to protect Yatsevitch's interests;
- Burk promoted the transactions and business dealings that resulted in Yatsevitch agreeing to serve as guarantor for the loan;
- Burk acted as counsel to CTI while owning a significant percentage of that same company and did business with a client (Yatsevitch) while failing to accurately, fully, and fairly disclose all aspects of the business to Yatsevitch.

Id. at 4-5.

When Yatsevitch filed suit, Burk held a legal professional liability insurance policy through American Guarantee and Liability Insurance Co. *Id.* at 5. The insurance policy specified that the insurer would pay claims "based on an act or omission in the Insured's rendering or failing to render Legal Services for others," with "legal services" defined as:

[T]hose services performed by an Insured as a licensed lawyer in good standing, arbitrator, mediator, title agent, notary public, administrator, conservator, receiver, executor, guardian, trustee or in any other fiduciary capacity but only where the act or omission was in the rendition of services ordinarily performed as a lawyer. Legal Services shall not be extended to include services rendered as a real estate agent or broker or as an insurance agent or broker[.]

Id. Burk reported Yatsevitch's claim to American Guarantee, but American Guarantee denied coverage based on two exclusions in the policy. *Id.* at 6-7. The first exclusion was the "insured status" exclusion. *Id.* at 6. The "insured status" exclusion precluded coverage for any claim "based upon or arising out of, in whole or in part ... the Insured's capacity or status as . . . an officer, director, partner, trustee, shareholder, manager or employee of a business enterprise, charitable organization or pension, welfare, profit sharing, mutual or investment fund or trust." *Id.* at 6. The second exclusion was the "business enterprise" exclusion, which precluded coverage for any claim "based upon or arising out of, in whole or in part . . . the alleged acts or omissions by any Insured, with or without compensation, for any business enterprise, whether for profit or not-for profit, in which any Insured has a Controlling Interest." *Id.* A "controlling interest" was defined as: the right of an Insured or a member of an

Insured's Immediate Family, directly or indirectly, to:

1. own 10% or more of an interest in an entity; or 2. vote 10% or more of the issued and outstanding voting stock in an incorporated entity; or 3. elect 10% or more of the directors of an incorporated entity; or 4. receive 10% or more of the profits of an unincorporated entity; or 5. act as general partner of a limited partnership, managing general partner of a general partnership, or comparable position in any other business enterprise.

Id. at 7.

Analysis: American Guarantee Did Not Have a Duty to Defend

After American Guarantee's denial of coverage, Burk sued American Guarantee, arguing it had a duty to defend him in the underlying suit by Yatsevitch. *Id.* at 7-8. Burk contended the legal malpractice claim was based on his rendering of legal services, or lack thereof, to Yatsevitch in connection with the loan, thus imposing a duty on American Guarantee to defend. *Id.* American Guarantee maintained it did not have a duty to defend because Burk fell within the insured status and business enterprise exclusions. *Id.* at 8.

Burk argued neither exclusion applied because Yatsevitch's claim did not "arise out of" Burk's status as a managing and controlling member of CTI. *Id.* Specifically, Burk contended the term "arising out of . . . means proximately caused [by]," and that Yatsevitch did not sufficiently allege in his legal malpractice claim that Burk's status as a managing and controlling member of CTI was the proximate cause of his alleged injuries. *Id.*

The court rejected the proximate cause argument and instead used the ordinary meaning of "arise out of." *Id.* at 10-11. To determine that ordinary meaning, the court cited a variety of cases holding that "arising out of" means: "originating from, growing out of, flowing from, or the like." The court then applied the ordinary meaning of "arise out of" to the two exclusions to determine that both exclusions applied. *Id.* at 11.

For the insured status exclusion, Yatsevitch's claims against Burk in the underlying action were "based upon or arising out of, in whole or in part," Burk's role as a manager of a business enterprise. *Id.* Yatsevitch's allegations demonstrated that Burk simultaneously wore two hats while advising Yatsevitch to invest in CTI: attorney and managing member of CTI. *Id.* For example, Yatsevitch alleged Burk legally advised Yatsevitch in obtaining the loan and induced Yatsevitch into guaranteeing the loan by promoting CTI transactions and business dealings, in addition to agreeing to make Yatsevitch a managing member of CTI. *Id.* The Yatsevitch allegations, therefore, stated that Burk, as a managing member of CTI, worked under a conflict of interest while he was giving legal advice to Yatsevitch regarding the loan transaction. *Id.* Thus, the legal malpractice claim arose, at least in part, out of Burk's "capacity or status" as a corporate representative of CTI. *Id.*

The court also explained that Yatsevitch's legal malpractice claim fit within the business enterprise exclusion. *Id.* at 11-12. This exclusion applied if Yatsevitch's claims against Burk were "based upon or arising out of, in whole or in part," Burk's conduct "for any business enterprise" in which he "has a [c]ontrolling [i]nterest." *Id.* at 11. Yatsevitch's allegations showed that Burk (1) provided legal assistance to Yatsevitch during the loan application process; and (2) concurrently attempted to advance CTI's business interests. *Id.* at 12. The legal malpractice claim therefore arose (at least in part) out of Burk's actions on behalf of CTI, a company in which he held a controlling interest. *Id.* Accordingly, the court held American Guarantee did not have a duty to defend Burk in the underlying action.

Conclusion

This case provides attorneys an excellent reminder of the dangers of improperly mixing legal and business interests. In addition to the risk of civil liability and of violating ethical obligations, an attorney might lose the benefits of having a legal malpractice insurance policy in force.

By Mohsen Pasha

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