Wednesday, October 22
11:00 am-12:30 pm

907 Attacks on In-house Counsel's Ethics

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Faculty Biographies

Suzanne Calvert

Suzanne Calvert is the managing attorney of State Farm's Claim Litigation Counsel office in Dallas, TX. In addition to managing an office of fifteen trial attorneys, Ms. Calvert is currently one of the leaders of State Farm's CLC talent identification initiative. Furthermore, she is a key leader on State Farm's CLC alternative work arrangement committee.

Ms. Calvert began her legal career as a litigator with Liddell, Sapp, Zivley, Hill & LaBoon in Dallas. Subsequently, she prosecuted felony criminal cases in the District Attorney's office in Nacogdoches County, TX. Ms. Calvert, along with her husband, was also a managing partner with Calvert & Calvert, P.C., where she represented numerous corporate clients throughout the state of Texas.

Ms. Calvert is a graduate of Baylor University School of Law.

Rod Hollenbeck

Rod Hollenbeck is the managing attorney for the Farmers Insurance Seattle branch legal office of Hollenbeck, Lancaster, Miller & Andrews. He also serves as the divisional supervising attorney for the west division of Farmers claims litigation department, and in that capacity oversees in house litigation law offices representing insurance clients in the states of Washington, Idaho, Oregon, Nevada, and Utah.

Prior to joining Farmers, Mr. Hollenbeck served as the managing attorney for Fireman's Fund in-house litigation program, overseeing the Seattle and Portland, OR operations as well as overseeing litigation in the state of Alaska. He has also had experience as a partner at Evans, Craven & Lackie P.S., a private insurance defense law firm.

Mr. Hollenbeck has served on the board of the Washington Defense Trial Lawyers and has frequently testified before the Washington legislature on insurance related issues.

Mr. Hollenbeck received a BS from Washington State University and is a graduate of Gonzaga University School of Law.

Michael Maguire

Michael Maguire is the managing attorney of Michael Maguire & Associates - House Counsel for State Farm Insurance in Orange County, CA.

Prior to joining State Farm, Mr. Maguire was a founding and general partner in the firm of Nyman, Johnson & Maguire, where he specialized in insurance defense litigation. Mr. Maguire began his professional career as a deputy district attorney in Orange County, CA where he went onto prosecute major felonies and homicides.

Mr. Maguire is a member of the American Board of Trial Advocates (ABOTA) where he currently serves as national treasurer of the national board of directors. He has also served on the statewide Cal-ABOTA executive board and is a past president of the Orange County chapter of ABOTA. Mr. Maguire is also past president of the Orange County Bar Foundation- dedicated to legal education especially for at-risk youth and their parents. He remains on the Orange County Bar Foundation's board of trustees and is chair of its national award winning *Shortstop* juvenile criminal diversion program. He also regularly sits as a temporary judge for the Orange County Superior Court.

Mr. Maguire received a BA from the University of California, Irvine and is a graduate of Loyola University School of Law.

Robert Taylor

Robert Taylor is senior vice president and senior associate general counsel for Safeco's Property and Casualty insurance companies in Seattle. His current responsibilities include supervision of 36 litigation staff offices around the country along with litigation against the Safeco companies.

Prior to joining Safeco, Mr. Taylor began his career as an associate of the Los Angeles firm of Tucker & Coddington where he focused primarily on insurance defense trial work in the area of aviation and public utilities.

Mr. Taylor is a member of ACC, where he is a member of the Executive Committee of the National Insurance Staff Counsel Committee and a past chair. He is also a member of the American Bar Association and the Defense Research Institute. Mr. Taylor has been a speaker at various seminars including the 1998 American Corporate Counsel Association Annual Convention where he spoke on "Providing Excellent Customer Service," the 2000 ACCA Annual Convention where he spoke on "States Under Siege," the 2002 ACC Annual Convention where he spoke on "Managing Litigation in the Future," and the 2005 ACC Annual Convention where he spoke on "Staffing Efficiencies in the 21st Century."

Mr. Taylor received a BA from the University of California, Los Angeles and is a graduate of Loyola University School of Law.

OUTLINE

Attacks on in-house counsel -
What is the fuss all about? Is it really about ethics or are there other reasons?

I. Historically- what issues have been raised (from high level have Bob Taylor share some observations)

UPL challenges
Ethical practice of law challenges – conflict of interest

II. Where have they originated and why? (whole panel can address, one by one for a few minutes each)

Who?
Why? What is motivation? Red herrings?
i. What is driver?
Ignorance?
Defense bar?
Query: If truly ethical based, why not raised earlier (i.e., driven by economics create by re-deployment of insurance staff counsel?)

III. Recent attacks - Suzanne & Jim can share response approach used most recently.

Suzanne Calvert- recent Texas challenges
Jim Whittle – UPL – Wisconsin & Nebraska

IV. How to best prepare and respond if YOU arrive at court and hear the judge asking the question re staff counsel propriety or Plaintiff's counsel hands you a motion to recuse yourself due to UPL or inherent conflicts

1) Knowledge of past attacks and arguments-

2) Knowledge of rulings and decisions supporting the legality
a) "Handout" of case, statutory and ethics opinions finding that in-house counsel ≠ UPL or unethical

b) ABA Opinion

2) Active bar participation – join
Be a ready resource- blunt or stop attacks/challenges from "get go"

3) Educate young associates and firms

4) Caesar's wife

ACC Association of Corporate Counsel

Challenges to Staff Counsel

You are served with a motion to disqualify the entire office on a case that is set for trial in two days. The motion argues conflict because of the conduct of a newly hired attorney. The motion is brought by that attorney's husband who represents the Plaintiff. What do you do?

ACC Association of Corporate Counsel

Challenges to Staff Counsel

The beginnings

- Litigation Guidelines
- Outside Fee Auditors
- Staff Counsel Challenges

- What motivated these changes and the responses to them?

Challenges to Staff Counsel

Arguments against the use of staff attorneys

- Corporation practicing law
- Misrepresentation of employment status
- Conflict of Interest
- Breach of Client Confidentiality

Challenges to Staff Counsel

Issues that have gone by the wayside ?

- Standing – personal injury plaintiff has no standing to litigate choice of defendant's attorney
- Competency
- Actual Harm suffered by insured client

Challenges to Staff Counsel

Justice Boehm wrote for the Indiana Supreme Court in the 1999 case of Celina Ins. v. Wills,

"It is of course true that a legal entity can be responsible for the professional actions of its partners, employees and agents under standard doctrines of respondeat superior, and in that sense is view as engaged in the activity. But that does not mean the entity unlawfully practices law any more than Federal Express unlawfully pilots airplanes."

Challenges to Texas Staff Counsel

- Historical Overview on the 10 year battle
- The Players:
  - Their Arguments,
  - Perspectives, and
  - Motives

Challenges to Texas Staff Counsel

- Analysis of the March 2008 Texas Supreme Court Decision
- Where are we today in Texas?

Challenges to Staff Counsel

- Are you ready to handle the next challenge?
- What will it look like?
- Has it happened elsewhere?
- Are your preparations in place?
- Let's find out.

Challenges to Staff Counsel

<u>The Administrative arena</u>

- Nebraska defines the practice of law
- Wisconsin continues to debate the definition of the practice of law
- Which state will be next?

Challenges to Staff Counsel

<u>What if your newest attorney was faced with the following,</u>

While appearing in court the Judge inquires into the structure of your office. The court asks whether your office maintain a trust account and who pays the bills.

Challenges to Staff Counsel

How about when your newest attorney runs into,

While selecting a jury the Court requires her to disclose the name of her employer to potential jurors.

Challenges to Staff Counsel

What does your newest attorney do when,

The Court wants you to take a criminal defense case like the other local attorneys appearing in his court.

Challenges to Staff Counsel

Does your newest attorney know what to do when,

While appearing in court it is asserted that he is not an employee of the defendant's insurer but of another insurer in the same group thus creating a conflict of interest that requires his withdrawal.

Challenges to Staff Counsel

What do you do when,

You get a letter from a Committee of your State Bar Association who has a few questions about the operation of your office.

Challenges to Staff Counsel

As corporate counsel,

You get a letter from your favorite outside law firm seeking a blanket waiver, past and future, so they can handle a matter that may be adverse to your interests. It offers a vague screening process within the firm

What do you do?

Challenges to Staff Counsel

What do you do when,

A former staff attorney sues you for wrongful termination and asserts that you forced him to compromise his ethics and because of his refusal to do so he was fired.

What did you do to avoid this before the problem arose?

Challenges to Staff Counsel

What do you do when,

You get a call complaining that a member of your staff has written a letter demanding that a case in your office be settled for policy limits.

Challenges to Staff Counsel

What do you do when,

An attorney leaves your staff and the underwriting department wants to review a couple of her files.

Challenges to Staff Counsel

Would your response to these scenarios be different if you were a panel attorney?

Challenges to Staff Counsel

Solutions offered by Courts and Bar

- Disclose employment relationship in letterhead, letter to client & office signage to prevent misrepresentation – (W. Va. & FL)
- Adopt physical and electronic means to protect client confidences
- Adopt a written policy that assures the attorney's primary duty of loyalty is to insured client (W. Va.)

Challenges to Staff Counsel

Impact on corporate practice of law

- Could this type of attack be made on corporate counsel representing a sister corp?
- What would be the consequence?
  - Loss of attorney/client privilege?
  - Disqualification to be involved in a matter?

Challenges to Staff Counsel

Assumptions

That employment status is disclosed to insured client, all parties and the court at the outset of the representation

That you have guidelines that defines duties of your staff re confidentiality, privilege, conflicts, and loyalty

That you have new employee training that addresses the issues we discussed today

ACC Association of Corporate Counsel

Challenges to Staff Counsel

- Know about past challenges
- Understand the rulings & how they relate to your practice
- Educate your entire staff
- Be active in bar activities
- Ethical practice above all else

AMERICAN BAR ASSOCIATION STANDING COMMITTEE ON ETHICS AND PROFESSIONAL RESPONSIBILITY
Formal Opinion 01-421
Ethical Obligations of a Lawyer Working Under Insurance Company Guidelines and Other Restrictions

February 16, 2001

A lawyer must not permit compliance with "guidelines" and other directives of an insurer relating to the lawyer's services to impair materially the lawyer's independent professional judgment in representing an insured. A lawyer may disclose the insured's confidential information, including detailed work descriptions and legal bills, to the insurer if the lawyer reasonably believes that doing so will advance the interests of the insured. A lawyer may not, however, disclose the insured's confidential information to a third-party auditor hired by the insurer without the informed consent of the insured. Moreover, if the lawyer reasonably believes that disclosure of the insured's confidential information to the insurer will affect a material interest of the insured adversely, the lawyer must not disclose such information without the informed consent of the insured.

The Committee addresses the ethical issues that arise under the Model Rules of Professional Conduct when a lawyer retained by an insurance company to defend an insured is required to work under litigation management guidelines or other restrictions imposed by the insurer. The Committee also addresses the ethical issues associated with insurance companies requiring a lawyer to submit detailed billing information to the insurer or an independent auditor so that the insurer can determine whether the lawyer's charges conform to the insurer's general requirements and guidelines.

For the reasons discussed below, we conclude that lawyers representing insured clients must not permit the client's insurance company to require compliance with litigation management guidelines the lawyer reasonably believes will compromise materially the lawyer's professional judgment or result in her inability to provide competent representation to the insured. A lawyer may not disclose the insured's confidential information n1 to a third-party auditor hired by the insurer without the informed consent n2 of the insured, but a lawyer may submit a client's detailed bills that contain confidential information to the client's insurer if the lawyer reasonably believes that disclosure: (1) impliedly is authorized and will advance the interests of the insured in the representation, and (2) will not affect a material interest of the insured adversely. If the lawyer believes that disclosure of billing statements or other confidential information to the insurer adversely will affect a material interest of the insured, the lawyer must not disclose such information without informing the client about the nature and potential consequences of both making and not making the requested disclosure and obtaining the client's informed consent to the release of the information.

n1 The term "confidential information" is used to denote information relating to the representation of a client as used in Rule 1.6 and elsewhere in the Model Rules of Professional Conduct.

n2 "Informed consent" and "consent after consultation" often are used interchangeably. The term "consultation" is defined to mean "communication of information reasonably sufficient to permit the client to appreciate the significance of the matter in question." "Informed consent" will be used throughout the balance of this opinion. *See* MODEL RULES OF PROFESSIONAL CONDUCT Terminology (2001); ABA Comm. on Ethics and Professional Responsibility, Formal Op. 94-388 (Relationships Among Law Firms), *in* FORMAL AND INFORMAL ETHICS OPINIONS 1983-1988 262, 266 n. 4 (ABA 2000).

I. Tripartite Relationship Among Lawyers, the Insurer and Insured

A. Background

By entering into a liability insurance contract with an insurance company, the insured gives certain contractual rights to the insurer and consents to giving the company some control over the direction of the defense and any settlement of the matter. n3 Pressured by increased litigation costs, n4 some insurance companies have implemented programs to monitor the services and fees of lawyers they retain. n5 Among the cost-saving strategies employed by these companies are the imposition of guidelines and procedures, regulation of expenses, and audits of legal bills. Insurance companies have a legitimate interest in lawyer billing practices and in controlling expenses. Some litigation management guidelines, however, go beyond describing the rights and duties of the insurer, the insured, and defense counsel

and give the insurance company the right to control the defense to the degree that the lawyer's professional judgment in rendering legal services may be materially impaired.

n3 *See* 7C JOHN ALAN APPLEMAN AND JEAN APPLEMAN, INSURANCE LAW AND PRACTICE, § 4681 at 203 (1979).

n4 Costs of defense can consume nearly 55 cents of every claim dollar. C. David Sullivan and Patrick T. Muldowney, *Changing Times in the Insurance Industry*, FOR THE DEFENSE (DRI Supp., February 1998).

n5 Some of the practices targeted by insurance companies include frequent and obvious billing abuses such as charging for doing extensive legal research on marginal issues and charging for "file review" unconnected to any particular objective. *See generally* J. Stratton Shartel, *Tensions Between Insurers, Outside Counsel Remain Near the Boiling Point*, 10 INSIDE LITIGATION 7, 20 (October 1993).

B. The Ethical Implications of the Tripartite Relationship

The tripartite relationship among defense lawyer, insured, and insurer requires a delicate balance of rights and duties. Some jurisdictions regard both the insured and insurer as clients in the absence of a conflict of interest. n6 Other jurisdictions regard only the insured as the client. n7 In ABA Formal Opinion 96-403 (1996) (Obligations Of A Lawyer Representing An Insured Who Objects To A Proposed Settlement Within Policy Limits), n8 the Committee observed, "the Model Rules of Professional Conduct offer virtually no guidance as to whether a lawyer retained and paid by an insurer to defend its insured represents the insured, the insurer, or both." n9 As was the case in Formal Opinion 96-403, we take no position as to whom the lawyer represents absent an express agreement as to the identity of the client.

n6 One court has held that "if there is no conflict, an attorney-client relationship can be created between an insurer hiring an attorney to represent an insured, despite the lack of an express agreement." Paradigm Ins. Co. v. Langerman Law Offices, 196 Ariz. 573, 576, 2 P.3d 663, 666 (Ariz. App. 1999) (citing Home Indem. Co. v. Lane Powell Moss and Miller, 43 F.3d 1322, 1330-31 (9th Cir.1995)). *See* MGIC Indem. Corp. v. Weisman, 803 F.2d 500, 504 (9th Cir.1986); Unigard Ins. Group v. O'Flaherty & Belgum, 38 Cal.App.4th 1229, 1236-37, 45 Cal.Rptr.2d 565, 568-69 (1995); Nandorf, Inc. v. CNA Ins. Cos., 134 Ill.App.3d 134, 136-37, 88 Ill.Dec. 968, 971, 479 N.E.2d 988, 991 (1985). *See also* State Farm Mut. Auto. Ins. Co. v. Federal Ins. Co., 86 Cal. Rptr.2d 20, 24-25, 72 Cal.App.4th 1422, 1428 (Cal.App. 1999) (lawyer represents two clients, the insured and the insurer but, "as a practical matter, the attorney may have closer ties with the insurer than with the insured"); Gray v. Commercial Union Ins. Co., 191 N.J.Super. 590, 596, 468 A.2d 721, 725 (1983) ("There is no dispute that as a fundamental proposition a defense lawyer is counsel to both the insurer and the insured."); Charles Silver, *Does Insurance Defense Counsel Represent the Company or the Insured?*, 72 TEX. L. REV. 1583 (1994) (lawyer represents both insured and insurer if retainer agreement so provides); Scott L. Machanic, *Insurance Defense Counsel: Who Is the Client?*, 43 FED'N INS. & CORP. COUNS. Q. 45 (1992) (parties and courts typically assume the lawyer represents both insured and insurer); Richard L. Neumeier, *Serving Two Masters: Problems Facing Insurance Defense Counsel and Some Proposed Solutions*, 77 MASS. L. REV. 66 (1992) 69 (1992) ("the law firm is attorney for the insured as well as the insurer. This is the majority rule.") (quoting McCourt Co. v. FPC Properties, Inc., 386 Mass. 145, 145, 434 N.E.2d 1234, 1235 (1982))).

n7 *See, e.g.*, In the Matter of the Rules of Professional Conduct and Insurer Imposed Billing Rules and Procedures, 2 P.3d 806, 814 (Mont. 2000); Atlanta Int'l Ins. Co. v. Bell, 438 Mich. 512, 519, 475 N.W.2d 294, 297 (Mich. 1991); Supreme Court of Washington v. Tank, 105 Wash.2d 381, 388, 715 P.2d 1133, 1137 (Wash. 1986). *See also* Colorado Bar Association Ethics Committee Formal Op. 107 (September 18, 1999); Florida Bar Staff Op. 20591 (December 31, 1997); Maine Professional Ethics Commission of the Board of Overseers Op. 164 (December 2, 1998); Pennsylvania Bar Association Committee on Legal Ethics and Professional Responsibility Informal Op. No. 97-119, 1997 WL 816708 *1 (Pa.Bar.Assn.Comm.Leg.Eth.Prof.Resp. October 7, 1997); Washington State Bar Association Formal Op. 195 (1999). The RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS, § (1)(a) (2000) ("the Restatement") acknowledges that a relationship arises when a "person manifests to a lawyer the person's intent that the lawyer provide legal services for the person" and "the lawyer manifests to the person consent to do so." Section 14(1)(b) states that a lawyer-client relationship can arise when "a person manifests to a lawyer the person's intent that the lawyer provide legal services for the person" and "the lawyer fails to manifest lack of consent to do so, and the lawyer knows or reasonably should know that the person reasonably relies on the lawyer to provide the services." The Comment to § 134 states that whether a lawyer-client relationship exists between the lawyer and the insurer is determined under § 14. *See also* Debra A. Winiarski, *Walking the Fine Line a Defense Counsel's Perspective*, 28 TORT & INS. L.J. 596-97 (1993); Robert E. O'Malley, *Ethics Principles for the Insurer, the Insured, and Defense Counsel: The Eternal Triangle Reformed*, 66 TUL. L. REV. 511, 512 (1991); Ronald E. Mallen & Jeffrey M. Smith, LEGAL MALPRACTICE § 28.3-5 (4th ed. 1996) (collecting authorities).

n8 FORMAL AND INFORMAL ETHICS OPINIONS 1983-1988 403 (ABA 2000).

n9 *See supra* text accompanying note 6.

Rule 1.2(a) requires a lawyer to abide by a client's decisions concerning the objectives of the representation and to consult with the client concerning the means by which those objectives shall be pursued. Comment [1] states that "the lawyer should defer to the client regarding such questions as the expense to be incurred." The question whether the insurance company may be deemed a "client" who can direct the scope and extent of the representation is unsettled although a majority of the jurisdictions that have addressed the issue have concluded that in the absence of a conflict, a lawyer concurrently may represent both the insurer and the insurer. Regardless of whether the insurer is a client, Rule 5.4(c) states that a lawyer "shall not permit a person who recommends, employs or pays a lawyer to render legal services for another to direct or regulate the lawyer's professional judgment in rendering ... legal services."

II. The Effect of Insurer Guidelines on the Lawyer's Ethical Obligations

The interests of the insurance company and the insured may diverge if the insurance company has a paramount interest in controlling or reducing its defense costs and the insured's main interest is to receive the best possible defense. Although defense lawyers must be sensitive to the economic interests of the insurance companies that employ them and cognizant of the fact that costs of litigation ultimately are borne by insureds through premiums, they must not allow their professional judgment or the quality of their legal services to be compromised materially by the insurer.

If the lawyer is hired to defend an insured pursuant to an insurance policy that authorizes the insurer to control the defense and, in its sole discretion, to settle within policy limits, the lawyer must communicate these limitations on his representation of the insured to the insured, preferably early in the representation. The lawyer should "make appropriate disclosures sufficient to apprise the insured of the limited nature of his representation as well as the insurer's right to control the defense in accordance with the terms of the insurance contract... No formal acceptance or written consent is necessary. The insured manifests consent to the limited representation by accepting the defense offered by the insurer after being advised of the terms of the representation being offered." n10 Once this communication takes place, the lawyer is free to settle the claim at the direction of the insurer n11.

n10 FORMAL AND INFORMAL ETHICS OPINIONS 1983-1988 at 406-07. In Opinion 96-403, we further stated that a lawyer could satisfy the requirements of Rule 1.2(c) by sending the insured a short letter clearly apprising the insured "of the limitations on the representation being offered by the insurer and that the lawyer intends to proceed in accordance with the directions of the insurer." *Id.* at 406.

n11 Some states hold that even if a settlement authority has been conferred on the insurer by the insurance policy, the lawyer's ethical obligations require the insured's informed consent before a settlement can occur. *See, e.g.*, Rogers v. Robson, Masters, Ryan, Brumund and Belom, 81 Ill. 2d 201, 205, 407 N.E. 2d 47, 49 (1980); Miller v. Byrne, 916 P.2d 566, 574 (Colo. App. 1996). This view is also consistent with Rules 1.2(a) and 1.4.

Because it is paying both the costs of defense and any resulting judgment or settlement up to the limits of the policy, the insurance company normally has the primary financial stake in the matter. Pursuant to the liability insurance contract, the insured delegates to the insurance company the right to defend the case and is required to cooperate in the insured's defense. However, the rules of professional conduct--and not the liability insurance contract--govern the lawyer's ethical obligations to her client, whether the client is the insured, the insurer, or both. To the extent that the insurance company and the insured seek an expeditious and favorable outcome to the litigation, their interests converge. Indeed, in Formal Opinion 282 (1950), n12 we stated that "a community of interest exists between the company and the insured growing out of the contract of insurance with respect to any action brought by a third person against the insured within the policy limitations. The company and the insured are virtually one in their common interest. The requirement that the insurance company shall defend an action contemplates that the company, because of its contractual liability and community of interest, shall take charge of the incidents of such defense including the supervising of the litigation." n13

n12 OPINIONS OF THE COMMITTEE ON PROFESSIONAL ETHICS at 621 (ABA 1967).

n13 *Id.* at 622-23.

In most cases, undivided loyalty to the insured thus would be fully consistent with undivided loyalty to the insurance company and its directives without regard to whether both insured and insurer are clients of the lawyer. In the vast majority of cases, litigation management guidelines do not raise ethical concerns. The insured no doubt is willing to entrust the litigation against him to the insurance company, which has risk management and litigation experience in similar matters. The insurance company is usually in the best position to manage the litigation to the advantage of both the insured and itself in the most cost-effective way. There are rare situations when the lawyer believes a limitation imposed by the insurer's litigation management guidelines is compromising the lawyer's ability to provide competent representation to both the insured and insurer clients.

If the lawyer reasonably believes her representation of the insured will be impaired materially by the insurer's guidelines or if the insured objects to the defense provided by a lawyer working under insurance company guidelines, the lawyer must consult with both the insured and the insurer concerning the means by which the objectives of the representation are being pursued. "If the lawyer is to proceed with the representation of the insured at the direction of the insurer, the lawyer must make appropriate disclosure sufficient to apprise the insured of the limited nature of his representation as well as the insurer's right to control the defense in accordance with the terms of the insurance contract." n14 If the insurer does not withdraw or modify the limitation on the lawyer's representation and the insured refuses to consent to the limited representation, the resulting conflict implicates Rule 1.7(b) and unless the lawyer is willing to represent the insured without compensation from the insurer, requires the lawyer to terminate the representation of both clients. n15

n14 *Id. See also* Rule 1.8(f)(2); Tenn. Formal Ethics Opinion 2000-F-145.

n15 Rule 1.7 Comment [2].

In such situations, the lawyer has few alternatives available to her. The lawyer can try to persuade the insurer to withdraw the limitation. If the lawyer is unable to persuade the insurer-client to withdraw the limitation, the resulting conflict between the insurer's directives and the insured's immediate interests requires the lawyer to withdraw from representing the insurer and to protect the immediate interests of the insured in the litigation. n16 In this unlikely situation, the lawyer must, in contemplation of her immediate resignation from representation of the insured, protect the immediate interests of the insured in order to assure that her withdrawal can be accomplished without material adverse affect on the insured's interests, as contemplated by 1.16(b). Thereafter, if the lawyer is unable satisfactorily to resolve the conflict implicated by the insurer's guidelines, the lawyer may seek to withdraw pursuant to Rule 1.7 or 1.16(b).

n16 Comment [4] to Rule 1.8(f) states that when a lawyer's services are being paid for by a third party, "such an arrangement must also conform to the requirements of Rule 1.6 . . . and Rule 1.7 . . . ."

III. Lawyer's Submission of Client Billing Records to the Insurer or to the Insurer's Third-Party Auditor

Another cost-containment measure used by the insurance industry is review of client billing information by third-party auditors. The phrase "legal bill audit" "encompasses a range of services, from an examination of the face of the legal bill for improper charges or errors to a detailed analysis of original time records, attorney work product, expenses and hourly rate benchmarks, and more. n17 In submitting a claim to the insurance company, the insured may be subject to the provisions of the contract of insurance that grant the insurance company access to confidential information. Moreover, most of the confidential information disclosed to the insurer usually will advance the interests of the insured as well as the interests of the insurer and will not affect a material interest of the insured adversely. n18

n17 *See generally*, John Toothman, *Surviving a Legal Bill Audit*, 15 COMPLEAT LAWYER 45 (Winter 1998).

n18 In Formal Opinion 95-398 (Access of Nonlawyers to a Lawyer's Data Base), we stated that law firms may give independent contractors access to the insured's confidential information to assist it in representing its clients.

An audit may include an examination of hourly rates and background information about the legal matters for which the bill was submitted, including examination of the lawyer's work product and opposing counsel's work product in order to gauge "quality, tactic, strategy, and performance in context." n19 A detailed bill review might include "verification of raw data, interviews of key personnel, examination of firm billing systems, checking the original time records against time entries in invoices, and reconciling receipts for expenses with the bill. n20 Most of the information supplied to insurers through billing records is of a general nature, is publicly known (*e.g.* the lawyer's court appearances), or already known as a result of the insured having forwarded it to the insurer to facilitate the defense (*e.g.* medical information). Although this information may be subject to the protections of Rule 1.6(a) as "confidential information," its disclosure to the insurer nonetheless would be authorized impliedly either to comply with the insurance contract or to carry out the representation, or both. n21 Billing records and underlying documentation may, however, reveal the motive of the client in seeking representation, litigation strategy, or the specific nature of the services provided to the insured. This information generally is protected by the confidentiality rule or the attorney-client privilege or both. n22 In addition to the foregoing justifications for disclosure of otherwise confidential and/or privileged information to the insurer, disclosure to the insurer may be appropriate when both the insured and insurer are regarded as clients of the lawyer. n23

n19 Toothman, *supra*, note 19 at 49.

n20 *Id.*

n21 *See* Stephen Gillers, *Ethical Issues in Monitoring Insurance Defense Fees: Confidentiality, Privilege and Billing Guidelines* 4-6 (Law Audit Services, Inc. 1998).

n22 *See* Clarke v. American Commerce Nat'l Bank, 974 F.2d 127, 129 (9th Cir.1992), *reh'g denied*, 977 F.2d 1533 (9th Cir. 1992); Licensing Corp. of America v. National Hockey League Players Ass'n, 153 Misc.2d 126, 127-28, 580 N.Y.S.2d 128, 130 (N.Y. Sup.Ct. 1992).

n23 Although the right to share confidential information between co-clients may be implied, *see, e.g.*, Brennan's Inc. v. Brennan's Restaurant, Inc., 590 F.2d 168, 173 (5th Cir. 1979), some jurisdictions have condemned the sharing of confidential information between and among co-clients in the absence of each client's informed consent. *See, e.g.*, D.C. Bar Opinion 296 (2000); Florida Bar Ethics Opinion 95-4.

Rule 1.8(f) prohibits a lawyer from accepting compensation for representing a client from one other than the client unless the client has given informed consent, there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship, and information relating to a client's representation is protected as is required by Rule 1.6. Comment [4] to the Rule states that when a lawyer's services are paid for by a third party, such an arrangement must protect the client's confidences and secrets from unauthorized disclosure as required by Rule 1.6 and that a lawyer may not represent a client under such circumstances if the representation is prohibited under Rule 1.7. n24

n24 *See supra*, note 18.

Under Rule 1.6, a lawyer may not reveal information relating to representation of a client in the absence of the client's informed consent, except for disclosures that are impliedly authorized in order to carry out the representation. Informing the insurer about the litigation through periodic status reports, detailed billing statements and the submission of other information is usually required, explicitly or implicitly, by the contract between the insurer and the insured and is also appropriate in those jurisdictions where the insurer is regarded as a client and there is no conflict between the insurer and insured. The disclosure of such information usually advances the interests of both the insured and the insurer in the representation and such disclosures are, therefore, "impliedly authorized to carry out the representation." n25 In those relatively rare situations when the lawyer reasonably believes that disclosure of confidential information to the insurer will affect a material interest of the client-insured adversely, the lawyer may not disclose such confidential information without first obtaining the informed consent of the client-insured. n26

n25 Rule 1.6(a); *see* Restatement § 61 cmt. b, which contains the functional equivalent of the "implied authorization" exception in Rule 1.6(a).

n26 *Id.* §§ 61 and 60(1)(a).

Nor may the lawyer disclose the insured's confidential information to a third-party auditor designated by the insurer without the insured's informed consent. n27 Unlike the disclosure of the insured's confidential information to secretaries and interpreters, the disclosure of such information to a third-party auditor, a vendor with whom the lawyer has no employment or direct contractual relationship, n28 may not be deemed essential to the representation and may, therefore, result in a waiver--albeit unintended--of the privilege. n29 Therefore, since such disclosures always involve the *risk* of loss of privilege, the lawyer must obtain the insured's informed consent before sending bills with such information to a third party hired by the insurer to audit the bills. n30

n27 A majority of jurisdictions have concluded that it is not ethically proper for a lawyer to disclose billing information to a third-party billing review company at the request of an insurance company unless he has obtained the client's consent. *See, e.g.*, Office of the General Counsel of the Alabama State Bar Op. RO-98-02 (November 9, 1998); Alaska State Bar Ass'n Ethics Committee Op. No. 99-1 1999, 1999 WL 1494993 (Alaska Bar Assn Eth Comm. October 22, 1999); Arizona State Bar Formal Op. 99-08 (September 1999); Cincinnati, Ohio Bar Association Op. 98-99-02 (February 1999): Colorado Bar Association Ethics Committee Formal Op. 107 (September 18, 1999); Connecticut Bar Association Committee on Professional Ethics Informal Op. 00-20; District of Columbia Legal Ethics Committee Op. No. 290 (April 20, 1999); Florida Bar Professional Ethics Committee Proposed Advisory Op. 99-2 (March 31, 1999) Florida Bar Staff Op. 20762 (March 9, 1998); Florida Bar Staff Op. 20591 (December 31, 1997); Georgia State Bar Proposed Advisory Op. No. 99-R2 (January 2000); Hawaii Bar Office of Disciplinary Conduct Op. 36 (March 25, 1999); Idaho State Bar Association Formal Op. 136 (January 2000); Indiana State Bar Association Op. 98-4 (1998); Iowa Supreme Court Board of Professional Ethics and Conduct Op. 99-01 (September 8, 1999); Kentucky Bar Association Op.E-404 (June 1998); Louisiana State Bar Association Ethics Advisory Service Committee Op. 45, *as reported in* LOUISIANA BAR JOURNAL 438 (February, 1998); Maine Professional Ethics Commission of the Board of Overseers Op. 164 (December 2, 1998); Maryland State Bar Association Committee on Ethics Op. No. 99-7 (January 1999); Massachusetts Bar Association Committee on Professional Ethics Op. 2000-4 (September 13, 2000); Mississippi State Bar Association Ethics Op. 246 (April 8, 1999); Chief Disciplinary Counsel of the Supreme Court of Missouri Informal Advisory Op. 980188 (September 9, 1998); New Mexico State Bar Formal Advisory Op. 2000-02 (June 20, 2000); New York State Bar Association Committee on Professional Ethics Op. 716 (March 3, 1999); North Carolina State Bar Proposed Formal Ethics Op.10, 1998 WL 609887 (N.C.St.Bar October 16, 1998); Oklahoma Bar Association Board of Governors Legal Ethics Advisory Op. No. 309 (March 27, 1998) (representation of insureds by lawyers who are employees of a liability insurer); Oregon State Bar Association Ethics Op. 1999-157, 1999 WL 521543 (Or. St. Bar Ass'n June 1999); Pennsylvania Bar Association Committee on Legal Ethics and Professional Responsibility Informal Op. No. 97-119, 1997 WL 816708 (Pa.Bar.Assn.Comm.Leg.Eth.Prof.Resp. October 7, 1997); Rhode Island Ethics Advisory Panel Op. 99-17 (October 27, 1999); South Carolina Bar Ethics Advisory Committee Op. 97-22; 1997 WL 861963 (S.C. Bar Eth Adv. Comm. December 1997); State Bar of South Dakota Ethics Op. 99-2 (April 16, 1998); Board of Professional Responsibility of the Supreme Court of Tennessee Ethics Op. 99-F-143, 1999 WL 406886 (Tenn.Bd.Prof. Resp. June 14, 1999); Utah State Bar Ethics Advisory Op. No. 98-03 (April 17, 1998); Vermont Bar Association Ethics Op. 98-7 (October 1998); Virginia Bar Legal Ethics Op. 1723 (November 23, 1998); Washington State Bar Association Formal Op. 195 (1999); West Virginia Lawyer Disciplinary Board Op. LEI 99-02 (April 30, 1999); Wisconsin State Bar Ethics Op. E-99-1 (October 1999).

n28 In ABA Formal Opinion 95-398 this Committee recognized that "in this era of rapidly developing technology," lawyers frequently use outside agencies for numerous functions such as accounting, data processing, photocopying, computer servicing, storage and paper disposal and that lawyers retaining such outside service providers are required to make reasonable efforts to prevent unauthorized disclosures of client information. The present inquiry is clearly distinguishable because the lawyer has neither a contract with nor any right to control the conduct of the third-party auditor retained by the insurer.

n29 In the Matter of the Rules of Professional Conduct and Insurer Imposed Billing Rules and Procedures, 2 P.3d at 817-22, United States v. Massachusetts Institute of Technology, 129 F.3d 681, 684-687 (1st Cir. 1997) ("an intent to maintain confidentiality is ordinarily necessary to continued protection, but it is not sufficient").

n30 *Id.* at 818-819 (the relationship between the insured and third-party auditor does not involve "...the kind of common interest" in which information can be exchanged without loss of privilege... Disclosure to persons needed in the representation or appropriate to a consultation does not also justify disclosure 'to a potential adversary.'" (quoting U.S. v. M.I.T., *supra* note 31 and accompanying text); *In re* Columbia/HCA Healthcare Corporation, 192 F.R.D. 575, 576, 579 (M.D. Tenn. 2000) ("the privilege is narrowly construed because it reduces the amount of information discoverable during the course of a lawsuit . . . clients who wish to selectively disclose privilege documents and the entity to whom they wish to disclose the documents cannot negate a waiver simply by agreeing to do so.") (internal citation omitted). Other cases rejecting selective waiver include In re Steinhardt Partners, L.P., 9 F.3d 230, 235 (2d Cir. 1993); Westinghouse Elec. Corp. v. Republic of the Philippines, 951 F.2d 1414, 1424-26 (3d Cir. 1991); In re Martin Marietta Corp., 856 F.2d 619, 623-24 (4th Cir.), *cert. denied*, 490 U.S. 1011, 109 S. Ct. 1655 (1989); Permean Corp. v. United States, 665 F.2d 1214, 1220-21 (D.C. Cir. 1981).

In order to obtain the insured's informed consent to such disclosures, the lawyer should at least discuss the nature of the information sought as well as the relevant legal and non-legal consequences of the client's decision. This would include giving advice concerning the extent of the client's obligation under the insurance contract to authorize such disclosures. The lawyer must evaluate the reasonably foreseeable adverse consequences of disclosure and inform the client of the adverse effects that may result, including communicating with the client about the consequences of not consenting to disclosure where the insurance contract requires the insured to cooperate in the defense of the claim and where failure to agree to disclosure could risk loss of insurance coverage. The client also should be informed that the insurance company may interpret the "duty to cooperate" clause in its contract with the insured as meaning that it has the right to give an independent contractor access to the client's confidential information to aid it in representing clients.

The lawyer should inform the client of the risk that the information to be disclosed to the auditor could be obtained by others directly or indirectly as a result of the disclosure, the risk that a disclosure could involve a waiver of the lawyer-client privilege, and that the disclosure could be used to the client's disadvantage.

"Consent" may be influenced heavily by the client's desire to take advantage of the insurance company's duty to defend. Where the client's interests would be placed at risk by disclosing information to the auditor, the lawyer must reasonably believe that the client's consent is uncoerced even after consultation, and the lawyer then must respond to the auditor's requests in a manner that safeguards the client's interests. This would include minimizing the extent to which information relating to the representation is disclosed to the auditor and avoiding, if at all possible, disclosures that could result in a waiver of the attorney-client privilege or otherwise adversely affect a material interest of the client-insured.

Although Rule 1.6 expresses the broad principle that all information relating to representation of a client is confidential, there is an exception when the disclosure is impliedly authorized in order to carry out the representation, *see* Rule 1.6(a), or in the specific and limited circumstances set forth in Rule 1.6(b). Comment [7] explains: "A lawyer is impliedly authorized to make disclosures about a client when appropriate in carrying out the representation, except to the extent that the client's instructions or special circumstances limit that authority." In the context of the tripartite relationship involving the lawyer, the insurer and the insured, the routine transmission of confidential information to the insurer from the lawyer retained by the insurer to represent the insured usually is necessary to advance the interests of both the insurer and the insured and is, therefore, impliedly authorized in order to carry out the representation without regard to whether only the insured or both the insured and insurer are clients. Moreover, we construed Comment [7] similarly in our Opinion 98-411 when we recognized that in the context of lawyer-to-lawyer consultations, the disclosure of confidential information is permitted to lawyers outside the consulting lawyer's firm "when the consulting lawyer reasonably believes the disclosure will further the representation by obtaining the consulted lawyer's experience or expertise for the benefit of the consulting lawyer's client." n33

n33 ABA Formal Opinion 98-411 (Ethical Issues in Lawyer-to-Lawyer Consultation).

As noted above, there may be occasions when the lawyer reasonably believes that disclosure of confidential information to the insurer may affect a material interest of the client-insured adversely. n32 Such occasions may arise when the information to be disclosed jeopardizes the insured's coverage under the insurance policy; reveals extremely sensitive or personal, irrelevant information about the insured; or otherwise implicates a conflict between the insurer and insured. In these relatively infrequent situations, it is essential that the lawyer obtain the informed consent of the client-insured before disclosing the confidential information in question. n33

n32 The Restatement precludes the disclosure of confidential information if there is a reasonable prospect that disclosure will adversely affect a material interest of the client. *See* § 60(1)(a).

n33 *Id.*

The disclosure to the client-insured in order to obtain informed consent within the meaning of Rule 1.6 must adequately and fairly identify the effects of disclosure and non-disclosure on the client's interests. Although the Model Rules do not specify the nature of the information that must be told to the client to obtain "consent after consultation," we stated in Formal Opinion 98-411 that in lawyer-to-lawyer consultations, the lawyer seeking his client's permission to consult another lawyer should inform his client of the possibility that privileges may be waived under applicable law and of the potential adverse effect of disclosure on the client's interest in the matter.

The rules of professional conduct are, of course, inapplicable to insurance companies but they are applicable to lawyers who represent insurance companies, both in-house and in private practice. When representing an insured client, a lawyer should identify with the insurance company and any potentially involved third-party auditor the type of information that would be requested during the representation. The lawyer also should discuss with both the insured and insurer clients the legal effects of disclosing or not disclosing such information. In assessing these legal effects, the lawyer should evaluate any agreement between the insurance company and the auditor regarding procedures for protecting confidential materials. Before disclosing client information to an insurance company, the insured's lawyer should satisfy herself that the insurance company will not release confidential client information and should designate all such information clearly. Identifying each party's interests and providing full disclosure to both the insured and insurer clients from the outset of the representation should result in a relationship that meets the needs of both the insurance company and the insured as well as one that satisfies the ethical obligations of the lawyer. If there is reason to believe that the insurer will disregard this instruction, then the lawyer should so advise the insured, prior to disclosure, explaining any additional risks that would result from disclosure by the insurance company to a third party.

Conclusion

In representing an insured, a lawyer must not permit compliance with "guidelines" or other insurer directives relating to the lawyer's services to impair materially the lawyer's independent professional judgment. There may be rare instances when the lawyer reasonably believes a limitation imposed by the insurer's directives is materially compromising the lawyer's ability to provide competent representation to both the insured and insurer. In such situations, if the lawyer is unable to persuade the insurer to withdraw the limitation, the resulting conflict between the insurer's directives and the insured's interests requires the lawyer to protect the immediate interests of the insured while preparing to withdraw from representing both the insured and the insurer.

A lawyer may disclose the insured's confidential information, including detailed work descriptions and legal bills, to the insurer if the lawyer reasonably believes that doing so will advance the interests of the insured. However, the lawyer may not disclose the insured's confidential information to a third-party auditor without the informed consent of the insured. It is also the opinion of the Committee that unless the lawyer reasonably believes that disclosure of the insured's confidential information to the insurer will affect a material interest of the insured adversely, the lawyer must not disclose such information without the informed consent of the insured.

AMERICAN BAR ASSOCIATION
STANDING COMMITTEE ON ETHICS AND PROFESSIONAL RESPONSIBILITY

Formal Opinion 03-430 **July 9, 2003**

Propriety of Insurance Staff Counsel Representing the Insurance Company and Its Insureds; Permissible Names for an Association of Insurance Staff Counsel

This opinion addresses two ethical issues arising under the Model Rules of Professional Conduct.[1] First, may insurance staff counsel[2] represent both their employer and their employer's insureds in a civil lawsuit resulting from an event defined in the insurance policy? Second, under what name may an association of insurance staff counsel practice?

For the reasons set forth below, the Committee reaffirms its prior opinions and concludes that insurance staff counsel ethically may undertake such representations so long as the lawyers (1) inform all insureds whom they represent that the lawyers are employees of the insurance company, and (2) exercise independent professional judgment in advising or otherwise representing the insureds.

The Committee also concludes that insurance staff counsel may practice under a trade name or under the names of one or more of the practicing lawyers, provided the lawyers function as a law firm and disclose their affiliation with the insurance company to all insureds whom they represent.

Background

A liability insurance policy, subject to stated policy limits, promises to pay on behalf of the insured any amount for which the insured is liable on claims falling within the policy's coverage. In addition to this duty to indemnify, the insurance company assumes the duty to defend the insured against any such claims. The insured, in turn, by entering into a liability insurance contract

1. This opinion is based on the Model Rules of Professional Conduct as amended by the ABA House of Delegates in February 2002 and, to the extent indicated, the predecessor Model Code of Professional Responsibility of the American Bar Association. The laws, court rules, regulations, rules of professional responsibility, and opinions promulgated in the individual jurisdictions are controlling.

2. "Insurance staff counsel" are insurance company employees. Alternatively, they are called "house," "in-house," "salaried," or, less precisely, "captive" counsel.

with an insurance company, consents to give the company considerable control over the direction of the defense and any settlement of the matter.[3]

If the insured asks the insurance company to defend a lawsuit, and the suit falls within the insurance company's duty to defend, the insurance company is contractually bound to retain a lawyer to represent the insured. Absent a conflict, the lawyer commonly represents the insurance company as well.[4] The determination of when and to whom the client-lawyer relationship attaches is a matter of state law and not governed by the rules of professional responsibility. However, once the client-lawyer relationship attaches, the rules of professional responsibility, not the insurance contract or the lawyer's employer, govern the lawyer's ethical obligations to clients.[5] These obligations, the Committee's prior opinions have found, largely are unaffected by the determination of whether or not the insurance company is a co-client.[6] In any event, the insurance company provides direction to defense counsel in accordance with the terms of the insurance policy, and often as a co-client as well.

Historically, most insurance defense lawyers practiced in private law firms. Today, however, many are employees of insurance companies.[7] Whether insurance companies may use employee-lawyers to defend insureds, therefore, has been the subject of numerous opinions by courts and state bar association committees.[8] The focus of these opinions customarily has been twofold. First, as a matter of the state's substantive law, does an

3. *See* JOHN ALAN APPLEMAN & JEAN APPLEMAN, INSURANCE LAW AND PRACTICE § 4681 (1979).

4. Many jurisdictions have adopted this "dual client" rule. For a collection of cases and authorities, *see* ABA Comm. on Ethics and Professional Responsibility Formal Op. 01-421 (Ethical Obligations of a Lawyer Working Under Insurance Company Guidelines and Other Restrictions) n. 6 (Feb. 16, 2001), and RONALD E. MALLEN & JEFFREY M. SMITH, LEGAL MALPRACTICE § 29.3 at 213 (5th ed. 2000).

Other jurisdictions have adopted a "single client" rule, in which the lawyer's sole client is the insured. For a collection of cases and authorities, *see* ABA Formal Op. 01-421 n.7. The ABA Ethics Committee's analysis and conclusions in this opinion are equally applicable in both "dual client" and "single client" jurisdictions.

5. ABA Comm. on Ethics and Professional Responsibility Formal Op. 96-403 (Obligations of a Lawyer Representing an Insured Who Objects to a Proposed Settlement Within Policy Limits) (Aug. 2, 1996), *in* FORMAL AND INFORMAL ETHICS OPINIONS 1983-1988 at 405 (ABA 2000).

6. ABA Formal Ops. 01-421 and 96-403, *supra* notes 4 and 5.

7. Insurance companies reportedly have employed insurance staff counsel to defend insureds since the 1890's. It is estimated that there are several thousand insurance staff counsel presently representing hundreds of thousands of insureds. *See* Charles M. Silver, *Flat Fees and Staff Attorneys: Unnecessary Casualties in the Continuing Battle Over the Law Governing Insurance Defense Lawyers*, 4 CONN. INS. L.J. 205, 237-40 (1997-98).

8. Many of these court decisions and bar association opinions are collected in Cincinnati Ins. Co. v. Wills, 717 N.E.2d 151, 155 (Ind. 1999).

insurance company that employs insurance staff counsel to represent the company's insureds engage in the unauthorized practice of law? [9] And second, as an ethical consideration, does the defense of insureds by employee-lawyers of the insurance company create an inherent and impermissible conflict of interest for the lawyer?[10] Because issues of substantive state law are beyond the purview of this Committee, we do not address the issue of the unauthorized practice of law. Rather, we focus exclusively on the second question, namely, the ethical considerations associated with the use of insurance staff counsel.

Issue one: May insurance staff counsel represent both their employer and their employer's insureds in a lawsuit seeking damages resulting from an event for which the insurance policy imposes a duty to defend?

The Committee first considered the ethical implications of lawyers serving as insurance staff counsel in Formal Opinion 282 (1950).[11] Applying the provisions of the Canons of Professional Ethics, we stated that "[a] lawyer, employed and compensated by an … insurance company, which holds a standard contract of insurance with an insured, may with propriety.... [d]efend the insured in an action brought by a third party...."[12] We noted that "a community of interest exists between the company and the insured growing out of the contract of insurance with respect to any action brought by a third person against the insured within the policy limitations. The company and the insured are virtually one in their common interest."[13]

We revisited the question in Informal Opinion 1370,[14] concluding that the

9. A substantial majority of jurisdictions that have addressed the issue have concluded the use of insurance staff counsel does not constitute the unauthorized practice of law. *See, e.g.*, Gafcon, Inc. v. Ponsor & Assoc., 98 Cal.App.4th 1388, 1396-97, 120 Cal.Rptr.2d 392, 397 (Cal. Ct. App. 2002). Illinois and Maryland have enacted statutes permitting insurance companies to employ staff counsel to defend insureds. 705 ILL. REV. STAT. ch. 220, para. 5 (2001); MD. CODE ANN. BUS. OCC. & PROF. § 10-206 (2001). Kentucky and North Carolina, however, have interpreted their unauthorized practice of law statutes to prohibit staff counsel operations. American Ins. Ass'n v. Kentucky Bar Ass'n, 917 S.W.2d 568, 571 (Ky. 1996); Gardner v. N.C. State Bar, 341 S.E.2d 517, 521 (N.C. 1986).

10. *See* Robert J. Johnson, *Comment: In-House Counsel Employed by Insurance Companies: A Difficult Dilemma Confronting the Model Code of Professional Responsibility*, 57 OHIO ST. L.J. 945, 965 (1996).

11. ABA Comm. on Ethics and Professional Responsibility Formal Op. 282 (May 27, 1950), *in* OPINIONS OF THE COMMITTEE ON PROFESSIONAL ETHICS 621 (ABA 1967).

12. *Id.*

13. *Id.* at 622.

14. ABA Comm. on Ethics and Professional Responsibility Informal Op. 1370 (Representation of Policy Holder by Insurance Company House Counsel) (July 16, 1976), *in* FORMAL AND INFORMAL ETHICS OPINIONS 252 (ABA 1985).

then-applicable Code of Professional Responsibility suggested "no different results."[15] A year later, in Informal Opinion 1402,[16] we reaffirmed an observation made in Formal Opinion 282 that "[t]he essential point of ethics involved is that the lawyer so employed shall represent the insured as his client with undivided fidelity...."[17]

We acknowledge that insurance staff counsel operations, perhaps due to their evolution and growth, continue to spawn ethical challenges.[18] Therefore, we revisit the issue in the context of today's Model Rules.

Insurance Staff Counsel and the Model Rules of Professional Conduct

The defense of an insured under an insurance contract gives rise to interrelated duties between the insurance company, the insured, and the lawyer retained by the insurance company. The Model Rules provide considerable guidance to insurance defense lawyers who must address the potentially divergent interests of insureds and their insurance companies on a daily basis. Fortunately, in the great majority of liability cases, the interests of insureds and their insurance companies do not collide.[19]

This is particularly true in the "full coverage case" in which the probable monetary exposure of the insured is within the limits of the insurance policy and there is no dispute regarding coverage for the incident. The interests of the company and the insured in these situations are financially aligned.[20]

We do not view the employment status of insurance staff counsel as itself creating a conflict between the insurance company and the insured when they are both represented by insurance staff counsel in a lawsuit.[21] In fact, the Model

15. *Id*.

16. ABA Comm. on Ethics and Professional Responsibility Informal Op. 1402 (Insured's Contractual Obligation to Reimburse Liability Insurer for Legal Expenses up to Deductible Amount in Defending Claim When Insurer's House Counsel Acts in Behalf of Insured) (November 3, 1977), *in* FORMAL AND INFORMAL ETHICS OPINIONS 290 (ABA 1985).

17. *Id*. at 292.

18. *See* Silver, *supra* note 7 at 237-58.

19. *See* Kent D. Syverud, *What Professional Responsibility Scholars Should Know About Insurance*, 4 CONN. INS. L.J. 17, 22 (1997-98) ("Intractable conflicts between insured and company have rarely developed, even though the insurance company largely calls the shots in the defense of claims.").

20. *See* In re Allstate Ins. Co., 722 S.W.2d 947, 952 (Mo. 1987) ("When coverage is admitted and adequate the interests of the insurer and the insured are congruent. Both are interested in disposing of the case on the best possible terms. Only the insurer's money is involved. Even though the insured may be interested in minimizing liability and damages, perhaps because of apprehension about insurance coverage and rates, this concern introduces no conflict and there is no reason why the same lawyer may not represent both interests.").

21. *See* In re Youngblood, 895 S.W.2d 322, 330 (Tenn. 1995) (employment relationship does not, in and of itself, constitute a violation of the professional duties of lawyers).

Rules dealing with conflicts of interest between co-clients specifically contemplate lawyers representing multiple clients. Of course, if a conflict of interest between the insurance company and the insured does arise in the course of the representation, the lawyer immediately must resolve it by either obtaining the insured's informed consent or terminating his representation of the insured.[22]

Some courts and commentators have argued that, when the insurance company uses insurance staff counsel to defend its insureds, the opportunity for undue influence by the insurance company is too great.[23] However, even if it were assumed that the insurance company has more control over its employees than it does over retained lawyers in private practice, that circumstance is of no significance in the full coverage case "in which there is no temptation to favor the insurer's interests over that of the insured."[24]

We do note, however, that in defending insureds, insurance staff counsel must be vigilant of Rule 5.4(c),[25] which requires a lawyer to exercise independent professional judgment in advising or otherwise representing clients, regardless of who may be paying for the lawyer's services.[26] This rule underscores the importance of undivided fidelity to the insured-client.[27] Nothing in

22. In re Allstate Ins. Co. 722 S.W.2d at 953; Cincinnati Ins. Co. v. Wills, 717 N.E.2d at 163 ("if [a conflict] arises retention of new counsel to represent the policyholder may be either preferred or necessary").

23. *See, e.g.*, American Ins. Ass'n v. Kentucky Bar Ass'n, 917 S.W.2d at 571, as well as Michael D. Morrison and James R. Old, Jr., *Economics, Exigencies and Ethics: Whose Choice? Emerging Trends and Issues in Texas Insurance Defense Practice*, 53 BAYLOR L. REV. 349, 401-02 (2001).

24. In re Allstate Ins. Co., 722 S.W.2d at 952. *See also* Cincinnati Ins. Co. v. Wills, 717 N.E.2d at 163 ("the potential for conflict is inherent in the insurer-insured relationship regardless of whether the attorney is house counsel or outside counsel, and the employment relationship is not qualitatively different in this respect"). Some authorities even assert that there is less opportunity for undue influence in an insurance staff counsel office than in a private law firm. *See* MALLEN & SMITH, *supra*, note 4, § 29.10 at 272 ("[I]n a properly structured corporate environment, salaried counsel does not face many of the economic pressures that can tempt outside counsel to favor the insurance company. Employed counsel has no bills to send out, justify or collect. There is no concern about receiving future assignments, and there is no economic benefit in seeking to increase the volume of the business."). For a description of the pressures placed upon outside insurance defense lawyers, *see* Stephen L. Pepper, *Applying the Fundamentals of Lawyers' Ethics to Insurance Defense Practice*, 4 CONN. INS. L.J., 27, 46 (1997-98).

25. Rule 5.4(c) states "[a] lawyer shall not permit a person who recommends, employs, or pays the lawyer to render legal services for another to direct or regulate the lawyer's professional judgment in rendering such legal services."

26. Although a lawyer has the duty to advise, the Model Rules leave to the client or the client's representative the decision whether to implement legal advice. As Rule 1.4(b) states, "[a] lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation."

27. GEOFFREY C. HAZARD, JR. & W. WILLIAM HODES, THE LAW OF LAWYERING § 12.13, at 12-31-12 to 32 (3d ed. 2002).

the status of insurance staff counsel as employees diminishes their obligation or ability to comply with Rule 5.4[c] or any of the other Model Rules.[28]

Disclosure of Employment Status

In Formal Opinion 96-403,[29] we discussed certain disclosures that an insurance defense lawyer must make to the insured-client. We noted that the Model Rules require the lawyer "to communicate with the client, and convey information 'sufficient to permit the client to appreciate the significance of the matter in question.'"[30] We advised that a prudent lawyer would inform the client of "basic information concerning the nature of the representation and the insurer's right to control the defense and settlement under the insurance contract...."[31] We suggested that this information could be routinely included in the retainer letter, or otherwise provided near the outset of the representation.

Here we interpret Rule 1.8(f) to require insurance staff counsel to disclose their employment status and affiliation with the insurance company to all insureds-clients.[32] Such disclosure should occur at the earliest opportunity practicable, such as during the initial meeting with the client or through appropriate language in the initial letter to the client.[33]

28. *See, e.g.,* California State Bar Standing Comm. on Professional Responsibility and Conduct Formal Op. 1987-91, 1987 WL 109707 * 3 (1987) ("the mere fact that the lawyers are employees of Insurance Company does not necessarily compromise the attorney's independent professional judgment").

29. ABA Comm. on Ethics and Professional Responsibility Formal Op. 96-403, *supra* note 5.

30. *Id*. at 406.

31. *Id*.

32. Model Rule 1.8(f) provides: "A lawyer shall not accept compensation for representing a client from one other than the client unless: (1) the client gives informed consent; (2) there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship; and (3) information relating to the representation of a client is protected as required by Rule 1.6." It typically applies when the insurance company pays the fees of the defense lawyer to represent the policyholder, whether or not the insurance company also is a client. *See also* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 16, cmt. e (2000). ("A lawyer may not knowingly make false statements to a client and must make disclosures to a client necessary to avoid misleading the client.").

33. These are not the exclusive means of informing insureds-clients. The disclosure of employment status to clients can be accomplished in a variety of ways, including a personal meeting with the insured or clear language in the engagement letter. As one bar association ethics committee has stated: "In this situation lawyers should exercise their own sound judgment as to how best to inform insureds whom they are designated to represent that they are paid by the insurers, whether as employees or independent contractors...." Nassau County Bar Ass'n Comm. on Professional Ethics Op. 95-5 (1995).

In contrast, the Model Rules do not place a similar duty of affirmative disclosure on insurance staff counsel in respect to communications with the courts or persons other than insureds-clients. As an ethical consideration, whether a lawyer is a member of an outside law firm or an employee of an insurance company is rarely material to persons other than insureds-clients. Therefore, although local law or court rule may require affirmative disclosure to persons other than insureds-clients, the Model Rules do not.

Issue two: How may an association of insurance staff counsel identify itself?

We next turn to the matter of names by which an insurance staff counsel office may identify itself. This subject has been of some concern to courts and state bar associations.[34] As the New Jersey Supreme Court stated: "We recognize the genuine interest of the petitioners in being permitted to practice under a name that they believe reflects the nature of their association."[35]

The inquiry must begin, as the New Jersey Supreme Court correctly assessed, with a determination of the "nature of the association." Stated directly: does an association of insurance staff counsel constitute a "firm" or "law firm" within the meaning of the Model Rules?

Whether an association of lawyers constitutes a "law firm" turns upon (1) the manner in which the association functions, and (2) the association's compliance with the responsibilities of a law firm, including those imposed by the Model Rules.[36] We thus examine the structure and function of insurance staff counsel operations.

Although there is substantial variation in approaches taken by different insurance companies, insurance staff counsel operations are most commonly unincorporated divisions of the insurance company's corporate law department. Typically, the offices of insurance staff counsel are physically and organizationally separate from the insurance company's business operations. A senior lawyer, often called a managing or supervising lawyer, oversees business and professional responsibilities in the office.[37] The supervising lawyer must make

34. *See* MALLEN & SMITH, *supra* note 4, § 29.10 at 261 (setting out the various jurisdictional approaches).

35. In re Weiss, Healy & Rea, 536 A.2d 266, 269-70 (N.J. 1988).

36. *See* Florida Bar Ass'n Report of the Special Comm'n on Ins. Practices II at 16 (Mar.1, 2002), *adopted by* Florida Bar Bd. of Governors (Mar. 15, 2002) ("It is recognized that what constitutes a law firm for purposes of the rules is to be determined by a functional analysis of particular relationships and the purposes of the relevant ethical strictures in protecting the public interest."). *See also* Amendment to Rules Regulating The Florida Bar Re: Rules of Professional Conduct, 838 So.2d 1140 (Fla. 2003) (court formally adopted amendments to rules of professional conduct recommended in Special Commission report).

37. Report and Recommendations of the House Counsel Task Force of the Ohio State Bar Ass'n 10 (2002) ("Staff counsel organizations should be designed as law firms that are controlled by senior attorneys.").

reasonable efforts to ensure the office's compliance with the ethical rules of the jurisdiction, including conflict of interest provisions. In this regard, the supervising lawyer functions much like a managing partner in a private firm.

The lawyers work collectively, usually in teams with other lawyers, paralegals, and support personnel. Those lawyers in a single location commonly share confidences and consult with each other on assignments and strategies.[38] In addition to functioning as a law firm, insurance staff counsel frequently are part of the insurance company's legal organizational structure, thereby falling within Model Rule 1.0's definition of "firm" or "law firm."[39]

Having shouldered the responsibilities associated with law firm status, are insurance staff counsel permitted to refer to themselves as a "firm," "law firm," or an "association" of lawyers? We conclude they may do so provided that the names satisfy Rule 7.5(a), which cautions that, "[a] lawyer shall not use a firm name, letterhead or other professional designation that violates Rule 7.1." Rule 7.1, in turn, reads:

> A lawyer shall not make a false or misleading communication about the lawyer or the lawyer's services. A communication is false or misleading if it contains a material misrepresentation of fact or law, or omits a fact necessary to make the statement considered as a whole not materially misleading.

We believe the use of traditional law firm names, without more, might mislead insureds-clients who do not know the firm's affiliation with the insurance

38. If lawyers residing in separate offices function as insurance staff counsel for the same insurance company, the lawyers may share the confidences of clients among the offices. However, if they do so, or otherwise hold themselves out as associated with lawyers in other offices, the lawyers in all locations will be subject to the imputation of conflicts of interest under Rule 1.10. Whether various offices of insurance staff counsel constitute one law firm or multiple law firms for purposes other than maintaining client confidences and conflict avoidance has received scant attention from courts or scholars. Furthermore, it would seem to have few, if any, practical implications. Ultimately, as Comment [1] to Rule 1.10 suggests, the determination of whether offices operate as separate law firms comes down to "specific facts."

For example, in ABA Comm. on Ethics and Professional Responsibility Informal Op. 1309 (Legal Services Offices Representing Opposing Sides) (January 13, 1975), *in* FORMAL AND INFORMAL ETHICS OPINIONS 181 (ABA 1985), the ABA Ethics Committee addressed whether lawyers of the Neighborhood Law Office ("N.L.O.") and those of the state bar association's Legal Services Project, could represent opposing sides. The N.L.O. was an unincorporated legal services project that received indirect funding through the Legal Services Project. The Committee reviewed how the N.L.O. and Legal Services Project functioned, and concluded the lawyers could represent opposing sides because the offices "operate[d] as separate law firms." *Id*. at 182.

39. Rule 1.0(c) defines "firm" or "law firm" to include "lawyers employed in a legal services organization or the legal department of a corporation or other organization." Comment [1] to Rule 1.10 states, "[f]or purposes of the Rules of Professional Conduct, the term 'firm' includes lawyers in a private firm, and lawyers in the legal department of a corporation or other organization, or in a legal services organization."

company. Such potential for misleading, however, is eliminated when insurance staff counsel disclose their employment status to their insureds-clients in the manner described above.[40]

As it happens, insurance staff counsel commonly include explanatory language on their letterhead, business cards, office entry signs, and court pleadings. The language identifies the lawyers in the firm as employees of the insurance company, *e.g.*, "Employees of the Corporate Law Department of ABC Insurance Company." Although permissible, the Model Rules do not require such explanatory language, provided that all insureds-clients are informed of the employment status of the lawyer. [41]

So long as disclosure is made to all insureds-clients, an insurance staff counsel office may refer to itself as an association of lawyers practicing under the name of the supervising lawyer, *e.g.*, "John Smith and Associates," or "Law Offices of John Smith." In addition, it is permissible for the lawyers to practice under the names of a former member of the firm who is totally retired from the practice of law, so long as the retired lawyer is designated as "retired" on firm letterhead and other firm listings.[42]

Insurance staff counsel offices may also practice under the name of two or more of the lawyers in the office, *e.g.*, "Smith and Jones." Care must be taken in the latter approach, however, to comply with the dictate of Rule 7.5(d) that "[l]awyers may state or imply that they practice in a partnership or other organization only when that is the fact." Specific and prominent disclosure of the employee status of the lawyers may be used to dispel any potential implication that the firm is a partnership.[43]

Insurance staff counsel offices also may use a trade name, subject to the limitations of Rule 7.5(a). For example, insurance staff counsel may include the name of the insurance company in the law firm's name, *e.g.,* "Law Offices of ABC Insurance Company."[44] The Model Rules allow for the use of

40. *See supra* note 33 and accompanying text.

41. We note that insurance staff counsel do not solicit clients. They obtain clients solely through their affiliation with their employer. Because the employment status of insurance staff counsel is seldom material to anyone other than insureds-clients, Rule 7.1's threshold of a "material misrepresentation" rarely will be met in this context.

42. *See* ABA Comm. on Ethics and Professional Responsibility Informal Op. 85-1511 (Use of Firm Name "The X Partnership" Where X is Retired) (March 26, 1995), *in* FORMAL AND INFORMAL ETHICS OPINIONS 1983-1988 at 547 (ABA 2000), finding it permissible for a firm to practice under the name of the "X Partnership" when founding partner X retired.

43. *Accord* New York State Bar Ass'n Comm. on Professional Ethics Op. 726, 2000 WL 567960 *3 (2000). Another means of preventing misunderstanding would be to incorporate the legend "an association of lawyers not in partnership" or similar language whenever the firm's name appears on letterhead, business cards, and signage.

44. *But see* Virginia Legal Ethics Op. 775 (1986) (impermissible to use on letterhead designation "Law Offices of the ABC Insurance Company," followed by names of staff counsel).

trade names (including the name of a deceased member of the firm) so long as the name is not misleading or deceptive.[45]

45. Comment [1] to Rule 7.5 provides an instructive example. "If a private firm uses a trade name that includes a geographic name such as 'Springfield Legal Clinic,' an express disclaimer that it is a public legal aid agency may be required to avoid a misleading implication."

CA Eth. Op. 1987-91, 1987 WL 109707 (Cal.St.Bar.Comm.Prof.Resp.)

California State Bar
Standing Committee On Professional Responsibility and Conduct

ISSUE: MAY AN INSURANCE COMPANY RETAIN ITS IN-HOUSE COUNSEL TO REPRESENT INSUREDS IN LITIGATION BROUGHT BY THIRD PARTIES PURSUANT TO THE POLICY?

Formal Opinion Number 1987-91

1987

DIGEST: In-house counsel for an insurer may represent insureds in litigation without violating the prohibition against aiding the unauthorized practice of law set forth in rule 3-101(A). However, the attorneys must be certain that the insurance company does not control or interfere with the exercise of professional judgment in representing insureds, that any fees are not split with the insurance company or any other third parties, that case involving conflicts of interest are referred to outside counsel, and that the firm name used by in-house counsel is not false, deceptive or misleading.

AUTHORITIES INTERPRETED: Rules 2-101(A), 2-102, 2-107, 3-101(A), 4-101, 5-102(B) and 6-101 of the Rules of Professional Conduct of the State Bar of California.Business and Professions Code sections 6125, 6160 et seq.

I. INTRODUCTION.

The Committee has been asked whether an insurer may appoint in-house counsel to defend the interest of its insureds against claims brought by third parties pursuant to the insurance policy. The insurer (hereinafter "Insurance Company") proposes to establish a Law Division. The attorneys in the Law Division will hold themselves out as a law firm practicing under the name of one or more of the attorneys in the firm. Insurance Company will decide the "firm name" to be used. All attorneys comprising the Law Division will be salaried employees of the Insurance Company. All personnel matters of each Law Division (hiring, firing, compensation, etc.) will be handled by Insurance Company's personnel department.

It is proposed that the Insurance Company will retain the Law Division to provide a defense to certain of its insureds. Insurance Company will have the right to assign individual cases either to the Law Division or to outside counsel. Insurance Company intends to assign a percentage of cases to the Law Division, with more complex cases being assigned to outside firms. The motivation is economic. It is believed that the cost of the Law Division providing a defense will be substantially less than the cost of retaining outside counsel to provide such a defense.

Attorneys and other time keepers in each Law Division will bill their time to particular files in the same manner as an outside law firm. Statements will be rendered by the Law Division to the Insurance Company and income will be credited to the Law Division with a corresponding expense charged to the Insurance Company on its books. In theory, the Law Division seeks to operate as an independent law firm.

All correspondence and pleadings emanating from the Law Division will be on the "firm's" letterhead. However, individual clients, i.e., insureds, will not be informed that the attorneys comprising the Law Division are employees of Insurance Company.

II. ARE THE ATTORNEYS ASSISTING THE INSURANCE COMPANY IN THE UNAUTHORIZED PRACTICE OF LAW?

A. Practice of Law By Insurers Generally.
The Law Division in effect operates as "in-house" counsel for Insurance Company. The question arises as to whether Insurance Company, by retaining its in-house counsel to represent third parties, is engaging in the unauthorized practice of law.

Business and Professions Code section 6125 states that "no person shall practice law in this state unless he is an active member of the State Bar." Rule 3-101(A) provides that:

> "A member of the State Bar shall not aid any person, association, or corporation in the unauthorized practice of law."

Although it is now commonplace for insurance carriers to retain outside law firms to defend insureds in litigation, whether an insurance carrier's in-house counsel may perform such a role has never been decided in California. Several earlier California decisions concluded that a corporation can "neither practice law for it nor hire lawyers to carry on the business of practicing law." (People ex rel, Los Angeles Bar Association v. California Protective Corporation (1926) 76 Cal.App. 354 [244 P.1089].) In California Protective Corp., a corporation contracted with its patrons to employ attorneys on their behalf and to furnish the patrons with legal services for a specified annual fee.

The rationale prohibiting a corporation from retaining attorneys to provide legal services to third parties was premised on the personal relationship of trust and confidence between attorney and client which would be undermined by a corporation undertaking to furnish its members with legal advice, counsel and professional services. (People v. Merchants Protective Corp. (1922) 189 Cal. 531, 538 [209 P. 363].) The court in Merchant Protective Corp. concluded that an attorney "in such case, owes his first allegiance to his immediate employer, the corporation, and owes, at most, but an incidental, secondary, and divided loyalty to the clientele of the corporation." [FN1]

The foregoing case law, however, has not outlasted the evolution of prepaid medical and legal service programs which, under these authorities, would theoretically violate the prohibition against corporations practicing law. In recent years the judicial attitude toward group legal and health insurance plans has been greatly relaxed. For example, rule 2-102, which is discussed below, now permits the participation of attorneys in legal service programs under conditions which do not permit the group or its agents or members to interfere with the attorney's duties to the client. (1 Witkin, Cal. Procedure (3rd ed. 1985) Attorneys, § 288, pp. 326-327.) [FN2] Underlying these developments is the recognition that an attorney may be hired by a corporation to represent third parties without compromising the lawyer's independent professional judgment if appropriate safeguards are taken.

That a corporation can retain lawyers to provide legal services to third parties is also consistent with the generally accepted recognition that an attorney's relationship with a client is that of an independent contractor and not an employee. (Associated Indemnity Corp. v. Industrial Accident Comm'n (1943) 56 Cal.App.2d 804 [133 P.2d 698].) Similarly, an attorney retained by an insurance carrier to conduct the defense of a suit against its insured is considered an independent contractor. (Merritt v. Reserve Insurance Co. (1973) 34 Cal.App.3d 858, 880 [110 Cal.Rptr. 511].)

B. Practice of Law Through In-House Counsel.
Although never expressly decided in California, the decisional law in other states recognizes that an insurer which retains lawyers to represent the interests of its insureds in litigation in accordance with its duty to defend the insured does not engage in the unauthorized practice of law because of its right to defend its own direct financial interest in the litigation. (Liberty Mutual Insurance Co. v. Jones (1939) 130 S.W.2d 945; Strothers v. Ohio Casualty Insurance Co. (1939) 5 Ohio Supp. 362.) Since a corporation cannot appear in court except through a licensed attorney (Woodruff v. McDonald Rest. (1977) 75 Cal.App.3d 655 [142 Cal.Rptr. 367]), an insurer would be powerless to defend its legitimate interests, and those of its insureds, without retaining counsel.

Turning to the facts at hand, the question is whether Insurance Company may retain the services of its in-house counsel to handle the defense of a litigation against the insured. While Insurance Company has attempted to distance itself from the practice of law by creating a distinct entity with a separate identity, the fact remains that the attorneys involved will continue to be employed by Insurance Company as salaried employees. However, the mere fact that the lawyers are employees of Insurance Company does not necessarily compromise the attorney's independent professional judgment.

First, as discussed above, Insurance Company has its own legitimate interest to protect. The corporation is not simply performing legal services for others, but it is also protecting its own legal interest, and it is not disputed that a corporation may retain counsel to protect its own interests. (See Woodruff v. McDonald Rest., supra, 75 Cal.App.3d 655.)

Decisions in other states support the conclusion that staff counsel for an insurer may also represent insureds in liability suits. In Coscia v. Cunningham (1983) 250 G.A. 521 [299 S.E.2d 880], the Georgia Supreme Court refused to disqualify defense counsel who was employed by the insurer as in-house counsel. (See also, In Re Allstate Ins. Co. (1987) 722 S.W.2d 947.) The court noted that the insurer was protecting its own financial interest which was consistent with that of the insured since there was no dispute over coverage under the policy. (See Goldenberg Corporate Air, Inc. (1983) 189 Conn. 504 [457 A.2d 296]; Joplin v Denver-Chicago Trucking Co. (8th Cir. 1964) 329 F.2d 396; Torres v. Nelson (1984) 448 So.2d 1058; Mallen, A New Definition of Insurance Defense Counsel, (Jan. 1986) Insurance Counsel Journal at page 108.).

Second, in absence of a conflict of interest between the insureds and Insurance Company, it cannot be presumed that simply because the attorneys handling defense cases are salaried employees of Insurance Company that they will act unethically or

will otherwise sacrifice their professional obligations to the insureds in favor of Insurance Company. The determinative factor is whether the Insurance Company's in-house counsel can maintain professional independence comparable to that of an outside law firm. Under the facts of this opinion, with one reservation, we believe they can.

C. Rule 2-102(A).
Rule 2-102(A) is instructive on the degree of independence that must exist between the Insurance Company and the Law Division. Rule 2-102 authorizes attorneys to participate in a "bona fide" program, activity, or organization that furnishes, recommends or pays for legal services, including but not limited to, group, pre-paid and voluntary legal service organizations . . ." Under rule 2-102(A), an attorney's participation in such an organization, program or activity is not permitted if the organization or operation allows any third person, organization or group to interfere with or control the performance of the member's duties to his or her clients; allows an improper division of legal fees in violation of rule 3-102; or violates rule 2-101.

While rule 2-102(A) is generally recognized to apply to legal service programs, its concepts could as easily apply to any organization that supplies legal services, including liability insurers. Although we decline to decide in this opinion that rule 2-102(A) was intended to apply to insurers, the Committee believes that the guidelines set forth in rule 2-102(A) are sound and may be followed in this context.

In considering rule 2-102(A), attorneys working within the Law Division should be sensitive to the possibility that the Insurance Company may directly or indirectly seek to interfere with or control the performance of the member's duty to his or her clients. However, the Committee recognizes that, in absence of a conflict of interest between the insurer and the insured, Insurance Company is entitled to control the defense of litigation and may in many circumstances dictate defense and settlement strategy. (Merritt v. Superior Court (1973) 34 Cal.App.3d 858.)

Attorneys working within the Law Division should be alert that the Law Division does not become a front or subterfuge for lay adjustors or other unlicensed personnel to practice law. Non-attorney personnel working under the attorney's supervision must be adequately supervised. (See rule 6-101; Black v. State Bar (1972) 7 Cal.3d 676, 692 [103 Cal.Rptr. 288].) The Law Division must attempt to function as a separate law firm as much as possible (e.g., to protect confidential attorney-client files under Bus. & Prof. Code § 6068, subd. (e).)

Steps must also be taken to guarantee that illegal fee splitting with Insurance Company does not occur. Apparently, the formal procedures for supplying statements for services rendered to the Insurance Company by the Law Division such that "income" will be credited to the Law Division and a corresponding expense charged to the Insurance Company is an attempt to avoid fee splitting. However, the possibility of fee splitting appears remote since the source of the fees is Insurance Company itself. The Insurance Company is not rendering legal services for profit; rather, the cost of retaining counsel to defend insureds (whether through in-house or outside counsel) constitutes an expense item to Insurance Company. [FN3]

III. CONFLICTS OF INTEREST.

An attorney retained by an insurer to represent the interest of its insured in litigation owes fiduciary obligations to both the insurer and the insured. (Lysick v. Walcom (1968) 258 Cal.App.2d 136 [65 Cal.Rptr. 406]; American Mutual Liability Insurance Co. v. Superior Court (1974) 38 Cal.App.3d 579 [113 Cal.Rptr. 561].) In absence of a coverage dispute between the insured and the insurer, the two have a common interest:

> "Both the insured and the carrier have a common interest in defeating or settling the third party's claim. If the matter reaches litigation, the attorney appears of record for the insured and at all times represents him in terms measured by the extent of his employment.
> "In such a situation, the attorney has two clients whose primary, overlapping, and common interest is the speedy and successful resolution of the claim and litigation. Conceptually, each member of the trio, attorney, client, insured, and client-insured has corresponding rights and obligations founded largely on contract, and as to the attorney, by the Rules of Professional Conduct, as well. The three parties may be viewed as a loose partnership, coalition or alliance, directed toward a common goal, sharing a common purpose which lasts during the pendency of the claim or litigation against the insured." American Mutual Liability Insurance Co. v. Superior Court (1974) 38 Cal.App.3d 579, 591-92 [113 Cal.Rptr. 561, 571].

When the interests of the insurer and the insured diverge to the point that a conflict of interest is deemed to exist, the attorney must advise both the insurer and the insured of the conflict and must, in absence of written consent of both parties, withdraw from the representation. The insured may be entitled to be represented by independent counsel at the insurer's expense. (San Diego Naval Federal Credit Union v. Cumis Insurance Society, Inc. (1984) 162 Cal.App.3d 358.)

Several types of recurring situations may give rise to a conflict of interest: (1) a settlement offer at or within policy limits where there is a substantial likelihood of an excess judgment (Merritt v. Superior Court (1973) 34 Cal.App.3d 858, 871-873 [110 Cal.Rptr. 511]); (2) a suit against the insured alleging alternative theories of recovery, the outcome of which will determine whether the claim is covered (San Diego Naval Federal Credit Union, supra, 162 Cal.App.3d 358, 365); and (3) representation of the insured in the third party suit while representing the insurer in a coverage action against the insured (Executive Aviation Inc. v. National Ins. Underwriters (1971) 16 Cal.App.3d 799).

If any of the foregoing circumstances exist, counsel for the Law Division should refrain from representing either party without the consent of both. (See rule 5-102(B).) Attorneys for the Law Division should never represent insureds while simultaneously advising Insurance Company on the coverage aspects of such representation. (See San Diego Naval Federal Credit Union, supra, 162 Cal.App.3d 358.)

IV. USE OF LAW DIVISION FIRM NAME.
Rule 2-101(A) prohibits a "communication," which is defined as a message concerning the availability of a member of the Bar for professional employment, which is untrue, false, deceptive, or misleading. In our Formal Opinion 1982-66, we concluded that trade names are "communications" within the meaning of rule 2-101 and may be regulated to ensure that they are not misleading or deceptive to the public.

In Formal Opinion No. 1986-90, we considered whether a law office comprised of separate sole practitioners who shared office space, but who were neither partners nor incorporated, could advertise as a single entity without identifying themselves as separate, individual practitioners. We concluded that use of such a firm name would be misleading in that the public would tend to believe that the firm was a partnership or corporation. We also pointed out the potential liability that would result because the firm would be viewed as the legal equivalent of a partnership or a partnership by estoppel. (Blackmon v. Hale (1970) 1 Cal.3d 548 [83 Cal.Rptr. 194]; Redman v. Walters (1979) 88 Cal.App.3d 448 [152 Cal.Rptr. 42].)

In the present context, the use of a firm name, other than "Law Division," or an equivalent thereof, would be misleading in that clients of the Law Division - i.e., insureds - would be misled as to the relationship between the Insurance Company and its attorneys. Clients would be unaware that the individual attorneys were employed by the Insurance Company and would assume that the entity was a separate law firm. For this reason, the letterhead used must indicate the relationship between the firm and the Law Division. For example, the letterhead could contain an asterisk identifying the firm as the Law Division for Insurance Company.

V. CONCLUSION.

In-house counsel for an insurer may represent insureds in litigation without violating the prohibition against aiding the unauthorized practice of law set forth in rule 3-101(A). However, the attorneys must ensure that the insurance company does not control or interfere with the exercise of professional judgment in representing insureds, that any fees are not split with the insurance company or any other third parties, that case involving conflicts of interest are referred to outside counsel, and that the firm name used by in-house counsel is not false, deceptive, or misleading.

This opinion is issued by the Standing Committee on Professional Responsibility and Conduct of The State Bar of California. It is advisory only. It is not binding upon the courts, The State Bar of California, its Board of Governors, any persons or tribunals charged with regulatory responsibilities or any member of the State Bar.

FN1 This prohibition also extended to corporations which sought to provide medical services on behalf of third parties. (Pacific Employers Insurance Co. v. Carpenters (1935) 10 Cal.App.2d 592 (holding that a corporation could not engage, directly or indirectly, in the practice of legal, medical or dental professions for profit by "engaging professional men to perform professional services for those with whom the corporation contracts to furnish such services.").) (See Parma, Corporations: Unlawful Practice of Law (1927) 15 Cal. L. Rev. 243)

FN2 The change in judicial attitude is also reflected in the authorization of law corporations to practice law. (See Bus. & Prof. Code, § 6160 et seq.) Each shareholder, director and officer of a professional corporation must be an attorney. (Bus. & Prof. Code, § 6065.) (See also, Bus. & Prof. Code, §§ 6165, 6161; Law Corporation Rules of State Bar of California, Rule IV(A)(4).)

FN3 To the extent that the insurance policy may provide that the deductible portion of the policy is chargeable as against legal expenses incurred by the Law Department, care should be taken to ensure that such payment properly corresponds to the costs of providing legal services to the insured. To avoid fee splitting, it is imperative that the insurance company not profit from the collection of the deductible.

CA Eth. Op. 1987-91, 1987 WL 109707 (Cal.St.Bar.Comm.Prof.Resp.)
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Compendium of Staff Counsel Challenges

Updated – 8/27/2008

The long-standing practice of using salaried attorneys of an insurer to defend lawsuits filed against insurers has been the subject of various legal and ethical challenges through the years. There are two primary objections voiced by opponents:

1) it constitutes the unauthorized practice of law by the insurer; and
2) it involves impermissible representation of conflicting interests.

Twenty-six states as well as the American Bar Association have either considered these issues. All but two of these opinions permit insurers to use salaried counsel. Insurers' use of staff attorneys to defend claims against insureds has been approved by the supreme courts of Georgia, Indiana, Missouri, Tennessee, and Texas. Lower courts in five other states have held insurers' use of staff attorneys does not constitute the unauthorized practice of law (California, Illinois, Connecticut, Ohio, and Pennsylvania). Three states-Maryland, Illinois, and Minnesota-have statutes that would, either expressly or as applied, except insurance companies and their use of staff counsel from the state's prohibition of the unauthorized practice of law. Ethics committees in eight states have issued opinions that insurers' use of staff counsel does not constitute the unauthorized practice of law (Alabama, Alaska, California, Colorado, Illinois, Michigan, New Jersey, and Wisconsin). And committees in three other states have held that it is not unethical for staff attorneys to represent insureds (New York, Oklahoma and Pennsylvania). A state-by-state analysis follows.

I. Unauthorized Practice of Law

A. Use of Salaried Attorneys is not Unauthorized Practice of Law

ALABAMA: Alabama Office of General Counsel, Ethics Op. RO-2007-01 (2007). Disciplinary Commission finds that the utilization of staff counsel to represent insureds, where the interests of the insured and the insurer are fully aligned and where the insurer has a direct financial interest in the outcome of the litigation, does not constitute the unauthorized practice of law.

ALASKA: Alaska Bar Committee Opinion 99-3 dated 10/22/99 approved the use of staff counsel but required disclosure of the employment relationship between the lawyer and the insurer to the insured/client and client consent to the representation was obtained after consultation.

CALIFORNIA: The California Standing Committee on Professional Responsibility & Conduct, in Formal Opinion No. 1987-91 (1988) determined that salaried counsel's representation of insureds neither aids an insurer in the unauthorized practice of law nor violated Disciplinary Rules if cases involving actual conflicts of interest are referred to outside counsel.. On August 23, 2000 the 2nd District Court of Appeal, in an unpublished opinion refused to disqualify a staff lawyer on the grounds that the Plaintiff had no standing to challenge the defendant's attorney (Martino v. Kiernan, B 137746).

In Gafcon v. Ponsor & Associates, et. al. 98 Cal.App. 4TH 1388, 120 Cal.Rptr.2d 392 (June 2002) the California Court of Appeals affirmed a trial court finding that the insurer did not engage in the unauthorized practice of law by using staff counsel. A motion for reconsideration was denied by the Court of Appeals.

In Ricketts v. Farmers Group, Inc., the 2nd District Court of Appeals reversed a lower court finding that the use of staff counsel was the unauthorized practice of law. This is an unpublished opinion that can be found at 2001 WL 1487700 (Cal.App. 2 Dist.).

COLORADO: Colorado Bar Association, Formal Ethics Op. 91 (1993). Lawyer retained by a liability insurance carrier to defend a claim against the company's insured must represent the insured with undivided fidelity. For purposes of this opinion, that retention does not create an attorney-client relationship between the lawyer and the carrier.

CONNECTICUT: In King v. Guiliani, No. CS92 0290370 S, 1993 WL 284462 (Conn. Super., July 27, 1993), a Connecticut Superior Court decided that the use of salaried counsel to represent insureds does not violate rules of professional conduct nor constitute the unauthorized practice of law.

FLORIDA: In Re Amendment to Rules Regulating the Florida Bar re Rules of Professional Conduct, 838 S02d. 1140 (Fla. 2003) refusing to approve an ethics rule that would have prohibited an employee-attorney from representing anyone other than the employer "unless it shall clearly appear that the sole financial interests and risk involved as that of the late agency".

GEORGIA: The use of an insurer's salaried counsel to represent its insured was approved in Georgia in 1983. The Georgia Supreme Court ruled that the insurer is obligated to defend the suit by the terms of the policy, and that providing a defense to the insured is within the insurance company's own immediate affairs. Therefore, the insurer was not engaging in the unauthorized practice of law. Coscia v. Cunningham, 250 Ga. 521, 299 S.E. 2d 880 (1983).

ILLINOIS: In this state, the use of salaried counsel was approved by an appellate court, which relied upon an Illinois statute allowing insurers to employ attorneys to handle litigation on a fee basis, or by salary. Kittay v. Allstate Insurance Company, 397 N.E. 2nd 200 (1st Dist. 1979).

Illinois State Bar Association, Committee on Professional Ethics, Op. 89 – 17 (1990) aff'd by Bd. Of Governors Jan. 1991 – Facts: A corporation engaged in the insurance business issues public liability insurance policies under the terms of which it is obligated to defend as well as to indemnify its insureds in exchange for its premiums. The company employs attorneys licensed to practice in Illinois upon a salaried basis. The attorneys' primary functions are to act as attorneys of record for insureds who are defendants in litigated matters. Opinion: Where an insurance company provides counsel to its insureds, the retained attorney's primary obligation is to the insured/client. The attorney for insured/client may not allow the exercise of his independent professional judgment to be influenced by one other than his client. The facts presented are insufficient for the Committee to express an opinion as to whether the insurance company may be engaging in the unauthorized practice of law.

705 ILL. COMP. STAT. 220/5 (West 2007) "nothing contained in the Corporation Practice of Law Prohibition Act shall prohibit… any litigation in which any corporation may be interested by reason of the issuance of any policy or undertaking of insurance"

INDIANA: In 1999, the Indiana Supreme Court held that the use of staff counsel by an insurer was not the unauthorized practice of law. Cincinnati Ins. Co. v. Wills, 717 N.E. 2d 151 (1999). The court joined the several states that reject the contention that house counsel representation of insureds presents an inherent conflict in violation of the Rules of Professional Conduct. "Compliance with the Code in all cases will be measured against the Code itself. The court went on to hold that staff counsel offices must indicate they are employees of the insurer. Use of a captive law firm name was not permissible as it can be misleading.

In a case involving staff counsel but not the issue of whether staff counsel is the unauthorized practice of law or not, the Indiana Supreme Court decided In The Matter of Robert R. Foos that the way staff counsel for Warrior Insurance Company identified themselves on stationery was inappropriate. However, the decision gives little guidance on what is appropriate. This is cited as 770 N.E.2d 335 (June 2002).

MARYLAND: MD. CODE ANN., BUS. OCC. & PROF section 10-206(b)(3) requiring admission to the bar to practice law except for "an insurance company while defending an insured through staff counsel"

MICHIGAN: Michigan Bar Committee on Professional and Judicial Ethics, Op. CI-1146 (1986) In this state, salaried counsel may represent insureds as long as the attorney withdraws if prevented from exercising independent professional judgment. Mouraud v Automobile Club Insurance Association 186 Mich App. 715, 465 N.W.2d 443 (1991) propriety of staff council deemed implicit in the opinion.

MINNESOTA: MINN. STA. ANN. Section 481.02, subd. 3(3) prohibiting the unauthorized practice of law but not "any insurance company from causing to be defended, or from offering to cause to be defended through lawyers of its selection, the insureds in policies issued ~~were~~ or to be issued by it, in accordance with the terms of the policies".

MISSOURI: The Missouri Supreme Court determined that the use of salaried counsel to represent insureds is not the unauthorized practice of law nor does it necessarily involve inescapable conflicts of interest. In re Allstate Ins. Co., 722 S.W. 2d 947 (Mo. 1987). Liberty Mutual Insurance Company v. Jones, 344 Mo. 932, 130 S.W. 2d 945 (1939) - court concluded that an insurance adjuster could participate in workers comp informal conferences within certain restrictions and set forth the parameters of authorized conduct (implicit). Joplin v Denver – Chicago Trucking (8th Cir. 1964) 329 F.2d 396 (1964 U.S. App) – "The first point urged by plaintiff is that the trial court erred in refusing to grant plaintiff's motion to strike the defendant's answer and enter an interlocutory judgment for the reason that counsel for defendant was 'house counsel' for the insurance company, a corporation, defendant's insurer. Plaintiff charges that defendant's counsel is a fulltime salaried employee-lawyer or 'house counsel'. A careful consideration of this question leads us to the conclusion that no merit exists in plaintiff's contention and the decision of the trial court was a proper ruling." Missouri Bar Formal Opinion 121 (April 5, 2006) - where an attorney is employed by a bona fide nonprofit charitable or social service corporation to provide legal services to its clients, such activity does not constitute unauthorized practice of law by the corporation, and attorneys engaged in such practice are not to be deemed to be assisting in the unauthorized practice of law, as long as adequate precautions have been taken to insure that the corporation entity is serving merely as a conduit for the representation, is not in any way involved in or in control of the representation, no fee is involved, and adequate precautions are taken to avoid lay interference and to preserve the integrity of relationship between the attorney and the individual client.

NEW JERSEY: The use of salaried counsel to defend insureds is not considered to be the unauthorized practice of law. New Jersey Supreme Court Committee on Unauthorized Practice, Opinion 23, 114 N.J.L.J. 421 (1984). Opinion 23 was reexamined and confirmed in 1996. See Committee on the Unauthorized Practice of Law Supplement to Opinion 23 (5 N.J.L. 1828, August 26, 1996; 145 N.J.L.J. 935, August 26, 1996). "Based upon the foregoing, the Committee on the Unauthorized Practice of Law concluded, as it did in Opinion 23, *supra*, 114 *N.J.L.J.* 421, that insurance companies conducting the defense of litigation in which they owe indemnification to their insureds through house counsel are not engaged in the unauthorized practice of law.") (http://lawlibrary.rutgers.edu/ethicsdecisions/cuap/cua23_2.html)

In Re Weiss, Healy & Rea, 109 N.J. 246, 536 A.2nd 266 (1988) the court held that an insurance staff counsel office could not name the office to give the effect that the law firm was that of an equity partnership.

NEW YORK: The New York Bar Association has determined in two opinions, New York State Bar Association, Unlawful Practice of Law Committee, Opinion 13 (1970) and New York Bar Association Professional Ethics Committee, Opinion No. 109 (1969) that it was proper for insurers to use salaried counsel to defend their insureds. See also Travelers insurance Co v. Commissioners of The State Insurance Fund. (1996 WL 251946 N.Y.A.D. 1 Dept.) The court rejected defendant's argument that claimants use of in-house counsel to perform the work in question constitutes the unauthorized practice of law by claimants or fee splitting

On February 2, 2000, the New York Bar Association's Committee on Professional Ethics issued Opinion No. 726. The Opinion deals with the question of whether staff attorneys of an insurance company may hold themselves out as a law firm when they are salaried employees working exclusively on behalf of the insurer's policyholders. The Opinion concludes that a group of lawyers who are salaried employees of an insurance company and whose practice is exclusively in defense of the company's policyholders may hold themselves out as a law firm only if they do the following:

- Undertake to act consistently with the professional responsibilities of a law firm; and
- Disclose that they are employees of the insurance company.

OHIO: In 1939, an Ohio Court decided that an insurance company's use of salaried attorneys to defend lawsuits filed against its insureds was permissible and did not constitute the unauthorized practice of law by a corporation. Strother v. Ohio Casualty Insurance Company, 28 Ohio L.Abs. 550, 14 Ohio Op. 139 (Com. Pleas 1939)

Eleven years later, the Toledo Bar Association requested an opinion from the American Bar Association on the propriety of using staff counsel to defend a company's insureds. In 1950, the ABA approved such a practice. American Bar Association Committee Professional Ethics and Grievances, Formal Opinion 282 (1950).

In a strange twist, this issue resurfaced in 1994 as the Ohio Board of Commissioners on Grievances and Discipline issued an ethics opinion, holding that insurers' use of in-house attorneys to prosecute subrogation claims violated the Ohio Code of Professional Responsibility. Ohio Formal Opinion 94-9 (1994). This opinion was quickly overruled the following year. Ohio Formal Opinion 95-14 (1995).

Since 1996, there are several unreported trial court decisions that have addressed the issue of staff counsel in response to Motions to Disqualify.

Molter v. Hansell, Judge Clark, Fairfield County Common Pleas (1996) Trial Judge granted motion and disqualified staff counsel based on employment.
Hinkle v. Wood, Judge Cain, Franklin County Common Pleas (1996), Motion to Disqualify overruled.
Leavelle v. McComb, Judge McGrath, Franklin County Common Pleas (1996), Motion to Disqualify denied.
Behmer v. Nguyen, Judge Sadler, Franklin County Common Pleas (1996), Motion to Disqualify denied.
Ruffing v. Miller, Judge Connor, Franklin County Common Pleas, (1996), Motion to Disqualify overruled.
Whisner v. Slone, Judge Frost, Licking County Common Pleas (1997), Motion to Disqualify overruled.
Marsico v. Nationwide, Judge Zaleski, Lorain County Common Pleas (1998), Motion to Disqualify denied.
Griffiths v. Boyles, Judge Hogan, Franklin County Common Pleas (1998), Motion to Disqualify denied.
Heinecke v. Johnson, Judge Kroncke, Lucas County, Sylvania Municipal Court, (1999) Motion to Disqualify overruled.

Supreme Court of Ohio – In re Cincinnati Bar Assn v. Allstate UPL02-02 (10/2003) 2003-1834. On October 20, 2003 movant, Cincinnati Bar Association, filed a motion requesting the court to review the October 1, 2003 dismissal by the Board of Commissioners on the Unauthorized Practice of Law, of Board case number UPL02–2. October 28, 2003, respondent, Allstate insurance Co., filed a response opposing the motion for court review. The court ordered that the movement's motion be denied and dismissed the cause.

PENNSYLVANIA: A bad faith case before the Court of Common Pleas in York County, Schoffstall v. Nationwide Insurance Co., 58 Pa. D. & C 4th 14 (2002 Pa Dist. & Cnty (2002) alleged that the use of staff counsel constitutes the crime of unauthorized practice of law by a corporation, making Nationwide per se liable for bad faith. Cross-Motions for Summary Judgement were filed and briefed. After sitting for more than two years, the trial court decided the Motion for Summary Judgment granting Nationwide's and dismissing the Complaint.

TENNESSEE: In 1995, the Tennessee Supreme Court, in In Re Youngblood, 895 S.W.2d 322, 1995 Tenn. LEXIS 46, overturned an ethics opinion that prohibited liability insurers from using salaried attorneys to defend insureds. The Court determined such arrangements did not violate the state's unauthorized practice of law statute. The Court further ruled that a staff counsel office couldn't use a name that gives the public the impression that the salaried attorneys are engaged in the general practice of law as partners or as sole practitioners. The employment relationship has to be clearly disclosed to the client and the public.

TEXAS: In 1958, the State Bar of Texas was faced with the issue of whether the use of salaried counsel to defend insureds constituted the unauthorized practice of law. The Committee determined that this method of defending insureds was proper, and that salaried counsel could prosecute subrogation cases too. State Bar of Texas Committee on Canons of Ethics, Opinion No. 167 (1958).

In 1963, the Commission on Interpretation of the Cannons of Ethics addressed the same issue and determined that a licensed attorney, employed by an insurer, may defend an insured in an action pending against him. State Bar of Texas, Commission on Interpretation of the Canons of Ethics, Opinion 260 (1963).

In 2008, the Supreme Court of Texas, in American Home Assurance Company & Travelers v. Texas UPLC No. 04-0138 (March 28, 2008) modified the Court of Appeals judgment ruling that the use of staff attorneys does not constitute the unauthorized practice of law. Insurance carriers may use staff attorneys to defend claims against insureds provided that the insurers' and insureds' interest in the situation are congruent as described in the opinion. Staff attorneys must disclose their affiliation to their clients.

VIRGINIA: In this state, the practice of using staff counsel to defend insureds is likewise not considered to be the unauthorized practice of law. Virginia State Bar Standing Committee on Legal Ethics Opinion 598 (1985). Unauthorized Practice of Law Opinion No. 60 (approved by Supreme Court 1985) a liability insurance carrier may use staff counsel to defend suits against its insureds, including suits claiming damages in excess of the amount of available coverage, so long as the insurance carrier is obligated to pay all or part of the judgment against its insureds. It may not employ staff counsel to represent its insureds if it's only obligation is to furnish legal representation to the insured, or if its obligation to pay all or part of any judgment against the insured is conditioned upon the outcome of the litigation, the outcome of subsequent litigation, or is otherwise qualified in any manner.

WEST VIRGINIA: In West Virginia Lawyer Disciplinary Board Op. 99-01, July 9, 1999, the Board concluded that the representation of insureds by employed lawyers in a "captive law firm" is permissible under the Rules of Professional Conduct subject to the criteria outlined in the opinion. Upon referral by the Lawyer Disciplinary Board, the West Virginia State Bar's Unlawful Practice Committee reviewed the unauthorized practice of law issue and in a letter to Disciplinary Counsel concluded that it did not believe that the operation of a captive law firm is the unlawful practice of law.

WISCONSIN: Wisconsin State Bar Commission on Professional Ethics, Formal Opinion E-95-2 - It generally is permissible for in-house counsel to represent others at the employer's direction and without compensation from the other person, subject to certain safeguards. The corporation is not practicing law; in-house counsel is stepping outside his or her regular role to do so and should evaluate the possible need for compliance with the trust account rule, SCR 20:1.15, as well as the possible need for legal malpractice insurance. In undertaking such representation, in-house counsel by definition steps outside the role of in-house counsel. Any lawyer-client relationship created with a person other than the corporate employer must stand on its own terms, complete with all the responsibilities that ordinarily attach to the relation, and impervious to interference by the corporate employer.

B. Use of Salaried Attorneys is the Unauthorized Practice of Law

NORTH CAROLINA: In 1986, the North Carolina Supreme Court ruled that the state's unauthorized practice of law statute precluded the use of an insurer's salaried counsel to represent its insureds. Gardner v. North Carolina State Bar, 316 N.C. 285, 341 S.E. 2d 517 (1986).

KENTUCKY: In 1996, the Kentucky Supreme Court refused to overrule a 1981 Unauthorized Practice of Law Opinion, which held that the use of salaried counsel constituted the unauthorized practice of law. American Insurance Association v. Kentucky Bar Association, 917 S.W. 2d 568, 1996 KY LEXIS 22 (1996).

C. States with Challenges Currently Pending

TEXAS: In 1998 the UPLC sued Allstate and its Managing Attorney, Patrick Collins, in the 298th Judicial District Court of Dallas County, Texas, alleging that Allstate's use of staff attorneys to defend insureds under liability policies constitutes the unauthorized practice of law ('the Allstate case"). State Farm, and several other carriers, intervened in that matter. After learning the UPLC was also investigating its use of staff attorneys, Nationwide filed a declaratory judgment action in federal court seeking a declaration that there is no disciplinary rule, ethical opinion or case law in Texas prohibiting an insurance company from using staff attorneys to defend its insureds ("the Nationwide case"). A district court for the Northern District of Texas abstained from exercising its jurisdiction and dismissed Nationwide's declaratory judgment action. That dismissal was later upheld by the United States Court of Appeals for the Fifth Circuit.

Following the dismissal of its federal case, Nationwide and the Managing Attorney for its Texas operations, Sean Martinez, filed a declaratory judgment action in San Antonio in the 131st Judicial District Court of Bexar County, Texas. Both sides subsequently moved for summary judgment after the declaratory judgment action was filed.

About the time Nationwide filed its federal action, two other insurance companies, American Home Assurance Company and Travelers Indemnity Insurance Company, filed a declaratory judgment action in the 68th Judicial District Court of Dallas County, Texas, seeking a declaration that an insurance company's use of staff attorneys to defend its insureds is not the unauthorized practice of law ("the Travelers case"). The 68th Judicial District Court ultimately held that the insurance companies engaged in the unauthorized practice of law when they used internal staff attorneys to represent their insureds. In 2003, the Eleventh Court of Appeals in Eastland, however, reversed the Dallas District Court's ruling in Travelers, holding that the use of staff attorneys to represent insureds is not the unauthorized practice of law.

After the Eleventh Court of Appeals handed down its opinion in Travelers, the Bexar County District Court conducted a hearing on the parties' motions for summary judgment in Nationwide. Following the hearing, the trial court granted Nationwide's motion and denied the UPLC's motion. The trial court's summary judgment order expressly declared Nationwide's use of staff attorneys to represent insureds is not the unauthorized practice of law.

Following the defeat in Eastland the UPLC, in April, 2004, filed a petition for review with the Texas Supreme Court in Travelers. After losing at the appellate level, the UPLC, in February, 2005, also filed a petition for review with the Texas Supreme Court in the Nationwide case.

The Supreme Court granted the petition in Travelers, heard oral argument and ultimately published an opinion favorable to the insurance industry on March 28, 2008. American Home Assurance Company & Travelers v. Texas UPLC No. 04-0138 (March 28, 2008) modified the Court of Appeals

judgment ruling that the use of staff attorneys does not constitute the unauthorized practice of law. Insurance carriers may use staff attorneys to defend claims against insureds provided that the insurers' and insureds' interest in the situation are congruent as described in the opinion. Staff attorneys must disclose their affiliation to their clients A motion for rehearing in that case remains pending.

On the same day, March, 28, 2008, the Supreme Court denied the petition for review in the Nationwide case. A motion for rehearing on that order also remains pending.

The Allstate case remains where it has been for the past ten years - before the 289th Judicial District Court of Dallas County. It has been set for trial on multiple occasions, but has never been called. The Court has informally stayed that action pending final resolution of Travelers.

II. Possible Conflicts of Interest Do Not Preclude the Use of Salaried Counsel–General Ethics Allegations

AMERICAN BAR ASSOCIATION: The ABA decided in 1950 that it was permissible under the ethical guidelines and rules of professional conduct for salaried counsel to defend insureds. ABA Committee on Professional Ethics and Grievances, Formal Opinion 282 (1950). **ABA Formal Opinion 03-430 (2003)** also states that insurance company staff counsel may ethically represent both their employer and their employer's insureds so long as (1) the lawyers inform the insureds that they are employees of the insurance company, and (2) the lawyers exercise independent professional judgment in representing the insureds.
The ABA also determined that salaried counsel may represent the subrogated interests of the carrier arising from settlement of claims of insureds and may represent the insured's interest in collecting the deductible. ABA standing Committee on Ethics and Professional Responsibility, Informal Opinion 1370 (1976). ABA Informal Opinion 1402 (1977)

ALABAMA: In 1981, the Alabama State Bar Ethics Committee ruled that salaried counsel may defend insureds in third-party litigation if extreme caution is exercised to advise the insureds when conflicts of interest or potential conflicts arise between the insurer and insured. Alabama State Bar, Ethics Opinion 81-533 (1981). Alabama Office of General Counsel, Ethics Op. RO-2007-01 (2007). Disciplinary Commission finds that the utilization of staff counsel to represent insureds is permitted, where the interests of the insured and the insurer are fully aligned and where the insurer has a direct financial interest in the outcome of the litigation. At the outset of representation, staff counsel must disclose that he/she is a full-time employee of the insurer and disclose any limitations upon the representation.

ALASKA: Alaska Bar Committee Opinion 99-3 dated 10/22/99 approved the use of staff counsel but required disclosure of the employment relationship between the lawyer and the insurer to the insured/client and client consent to the representation was obtained after consultation. In addition, Alaska Bar Committee Opinion 99-3 requires that the insurance company lawyer reasonably believes the representation will not be adversely affected by the employment, and that there is no conflict of interest between the insurer and the insured.

ARIZONA: In 1975, an Arizona Ethics Committee was asked whether it was proper for an insurer's salaried counsel to represent the company's insureds. In addressing the conflict of interest issue, the Committee decided that there was no difference in the ethical obligations owed to the insured between salaried attorneys and outside counsel. The Committee concluded by finding the insurer's practice of using a salaried counsel to be proper. Arizona State Bar Association Ethics Committee, Opinion 75-4 (1975).

CALIFORNIA: The California Standing Committee on Professional Responsibility & Conduct, in Formal Opinion No. 1987-91 (1988) - attorneys must ensure that the insurance company does not control or interfere with the exercise of professional judgment when representing insureds, that any fees are not split with the insurance company or with other third parties, that case involving conflicts of interest are referred to outside counsel, and that the firm name used by in-house counsel is not false, deceptive, or misleading.

COLORADO: The use of salaried counsel to defend insureds was approved by the Colorado Bar Association Ethics Committee in Formal Opinion 91 (1993). The Committee went on to address the requirement that the employment relationship with the insurer must be clearly disclosed to the insured.

FLORIDA: In 1969, the Florida Supreme Court was asked by the State Bar to approve a new rule, which would have prohibited an insurer from using salaried counsel to represent its insureds. The Bar reasoned that a conflict of interest developed when a salaried attorney was representing a policyholder in a case where the value of the claim exceeded the policy limits or a settlement demand was made that was in excess of the policy limits. The Florida Supreme Court rejected these arguments and refused to authorize the proposed rule. In re Proposed Addition to the Additional Rules Governing the Conduct of Attorneys in Florida, 220 So. 2d 6 (Fla. 1969). In Re Amendment to Rules Regulating the Florida Bar re Rules of Professional Conduct, 838 S02d. 1140 (Fla. 2003) refusing to approve an ethics rule that would have prohibited an employee-attorney from representing anyone other than the employer "unless it shall clearly appear that the sole financial interests and risk involved as that of the late agency". The court rejected the "economic pressure" of full-time employment argument finding that house counsel's responsibilities are no different than any other lawyer's responsibilities to one of two clients whose interests are in conflict. Special advisory commission established guidelines.

INDIANA: Cincinnati Ins. Co. v. Wills, 717 N.E. 2d 151 (1999). The court joined the several states that reject the contention that house counsel representation of insureds presents an inherent conflict in violation of the Rules of Professional Conduct. "Compliance with the Code in all cases will be measured against the Code itself. The court went on to hold that staff counsel offices must indicate they are employees of the insurer. Use of a captive law firm name was not permissible as it can be misleading. Siebert Oxidermo, Inc v. Shields, Ind. App. 430 N.E.2d 402 aff'd 446 N.E.2d 332 (Ind, 1983) on a daily basis defense attorneys employed by insurance carriers on behalf of policyholders are called upon to deal with matters in litigation where the interests of the policyholder and the carrier do not fully coincide. Under such circumstances the attorney's duty is, of course, to the insured whom he has been employed to represent. In response the defense bar has exhibited no inability to fully comply with both the letter and spirit of Canon 5 of the Code of Professional Responsibility. If it were otherwise we suspect the desirability of requiring carriers to supply defense counsel would have long since disappeared as a term of the policy.

IOWA: The use of an insurer's salaried counsel to represent insureds was approved in this state in 1989. Iowa State Bar Ethics Committee, Opinion 88-14 (1989). Generally, employed lawyers are bound by the same rules of professional conduct as are independent practitioners.

MICHIGAN: In this state, salaried counsel may represent insureds as long as the attorney withdraws if prevented from exercising independent professional judgment. Michigan State Bar, Committee on Professional and Judicial Ethics, Opinion CI-1146 (1986). (Supported and cited approvingly in Opinion RI-343 January 25, 2008, in a case involving flat fee arrangements. "Representation of an insured on a fixed fee basis paid by the insurance company is not unethical, so long as the arrangement does not adversely affect the lawyer's independent professional judgment and the lawyer represents the insured with competence and diligence. Although there is nothing in the Rules that would require disclosure to an insured of the basis of the fee to be paid by the insurer to the lawyer, the lawyer may not agree with the insurer that it will not disclose to the insured information about the fee arrangements.)

NEW YORK: Nassau County Bar Association commission on professional ethics opinion and 95-5 (1995) – lawyers should exercise their own sound judgment as to how best to inform insureds whom they are designated to represent that they are paid by insurers, whether as employees or independent contractors. New York Committee on Professional Ethics Opinion 519 (1980) – there is no doubt that an insurance company's staff lawyer may ethically represent an insured in the usual case of defending against the claims of third parties. .New York Committee on Professional Ethics Opinion 726 (2000) – a group of lawyers who are salaried employees of an insurance company and whose practice is exclusively in defense of the company's policyholders may hold themselves out as a law firm only if a the undertake to act consistently with the professional responsibilities of a law firm and be they disclose that they are employees.

OKLAHOMA: Likewise, salaried counsel received the same approval in Oklahoma. Oklahoma Opinion 1997-1 (1997). Oklahoma Legal Ethics Advisory Opinion No 309 – a lawyer who is employed by a liability insurer may represent his employers insured, provided the lawyer discloses all limitations upon the representation, insurer does not interfere with independent professional judgment, lawyer fulfills his duty of confidentiality to his client, and otherwise complies with the rules of professional conduct.

PENNSYLVANIA: The Philadelphia Bar Association, in Op. 86-108 (1986) ruled that salaried counsel may pursue subrogation claims and represent an insured if all foreseeable issues of conflict have been resolved or do not exist. This same result was reached by the Pennsylvania Bar Association, Committee on Legal Ethics a Professional Responsibility, Formal Opinion 96-196 (not issued but cited in Texas Supreme Court opinion UPLC adv. American home) (2008).

WEST VIRGINIA: In West Virginia Lawyer Disciplinary Board Op. 99-01, July 9, 1999, the Board concluded that the representation of insureds by employed lawyers in a "captive law firm" is permissible under the Rules of Professional Conduct subject to the criteria outlined in the opinion.