

Business Enterprise Exclusion Does Not Bar Coverage

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Applying Maine law, the United States Court of Appeals for the First Circuit has held that a business enterprise exclusion in a lawyer's professional liability policy does not bar coverage for a malpractice claim alleging that an insured lawyer improperly negotiated a book deal for a client in which all proceeds from the book sales were channeled into the client's corporation in which the lawyer's wife owned 25 percent of the shares. *Am. Guarantee & Liab. Ins. Co. v. Keiter*, 360 F.3d 13 (1st Cir. 2004).

The insurer issued a lawyer's professional liability policy that contained an exclusion for "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...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 exclusion stated that "[f]or purposes of this policy, ownership or shares in a corporation shall not be considered a 'pecuniary or beneficial interest' unless one Named Insured or members of the immediate family of the Named Insured own(s) 10 percent of the issued and outstanding shares of such corporation."

In the underlying action, a former client brought a malpractice suit against the insured attorney alleging, among other things, that the attorney breached his fiduciary duty to the client by negotiating a book contract on the client's behalf in a manner to benefit the attorney. Specifically, the client alleged that the attorney negotiated the contract to channel all proceeds into the client's corporation in which the lawyer's wife owned 25 percent of the shares. The insurer filed a declaratory judgment action seeking a ruling that it had no duty to defend or indemnify the lawyer based on the business enterprise exclusion.

The First Circuit initially noted that "[p]rofessional liability insurers generally do not wish to provide coverage for the business activities of insured lawyers," and therefore generally include a business enterprise exclusion in their policies. In this instance, however, the court concluded that the business enterprise exclusion did not unambiguously bar coverage. The court explained that, under the first sentence of the exclusion, the attorney had no pecuniary interest in the corporation since he did not own shares, though he might be deemed to have a beneficial interest in it through his wife's stock ownership. The court then turned to the second sentence of the exclusion and reasoned that it could be construed in two different ways, only one of which would preclude coverage. On one hand, the sentence could be read, as the insurer argued, to bar coverage

whenever an immediate family member owns 10 percent of the outstanding shares of a corporation. Alternatively, the court reasoned that the second sentence could be read "as a carve out, not as definition." Under this approach, the exclusion would be triggered only by a determination that, under the first sentence of the exclusion, the insured has a "beneficial interest" in the business at issue. The court concluded that the second approach was preferable because "[t]his is the most literal reading of the two sentences. It also has the benefit of looking to state law definitions of property rights in the absence of an express definition of the term 'pecuniary or beneficial interest' in the Policy."

Applying this reading of the business enterprise exclusion, the court held that the exclusion did not apply and the insurer had a duty to defend the lawyer. The court explained that, under Maine law, a husband does not by virtue of marriage alone gain a beneficial interest in property owned by his wife absent divorce. Since there was no indication that the attorney and his wife were in a divorce situation, the husband had no beneficial interest in his wife's stock, and the exclusion did not apply.

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