

# In-House Insurance Defense Counsel

Unauthorized Practice of Law  
and  
Fatal Conflict of Interest

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# Why have In-House Counsel?

- From Company's point of view:
  - Control – Effective management of legal costs and strategy for both transactional and litigation practice
  - Availability and Efficiency – All files and attorneys in the same place, instead of spread out over dozens of private offices
  - Others?

# Why have In-House Counsel?

- From Lawyer's point of view:
  - ▶ One client, not twenty or a hundred
  - ▶ More reasonable hours and no time sheets
  - ▶ More varied work
  - ▶ Others?



# Insurance Defense Litigation

- Practical Effect:
  - ▶ Litigation isn't really a 9 to 5 job
  - ▶ Poor representation from policyholder's point of view

# Two Issues

1. Does it Constitute the Unauthorized Practice of Law for a Corporation to Represent a Customer during Litigation?

and

2. Is it Ethical for a Corporation to Represent a Customer during Litigation?



# Issues of First Impression in Arkansas

- We'll focus on insurance cases, because this issue was just decided in a case of first impression by the Arkansas Supreme Court.
- *Brown v. Kelton*, 2011 Ark. 93 (March 3, 2011)
  - ▶ captive law firm in Memphis (Stewart Stallings & Associates, employees of Farmers Insurance) representing insureds in litigation
  - ▶ substituted in for independent insurance defense firm four months after answer filed
  - ▶ informed consent not sought from insured until several weeks after motion for disqualification filed
  - ▶ I disqualified them in trial court, which was affirmed on appeal

# Legality of Corporate Representation of Customers

Applicable Statute is Ark. Code Ann. § 16-22-211:

**It shall be unlawful for any corporation or voluntary association to practice or appear as an attorney at law for any person in any court in this state** or before any judicial body, to make it a business to practice as an attorney at law for any person in any of the courts, to hold itself out to the public as being entitled to practice law, to tender or furnish legal services or advice, **to furnish attorneys or counsel**, to render legal services of any kind in actions or proceedings of any nature or in any other way or manner, or in any other manner to assume to be entitled to practice law or to assume or advertise the title of lawyer or attorney, attorney at law, or equivalent terms in any language in such a manner as to convey the impression that it is entitled to practice law or to furnish legal advice, service, or counsel or **to advertise that either alone or together with or by or through any person, whether a duly and regularly admitted attorney at law or not, it has, owns, conducts, or maintains a law office or any office for the practice of law or for furnishing legal advice, services, or counsel.**

\* \* \*

**The fact that any officer, trustee, director, agent, or employee shall be a duly and regularly admitted attorney at law shall not be held to permit or allow any such corporation or voluntary association to do the acts prohibited in this section** nor shall that fact be a defense upon the trial of any of the persons mentioned for a violation of the provisions of this section.



# Legality of Corporate Representation of Customers

- So, corporate representation of customers during litigation is illegal — it constitutes the Unauthorized Practice of Law (UPL).
- Penalties for violation include:
  - ▶ fines between \$100 and \$5,000
  - ▶ injunctive relief
  - ▶ disciplinary proceedings
  - ▶ contempt proceedings



# Legality of Corporate Representation of Customers

**BUT...**

There's an exception at Ark. Code Ann. § 16-22-211(d):

This section shall not ... prohibit a corporation or a voluntary association from employing an attorney or attorneys in and about its own immediate affairs or in any litigation to which it is or may become a party.

# Parsing the Exception

This section shall not ... prohibit a corporation or a voluntary association from employing an attorney or attorneys[:]

[1.] in and about its own immediate affairs[,]  
or

[2.] in any litigation to which it is or may become a party.



# First School of Thought

First school of thought is that the phrase

**in and about its own immediate affairs**

includes representation of policyholders by an insurance company. This is under the theory that the insurance company has a duty to defend and will be liable to pay any judgment, and so the case involves the insurance company's "own immediate affairs."

# First School of Thought

The first school of thought defines “in and about its own immediate affairs” as **including litigation to which it is not a party** and cannot become a party under the facts of the case.

**BUT** statutes must be interpreted according to their plain meaning:

**litigation to which it is or may become a party**

≠

**litigation to which it is not and cannot be a party**



# Second School of Thought

Second school of thought is that the phrase

**in any litigation to which it is or may become a party**

narrowly defines when a corporation may litigate, and **only** includes cases in which the corporation is (or may be) a named party based upon the facts of the case. This school of thought is based upon a statutory construction argument.

# Second School of Thought

- Second school of thought is that the exception distinguishes between:
  - Transactional practice = in and about its own immediate affairs
  - and
  - Litigation practice = litigation in which it is or may become a party



# Other Issues on Legality of Corporate Representation

- Standing
  - A litigant has standing to challenge his opponent's unauthorized practice of law.
  - The unauthorized practice of law renders pleadings filed by the corporation a **nullity**, so complaints and answers may be stricken even if such actions result in great prejudice to the litigants.

# Other Issues on Legality of Corporate Representation

- Standing
  - The issue of pleadings being declared a **nullity** is important for Plaintiffs' lawyers who currently have cases being advanced by in-house insurance defense counsel.
  - One must object within a reasonable time to the UPL in order to have pleadings stricken.
  - What will happen in currently pending cases if this issue is resolved against in-house insurance defense counsel on appeal?



# Other Issues on Legality of Corporate Representation

- Constitutionality
  - ▶ Ark. Const. Amend. 28 reserves rules of practice to the Arkansas Supreme Court
  - ▶ Statutes on the UPL are considered to be “in aid” of the Arkansas Supreme Court’s responsibility to regulate the rules of practice and not in derogation thereof
  - ▶ The UPL statute was upheld against a constitutional challenge by the Arkansas Supreme Court as early as 1954
  - ▶ The UPL statute remains constitutional, according to 4 justices
  - ▶ Other 3 justices would hold the statute unconstitutional

# Recap – Is Corporate Representation Legal?

4 Justices of our Supreme Court adopted the Second School of Thought:

**Insurance companies can't employ captive attorneys to represent policyholders**

and affirmed disqualification.



# Ethics of Corporate Representation of Customers

- Essential Ethical Concerns:
  - ▶ Back to legality — Is the representation **legal**?
  - ▶ Does a party have **standing** to raise a conflict of interest to disqualify the attorney for the other party?
  - ▶ Is there a concurrent **conflict of interest**?
  - ▶ Has the conflict of interest been **waived**?

# Back to Legality — Is the Representation Legal?

- If representation isn't legal, it isn't ethical either:
  - (b) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:
    - (2) the **representation is not prohibited by law**[.]

Ark. R. Prof. Conduct 1.7(b)(2).



# Standing to Raise Conflict of Attorney for Opposing Party

- Not ordinarily...

...BUT...

Where **the conflict is such as clearly to call in question the fair or efficient administration of justice**, opposing counsel may properly raise the question. Such an objection should be viewed with caution, however, for it can be misused as a technique of harassment.

Ark. R. Prof. Conduct 1.7 cmt. 36.

# Standing to Raise Conflict of Attorney for Opposing Party

- There's lots of case law on the tension between insurance companies and their policyholders:
  - ▶ the insurer owes a policyholder **undivided fidelity** — no man can serve two masters
  - ▶ the insurer may be motivated out of a desire to delay ultimate payment of the claim, or to save money on claims and/or litigation expenses
  - ▶ a policyholder's primary interest is usually getting out of the lawsuit without paying anything out of pocket
  - ▶ sometimes, though, policyholders want to clear their names even though the insurers may wish to minimize exposure by paying the claim
  - ▶ lawyers receive pressure to act in a way beneficial to the insurer
  - ▶ Others?
- These issues are difficult even for outside counsel to address, but **for in-house counsel these concerns call into question the fair and efficient administration of justice**



# Standing to Raise Conflict of Attorney for Opposing Party

- Standing can also be justified where the opposing party might not have known about the conflict but for the challenge:

Self-regulation of the legal profession requires that members of the profession initiate disciplinary investigation when they know of a violation of the Rules of Professional Conduct... An apparently isolated violation may indicate a pattern of misconduct that only a disciplinary investigation can uncover. **Reporting a violation is especially important where the victim is unlikely to discover the offense.**

Ark. R. Prof. Conduct 8.3 cmt. 1.

- Would the policyholder be likely to discover the conflict absent it being raised by opposing counsel?

# Concurrent Conflict of Interest

- Rule — A concurrent conflict of interest exists if ... there is a **significant risk** that the representation of one or more clients will be **materially limited** by the **lawyer's responsibilities to ... a third person** or by a **personal interest of the lawyer**.
  - ▶ Previous slide reviewed case law about how insurance companies pressure outside counsel to serve their interests
  - ▶ Are there reasons to think in-house counsel would receive different treatment?
  - ▶ Personal interest of lawyer – company car, company credit card, bonuses, advancement, etc. – do these considerations materially limit representation?



# Concurrent Conflict of Interest

- Rule — 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.
  - ▶ As employees, in-house lawyers are paid by the company.
  - ▶ Where is the line drawn on how much input the insurer can have on directing or regulating the course of litigation for a policyholder?

# Concurrent Conflict of Interest

- Rule — A lawyer shall not acquire a **proprietary interest in the cause of action or subject matter of litigation** the lawyer is conducting for a client.
  - ▶ Assuming in-house lawyers are promoted and receive bonuses based on their performance, is this rule implicated?
  - ▶ Depends on whether financial incentives are tied to lowering verdicts, settlements, and claim payouts (i.e., “subject matter of litigation”), doesn’t it?



# Concurrent Conflict of Interest

- Rule — A lawyer shall not accept compensation for representing a client from one other than the client unless the client gives **informed consent**; there is **no interference with the lawyer's independence of professional judgment** or with the client-lawyer relationship; and **information relating to representation of a client is protected** as required by Rule 1.6.
  - ▶ Informed consent required — what types of potential conflicts between the insurer and policyholder should be disclosed?
    - One example: minimizing claim payouts vs. protracted litigation and hassle for the policyholder
    - Others?
  - ▶ How does an employee maintain client information in strict confidence to the exclusion of his employer?

# Other Considerations

- Can the policyholder elect between a captive attorney and an independent attorney?
- Can informed consent really be obtained if an election of attorneys isn't offered?
- Are complex firewalling techniques capable of shielding in-house counsel from his employer?
- Does firewalling comply with the mandate to avoid the appearance of impropriety?



# Is In-House Representation of a Policyholder Ethical?

Show of hands:

Ethical

or

Not Ethical?

# Is In-House Representation of a Policyholder Ethical?

- 4 Justices of our Supreme Court declined to issue an advisory opinion on ethics, since they held the practice was illegal.
- However, they did note representation is unethical where it is illegal.



# Is In-House Representation of a Policyholder Ethical?

- 3 Justices of our Supreme Court held that representation was unethical because:
  - ▶ an attorney may not serve two masters
  - ▶ during representation of employer's clients, the attorney is subject to the directions of the corporation, not the client
  - ▶ insurance company's interests are profits
  - ▶ clients interests are different, and may vary greatly
  - ▶ artificial creations like corporations can't provide confidential and undivided allegiance to clients

## Recap — No More In-House Representation of a Policyholder in Arkansas

- 4 Justices — Practice is **ILLEGAL** because it constitutes the unauthorized practice of law
- All 7 Justices — Practice is **UNETHICAL**
  - ▶ 4 Justices — unethical because illegal
  - ▶ 3 Justices — unethical because policyholder can't be represented with undivided fidelity



Questions?



