*Approved by the Supreme Court*
*Of Virginia March 8, 1985*
*Effective June 1, 1985*
*Justices Stephenson and*
*Russell would disapprove*
*The opinion*

**UPL Opinion No. 60.**

**Activities of House Counsel of Liability Insurance Carriers In Defending Insureds in Civil Litigation.**

*Subject:*

Activities of house counsel of liability insurance carriers in defending insureds in civil litigation.

*Inquiry:*

May house counsel employed on a salaried basis by a liability insurance carrier represent the company's insureds in civil suits alleging claims covered by the policy without the insurance carrier thereby engaging in the unauthorized practice of law?

*Opinion:*

The answer to this inquiry requires an examination of the applicable law, and depends upon the particular circumstances under which the representation is undertaken.

In a typical liability insurance policy, the carrier agrees "to pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages" because of an accident, error, omission or other event for which coverage is provided. The policy also typically provides that "the company shall defend any suit alleging such [insured event] and seeking damages which are payable under the terms of this policy, even if any of the allegations of the suit are groundless, false or fraudulent…." The first provision is generally referred to as the "duty to pay"; the second, as the "duty to defend."

Normally, the company has a dual motive in defending a suit against its insured. First, since the company is obligated by contract to pay any judgment against its insured up to the policy limits, it has a direct financial interest in the outcome of the litigation and wants it properly defended. Secondly, the company has obligated itself by contract to provide a proper legal defense for its insured.

Insurance carriers have traditionally employed private lawyers on a case by case basis to fulfill their obligation to defend. More recently there has been a trend among some carriers to employ full-time staff or house counsel to defend their insureds. Typically, staff counsel are paid a direct salary and are provided office space, equipment, supplies and secretarial support by the insurance carrier. It is this practice we will analyze herein.

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It is now well settled that a lay corporation[1] may not ordinarily employ an attorney to provide legal services to customers or clients of the corporation. [2] See, e.g., Richmond Ass'n of Credit Men v. Bar Ass'n of City of Richmond, 167 Va. 327, 189 S.E. 153 (1937). The underlying basis of this rule was explained by the Virginia Supreme Court in *Richmond Association of Credit Men* as follows:

> [The practice of law] is not a lawful business except for members of the Bar who have complied with all the conditions required by statute and the rules of the Courts. As these conditions cannot be performed by a corporation, it follows that the practice of law is not a lawful business for a corporation to engage in.
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> The relation of attorney and client is that of master and servant in a limited and dignified sense, and it involves the highest trust and confidence. It cannot be delegated without consent, and it cannot exist between an attorney employed by a corporation to practice law for it, and a client of the corporation, for he would be subject to the directions of the corporation, and not to the directions of the client. [Citation omitted.]
>
> Independent of statute, it is contrary to public policy for a corporation to practice law, directly or indirectly. [Citations omitted.]

The general principles applicable to staff counsel have been summarized in the Unauthorized Practice Considerations adopted by the Virginia Supreme Court. UPC 1-4 guarantees staff counsel for a corporation the same privileges as a lawyer in private practice so long as the staff counsel is representing the corporation which employs him:

> *UPC 1-4.* A lawyer who is duly authorized or licensed to practice law in Virginia and who is also regularly employed on a salary basis by a corporation may represent such corporation before a tribunal as lawyer for the corporation, with the same privileges of a lawyer in private practice (including confidential communications with his employer when he is acting as a lawyer in connection with such communication). 226 Va. – (1983).

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[1] See Code of Virginia §§ 54-42.2 (now § 54.1-3902) and 54-42.3 (now deleted) (1950) for licensing requirements for professional corporations and associations, respectively.

[2] Consistent with this rule, the State Corporation Commission is empowered to investigate complaints of unauthorized practice of law by corporations and may, under certain circumstances, order involuntary dissolution of domestic corporations and may revoke a foreign corporation's certificate of authority to transact business in Virginia. See Code of Virginia §§ 13.1-133 (now repealed), 13.1-294 (now repealed), 13.1-311.1 (1950).

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However, UPC 1-5 provides that house counsel's representation before a tribunal is normally limited to representing his employer a subsidiary or affiliated corporation:

> *UPC 1-5*. A lawyer who is duly authorized or licensed to practice law in Virginia and who is regularly employed on a salary basis by a corporation may also represent before a tribunal the interest of a subsidiary or affiliated corporation when requested to do so by his employer and when not otherwise in conflict with the Virginia Code of Professional Responsibility. Such lawyer (unless a regular employee of a duly registered law corporation) in the course of his employment may not *normally* represent before a tribunal customers or patrons of his employer. [Emphasis added] 226 Va. – (1983)

Courts have recognized that a suit against an insurance carrier's insured may in some instances be tantamount to a suit directly against the carrier. In many suits against insured defendants, the carrier's obligation to fully satisfy any judgment is fixed by contract and is unquestioned by the insurer. Such cases, while brought against the insured, are sometimes said to be *de facto* suites against the insurance carrier. Some states permit the insurer to be sued directly by the injured party, and the carrier has been regarded as the "real party in interest" in federal courts interpreting the laws of those states. Lumbermen's Casualty Company v. Elbert, 348 U.S. 48, 51 (1954) (diversity of citizenship existed between Louisiana plaintiff and Illinois insurer, even though insured was also a Louisiana resident, since insurance carrier was "real party in interest").

We conclude that staff counsel for a liability insurance carrier may properly defend the insured when the amount sought does not exceed the coverage limits of the policy, *and* the company is not asserting any coverage defenses, *and* any judgment against the insured will be fully satisfied by the insurer. In such cases we find that insurance carriers are protecting their exclusive financial interests, and are not engaged in the unauthorized practice of law. Compare Cosica v. Cunningham, 250 Ga. 521, 299 S.E.2d 880 (1983) (House counsel's defense of suit covered by policy constitute activities "in and about" the company's "own immediate affairs" within meaning of statute authorizing such activities by corporate house counsel).

A second situation which frequently arises involves suits which claim amounts in excess of the insured's policy limits. In such cases staff counsel would be protecting not only the insurance carrier's financial stake in the outcome of its suit, but would also be responsible for protecting the financial interests of the insured. In this situation, where there are no potential coverage defenses, the decided cases in the limited number of jurisdictions which have dealt with the issue suggest that the carrier may still employ staff counsel to defend the insured without engaging in the unauthorized practice of law. The rationale for these holdings is that the company's direct financial interest in the outcome of the litigation justifies the incidental provision of legal services to the insured

by staff counsel. See In Re Rules Concerning the Conduct of Attorneys in Florida, 220 So.2d 6 (1969); Opinion of the Committee of Unauthorized Practice of Law, State Bar of Michigan (September 22, 1959); Coscia v. Cunningham, 250 Ga. 521, 299 S.E.2d 880 (1983).

Based upon the decided cases, we conclude that when an insurance carrier is obligated by contract to pay a judgment against its insured up to the policy limits, and neither reserves nor subsequently asserts any defenses to such contractual obligation, it may defend such suits with staff counsel without engaging in the unauthorized practice of law.

In many cases the liability insurance carrier's duty to pay is not absolute. The contractual obligation to defend its insured is separate from the obligation to pay, and the carrier's duty to defend under most policy provisions is not conditioned upon the duty to pay:

> [A]n insurer's obligation to defend is broader than its obligation to pay, and arises whenever the complaint alleges fats and circumstances, some of which would, if proved, fall within the risk covered by the policy. Lerner v. Safeco, 219 Va. 101, 245 S.E.2d 249 (1978).

Thus, insurance carriers are frequently called upon to defend suits for which there is or may be no coverage for any judgment against the insured. For example, coverage may be questioned because of the alleged breach of some material policy conditions, such as failure to give the carrier timely notice of the accident, e.g., State Farm v. Porter, 221 Va. 592, 272 S.E.2d 196 (1980); failure to turn over suit papers to the carrier, e.g., Harmon v. Farm Bureau Auto Ins. Co., 172 Va. 61, 200 S.E. 616 (1939); or failure to cooperate in the defense of the suit, e.g., Cooper v. Employers Mutual, 199 Va. 908, 103 S.E.2d 210 (1958). Coverage may be in doubt because of the nature of the claim asserted. See, e.g., *Lerner v Safeco*, supra, (punitive damages); Parker v. Hartford, 222 Va. 33, 278 S.E.2d 803 (1981) (intentional acts). The company many no longer have an obligation to pay because its coverage has been exhausted by prior payments, yet it may still have an obligation to defend. Compare American Employers Ins. Co. v. Goble Aircraft Specialities, Inc., 205 Misc. 1066, 131 N.Y.S.2d 393 (1954), and American Casualty v. Howard, 187 F2d 332 (4th Cir. 1951) with Denham v. La Salle-Madison Hotel co., 168 F.2d (7th Cir. 1948). In some instances the policy may provide only for a legal defense, such as a suit seeking injunctive or other non-monetary relief.

In some cases it will be determinable at the outset that the company's only obligation is to provide a legal defense, and not to pay a judgment against the insured. See, e.g., *American Employers Ins. Co. v. Goble Aircraft Specialities, Inc.,* supra, (coverage exhausted by prior settlements). In other cases the issue of whether there is a duty to pay will be resolved by the outcome of the tort litigation against the insured. See,

e.g., Norman v. I.N.A., 218 Va. 718, 239 S.E.2d 902 (1978) (tort litigation established that shooting was intentional). In still other cases the question of the insurer's duty to pay does not turn on facts which are relevant in the tort litigation, and the question of coverage may not be resolved until concurrent, or subsequent litigation is concluded. See, e.g., *State Farm v. Porter*, supra.

When the insurer does not have a duty to pay all or part of an judgment which may be entered against its insured in the tort litigation, or if the existence of such duty is conditioned on the outcome of the tort litigation, the outcome of collateral litigation, or is otherwise contingent or indefinite, we conclude that the carrier does not have a sufficiently direct financial interest in the outcome of the litigation to permit it to defend its insured with staff counsel without thereby engaging in the unauthorized practice of law.

In Rhode Island Bar Ass'n v. Automobile Service Ass'n, 55 R.I. 122, 179 A. 139 (1935), the Automobile Service Association sold contracts to its customers in which the Association undertook to provide the customers legal services in connection with the ownership and operation of automobiles. The services included defending criminal charges arising out of the operation of automobiles, prosecuting claims for damages to the customer's automobile, and his automobile and defending suits against the customer arising out of the customer's operation of his automobile. There was no obligation to pay any judgment against the customer. The Association furnished these services through staff counsel, who was a member of the Rhode Island Bar. It was held that the Association was engaged in the unauthorized practice of law on the grounds that the test was "whether [the Association] could perform the services promised under their contract without the assistance of a duly licensed attorney." The Court ruled that the services which the Association contracted to furnish were legal services, and "what these respondents cannot legally do directly they may not do indirectly."

In *Richmond Association of Credit Men v. Bar Association of City of Richmond*, supra, the Credit Association solicited collection cases from its customers, and then hired lawyers to prosecute the claims. The Court held that the Association was engaged in the unauthorized practice of law. The Court asked the following rhetorical question, which was apropos to this inquiry:

> If a lay agency may engage for compensation in the business of employing lawyers to collect liquidated debts for others, why could it not run an agency to supply lawyers to perform other legal services – that is, to prosecute suits for unliquidated tort claims, unliquidated contract claims, and other suits, so long as such suits are prosecuted by the lawyers in the names of the claimants as their technical clients?
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> Our view is that while technically the relation of attorney and client is established between the lawyer and the creditor, in the final analysis the

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> credit association is the master and real client, since it selects the lawyer, employs him, fixes his compensation and shares therein, prescribes the term of his employment, and controls and directs his actions, even to the point of discharging him if it sees fit. All of which it holds out to its customers that it does and will do. In substance, we think, this is the business of supplying for a consideration to others the legal services of lawyers, and is the practice of law by an unlicensed law agency. Such is against the public policy of the state and violates Code § 3422, as amended, as well. *Id*. At 189 S.E. 160.

If an insurance carrier were permitted to use its staff counsel to defend claims in which its only obligation is or may be to defend the suit, and not to pay any judgment, why could it not sell policies which obligated itself, like the Automobile Services Association in *Rhode Island Bar Ass'n v. Automobile Service Ass'n,* to provide legal services, through its staff counsel, to its policyholders for a multitude of legal problems? The answer is that corporations may use staff counsel to represent others only when the corporation itself has a direct and unconditional interest in the outcome of the litigation.

It is therefore our opinion to 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 judgment against its insured. It may not employ staff counsel to represent its insureds if its 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.

This opinion is restricted to the unauthorized practice of law implications of the question presented and does not attempt to analyze any ethical considerations which might be raised by the inquiry. Staff counsel, in undertaking the representation of the insureds of his or her employer within the guidelines established herein, is clearly bound by the same ethical obligations and constraints imposed on attorneys in private practice. This includes zealously guarding against any potential erosion, actual or perceived, of the duties of undivided loyalty to the client (the insured), independence and confidentiality, to mention on the most obvious areas of potential concern in their relationship.

Finally insurance carriers, in selecting cases for handling by staff counsel which involve potential excess exposure to the insured, should be aware that the employer-employee relationship between the insurer and the insured's counsel carriers with it certain risks. The opinions of staff counsel in regard to legal liability, potential verdict ranges, and settlement value and his or her decisions concerning trial preparations and trial strategy will be subjected to unusually close scrutiny and subsequent litigation following any excess verdict.

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