ALASKA BAR ASSOCIATION
ETHICS OPINION NO. 99-3

May In-House Staff Counsel For An Insurance Company Represent Insureds?

INTRODUCTION

A three-way relationship amongst a liability insurer, its insured, and defense counsel retained by the insurer to represent the insured, gives rise to numerous ethical considerations for defense counsel.[1] Insurers have attempted to institute a number of measures to control costs in recent years, including the provision of defense services directly through salaried lawyer employees. The Ethics Committee has been asked to consider the ethical propriety of this arrangement. May an insurance company employ in-house counsel (salaried employees) to represent their insured in litigation before Alaska courts?

The Committee concludes that the attorney/employee of an insurer may provide defense services to an insured so long as: (1) there is full disclosure of the attorney's relationship with the insurer; (2) the client consents after consultation; (3) the lawyer reasonably believes the representation will not be adversely affected by his employment; and (4) there is no conflict of interest between the insurer and insured.

ANALYSIS

1. The Tripartite Relationship

An analysis of the issues involved in this opinion requires a brief discussion of the different aspects of the relationship between the insurer, its insured, and the defense attorney retained by the insurer to represent the insured. First, the insured has contracted with the insurer for insurance. As part of this insurance, the insurer typically agrees to provide a defense, including legal representation, for the insured. Often times, the insurer has a contractual duty to provide the insured with legal representation. In exchange,

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[1] *See, e.g.,* Ethics Opinion Nos. 89-3 (Duty of Defense Attorney Where Insured Objects to Insurer's Selection of Defense Counsel); 90-2 (Duty of Defense Attorney Where Insurer Directs Offer of Judgment); 99-1 (Disclosure of Detailed Information to Outside Billing Auditors). *See also CHI of Alaska, Inc. v. Employers' Reins. Corp.*, 844 P.2d 1113 (Alaska 1993); A.S. 21.89.100.

the insurer typically receives the right to control the defense (and often the settlement) of the underlying claim against the insured. When the insurer retains an attorney to represent the insured, the insured becomes the attorney's client. Even though the insurer is paying for the attorney's legal services (by fee or salary), professional responsibilities of the attorney, including the duties of confidentiality and loyalty, run to the insured.[2]

2. The Alaska Rules

The Alaska Rules of Professional Conduct expressly recognize that an attorney may ethically represent a client, where another pays the legal fees or salary. 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 consents after consultation;
>
> (2) there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship; and
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> (3) information relating to representation of a client is protected as required by Rule 1.6.

Rule 1.7 is also implicated:

> (b) A lawyer shall not represent a client if the representation of that client may be materially limited

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[2]Much has been written about the tripartite relationship between insured, insurer, and defense counsel. It is a triangular relationship because each of the three parties owe, in some respect, either contractual, statutory, or common law duties to the other. It is unresolved in Alaska as to whether both the insurer and the insured are clients of the defense counsel. Some would argue that the only attorney-client relationship that exists is between the defense counsel and the insured, while others have taken the position that the insurer and insured are co-clients of the defense counsel. *See CHI of Alaska*, 844 P.2d at 1116 (noting the different authorities that take the view that appointed counsel represents both the insurer and the insured); *Home Indem. Co. v. Lane, Powell, Moss & Miller*, 43 F.3d 1322, 1331 (9th Cir. 1995) (holding the Alaska Supreme Court would find an attorney-client relationship between the insurer and the counsel it retains for the insured). The Ethics Committee takes no position on this debate, and notes that there is no debate that the insured is a client.

> by the lawyer's responsibilities to another client or to *a third person, or by the lawyer's own interests,* unless;
>
> > (1) the lawyer reasonably believes the representation will not be adversely affected; and
> >
> > (2) the client consents after consultation. When representation of multiple clients in a single matter is undertaken, the consultation shall include explanation of the implications of the common representation and the advantages and risks involved.

(Emphasis added.)

3. <u>The Lawyer Must Maintain Independent Professional Judgment</u>

In all cases, the lawyer for the insured must maintain his or her professional independence, and exercise professional judgment for the sole benefit of the client. A lawyer may accept compensation from someone other than the client only if there is no interference with his independence and professional judgment. In *CHI of Alaska, Inc. v. Employers' Reins. Corp.*, 844 P.2d 1113 (Alaska 1993), the supreme court noted that appointed defense counsel owes "an absolute duty of fidelity to the insured over the interests of the insurer." *Id.* at 1116. The court further quoted with approval from a decision of the Arizona Supreme Court:

> We emphasize that the attorney who represents the insured owes him an undeviating allegiance whether compensated by the insurer or the insured and cannot act as an agent of the insurance company by supplying information detrimental to the insured.

Id. (quoting *Farmers' Ins. Co. of Ariz. v. Vagnozzi*, 138 Ariz. 443, 448, 675 P.2d 703, 708 (Ariz. 1983)). Thus, regardless of who pays the lawyer's bill (or salary), the insurance defense attorney owes a duty of unfettered loyalty to the client insured.

In some states, the use of salaried staff counsel to defend the insured has been criticized on legal and ethical grounds. However, the majority of states which have considered the use of staff counsel to defend insureds have approved of the arrangement.

The early decisions uniformly approved the insurer's use of salaried lawyers to defend their insureds. The American Bar Association Committee on Ethics and Professional Responsibility has opined that ethics rules apply uniformly to all attorneys, regardless of how they are paid. In a 1950 opinion, the ABA Committee stated that a lawyer employed and compensated by an insurance company, which holds a standard contract of insurance with its insured, "may with propriety defend the insured in an action brought by a third party." ABA Comm. on Professional Ethics, Formal Op. 282 (1950). The ABA noted the "essential point of ethics" raised by the use of salaried staff counsel to defend insureds is the question of conflict of interest. The ABA opinion concludes that conflicts will not arise as long as staff counsel "represent[s] the insured as his client with undivided fidelity as the rule requires." *Id.* This position is consistent with Alaska law on defense counsel's duty of loyalty. *See CHI of Alaska, Inc.*, 844 P.2d at 1116.

Critics have sought to prohibit the use of salaried counsel on two basic grounds. First, they charge that the use of in-house counsel engages the insurance company in the unauthorized practice of law. Second, the practice is claimed to result in actual or potential conflicts of interest.

4. The Insurer and the Unauthorized Practice of Law

The majority of courts which have looked at the unauthorized practice of law issue have concluded the attorney-employee is not aiding a non-attorney in the practice of law. In fact, until 1986, every court and ethics group that had carefully studied the salaried counsel issue found the practice permissible. *See* Jackson, *Defending the Insured with Salaried Counsel: Legal and Ethical Considerations,* Vol. 27, No. 2 The Brief 38, 40 (Winter 1998). In *Gardner v. North Carolina State Bar*, 341 S.E.2d 517 (N.C. 1986), the North Carolina Supreme Court held that state's unauthorized practice statute precluded the use of salaried house counsel. The court initially observed that by making an appearance, the lawyer was in effect appearing for his corporate employer. If the lawyer appeared for an insured, the insurer would be appearing for someone else, in violation of North Carolina's practice of law statute. The court reasoned that the insurance company itself could not be a party to the action.[3]

The *Gardner* decision has been severely criticized. The Missouri

[3] The *Gardner* court noted the substantial contrary authority from other jurisdictions, but distinguished its own unauthorized practice statute. *Gardner*, 341 S.E.2d at 522. The North Carolina statute provided: "It shall be unlawful for any corporation to practice law or appear as an attorney for any person in any court in this state . . . ." *Id.* at 520. Alaska's unauthorized practice laws do not contain the same prohibitions.

Supreme Court refused to adopt the reasoning of the *Gardner* case, and instead chose to follow what it described as the weight of authority. *In re Allstate*, 722 S.W.2d 947 (Mo. 1987). The Missouri court noted the unauthorized practice statutes were designed to preclude a corporation with non-professional shareholders from obtaining a proprietary interest in the practice of law. In 1993, a Connecticut court also reviewed the unauthorized practice claim. *King v. Guiliani*, 1993 WL 284462 (Conn. Super. Ct. 1993). It found the *Gardner* decision unpersuasive, and chose to follow *Allstate*. The Connecticut court concluded the overwhelming weight of authority permitted the use of salaried attorney employees to represent the interests of the insured and the insurer provided there was no conflict of interest.

In 1995, the Tennessee Supreme Court overturned an ethics opinion prohibiting liability insurers' use of salaried lawyers to defend their insureds. One of the original reasons for the ethics opinion was the conclusion that the use of salaried lawyers violated Tennessee's unauthorized practice statute. Once again, the Tennessee Supreme Court rejected a *per se* rule that the use of salaried attorney employees aided non-attorneys in the practice of law.

> However, the mere fact that the lawyers are employees of [an] insurance company does not necessarily compromise the attorney's independent professional judgment.
>
> As stated with regard to the conflict of interest issue, the specific facts of each situation must be examined to determine if the attorney is aiding a non-attorney in the practice of law. The mere showing of the relationship of employer/employee, without a definition of the duties, loyalties, prerogatives, and interests of the parties, is not a sufficient basis on which to conclude that the attorney employee is aiding a non-attorney in the practice of law.

Petition of Youngblood, 895 S.W.2d 322, 331 (Tenn. 1995).

Like most states, Alaska has statutes and rules prohibiting the unauthorized practice of law. Alaska Rule of Professional Conduct 5.5 prohibits a lawyer from assisting a person who is not a member of the bar in their performance of activity that constitutes the unauthorized practice of law. In addition, under Alaska Rule of Professional Conduct 5.4, a lawyer is

prohibited from sharing legal fees with a non-lawyer, except under defined circumstances. Finally, and most importantly,

> 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.

Alaska R. Professional Conduct 5.4(c).

In the Committee's view, the Alaska Rules clearly provide for the professional independence of a lawyer, even though he or she may be employed by a non-lawyer. A staff lawyer who represents the insured using the best of his or her independent professional judgment, is not aiding the insurer in the unauthorized practice of law. The Committee fails to see a distinction between the lawyer employee of an insurance company, and any other lawyer employee of a corporation, association or public entity.[4]

5. Potential Conflicts of Interest

The second reason usually given by critics of salaried staff counsel for objecting to the relationship is the potential for conflicts of interest. Some courts, like Kentucky, have concluded the potential for conflict is so great that a *per se* rule is required. In *American Ins. Ass'n v. Kentucky Bar Ass'n.*, 917 S.W.2d 568 (Ky. 1996), the court acknowledged the trends of other jurisdictions, but concluded, without analysis, that staff counsel would be incapable of providing undivided loyalty to the insured. Most other courts, however, have concluded the relationship of staff counsel to the insured is no different than any other potential conflict of interest situation. In the

[4]A contrary conclusion could lead to absurd results. Corporate entities of all kinds would be prohibited from using their staff counsel in litigation matters. Banks or other lenders would be unable to pursue collections actions through their staff lawyers. Corporations of all kinds would be prohibited from using their own in-house lawyers in litigation matters. Unions and other professional organizations would be unable to use staff lawyers in litigation for and against their membership. Government and quasi-governmental bodies would similarly be prohibited from using lawyer employees. For example, employees of the Attorney General's Office who are appointed to represent individual State employees, could be aiding the unauthorized practice of law by the State. Lawyer employees of the Municipality could be aiding the Municipality in the unauthorized practice of law when they represent Municipal officers or other City employees. School District lawyers could be aiding the unauthorized practice of law by the School District when they represent teachers. Thus, the Committee fails to see a distinction if the lawyer is employed by an insurance company.

Committee's view, a *per se* rule against the use of salaried staff counsel is overly restrictive. The Rules of Professional Conduct recognize that certain situations are fraught with potential conflicts. However, the potential for conflict does not mean the lawyer must, in all cases, avoid the representation. On the contrary, the Rules recognize that a potential for conflict does not preclude employment. *See* Alaska R. Professional Conduct 1.7 cmt.[5]

Finally, the New Jersey Supreme Court Committee on Unauthorized Practice recently addressed whether the use of salaried staff counsel was prohibited by the rules of ethics. The New Jersey Committee concluded that an insured's representation by a salaried attorney was permissible. The Committee noted the ethical issues confronting in-house counsel were no different than those confronting appointed counsel in most insurance defense contexts. Consequently, whether the insured was represented by a salaried attorney or outside counsel was merely a "distinction without a difference." *See* New Jersey Supreme Court Comm. on Unauthorized Practice, Op. 23 (1996).

In the Committee's view, a *per se* rule prohibiting staff counsel would presume unethical conduct on the part of the lawyer. The Committee refuses to condone such a presumption. All lawyers practicing in this state must abide by the Alaska Rules of Professional Conduct. To presume that any lawyer will ignore his or her professional responsibilities when it would be in their employer's, but not their client's interest, would stand the ethical rules on their head.

6. <u>Real Conflicts of Interest</u>

Where an actual conflict of interest exists between the insurer and the insured, the use of salaried staff counsel should be avoided. For example, where the insurer wishes to defend under a reservation of its right to later contest coverage, the Alaska Supreme Court has recognized the existence of various conflicts of interest between the insured and insurer. *See CHI of Alaska, Inc. vs. Employers Reinsurance Corp.*, 844 P2d. 1113, 1116 (Alaska 1993). Because of these conflicts, the insured is entitled to reject appointed defense counsel and select independent counsel of his or her own choosing. *Id.*

[5]A possible conflict does not itself preclude the representation. The critical questions are the likelihood that a conflict will eventuate and, if it does, whether it will materially interfere with the lawyer's independent professional judgment in considering alternatives or foreclose courses of action that reasonably should be pursued on behalf of the client. Alaska R. Professional Conduct 1.7 cmt.

at 1118. In such a case, the Committee believes it would be inappropriate for salaried staff counsel to defend the insured. Another commonly recurring situation which may give rise to a conflict of interest is a settlement offer at or within policy limits where there is a substantial likelihood of an excess judgment.[6] In such situations, where an actual conflict is identified, the Committee believes representation by salaried staff counsel is prohibited since counsel could not reasonably believe the representation would both be adversely affected. *See* Alaska R. Professional Conduct 1.7(b)(1).

CONCLUSION

In summary, the Committee believes the use of salaried staff counsel to represent an insured is permissible so long as the following conditions are met: (1) the lawyer reasonably believes the representation will not be adversely affected by the lawyer's responsibilities to his employer/insurer, or his own interests; (2) the client consents after consultation; and (3) there is no conflict of interest between the insured and the insurer.

Approved by the Alaska Bar Association Ethics Committee on September 2, 1999.

Adopted by the Board of Governors on October 22, 1999.

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[6] In *CHI*, the Alaska Supreme Court noted three conflicts which had previously been identified. First, the insurer may offer only a token defense if it knows it may later assert non-coverage. Second, the insurer may be tempted to steer the defense toward an "uninsured theory" where there are several theories of recovery, but only some are covered under the policy. Third, the insurer may gain access to confidential information in the process of the defense which it may later use to its advantage in coverage litigation. *CHI,* 844 P2d. At 1116; *see also Continental Ins. Co. vs. Bayless & Roberts, Inc.*, 608 P2d 281, 291 (Alaska 1980).