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PRODUCT ARTICLE

THE NEED FOR EMPLOYED LAWYERS INSURANCE COVERAGE

By Thomas W. Quinn, Esq. and Steven L. Young, Esq., *Wilson Elser*

The in-house attorney thinks: *"It can't happen to me. I left the grind and concerns of private practice so I wouldn't have to worry about malpractice exposures. I don't make mistakes and I don't have problems. My employer will protect me from any liability."*

The CFO thinks: *"We hire the best attorneys in house and pay top-notch outside counsel to protect us from mistakes. We won't be suing our in-house attorneys and we are their only clients. Our insurance costs are already too high."*

While not every in-house attorney or CFO has voiced those sentiments, exposures continue to grow for in-house attorneys from errors and omissions claims arising from representation of their employers, advice given to other employees, regulatory reviews, and even *"moonlighting"* favors done for relatives or friends. Even if all of those sentiments were correct, the costs of defending any lawsuit – from a multimillion-dollar securities claim to a botched real estate closing – can be enormous and cause a disruption in the attorney's performance.

Exposure

Every opinion, letter, regulatory filing, instruction to an employee, email, or action taken in connection with supervising litigation involving the company puts both the individual attorney and the employer corporation at risk of a claim. Some of the risks attendant to such claims can be avoided by purchasing employed attorney insurance coverage, which can be mutually beneficial for employers and the individual attorneys they employ. Any corporation that questions the need to protect their employed attorneys from outside exposures need only look at the time and expense required to defend even specious claims brought against a staff attorney. Not only does an employed attorney face the business exposures of directors and officers who participate in business decisions but the company is also at risk for any substantive errors the employed attorney makes in the conduct of the company's business. The cost of defense alone often warrants the addition of an employed attorney endorsement to the directors' and officers' (D&O) policy, if such coverage is not included in their policy.

In-house attorneys are often without any other malpractice insurance and, whether or not countenanced by their employers, have been known to perform pro bono legal services for charitable organizations or "favors" for friends, relatives, neighbors, or others for no fee. Some even collect referral fees from other attorneys. Of course, the provision of free services or the fact that an attorney's name is not on the pleading does not insulate the attorney from exposure. Some attorneys have been known to "moonlight" and get paid by others. In each of these instances, the attorney and the employer could face, at a minimum, defense cost exposure.

The Sarbanes-Oxley Act of 2002 focused the industry on additional exposures of an in-house attorney. Section 307 requires an in-house attorney to report evidence of a material securities violation "up the ladder" to the chief legal officer or chief executive officer of the corporation. If the attorney does not receive an appropriate response, the attorney must report the evidence to the audit committee or board of directors, and the attorney is permitted to report the information to the Securities and Exchange Commission. There have been significant exposures for in-house counsel of major corporations, including Hewlett-Packard, Apple, Tyco International, Enron, Arthur Anderson, Rite Aid Corp., and U.S. Wireless Corp., all of which were sued by shareholders. Cases arising from mortgage-backed securities are equally rampant.

Malpractice

Malpractice claims often arise when an attorney specializing in one field seeks to expand his or her practice to another field without the requisite experience. The general *"jack of all trades"* role of many in-house attorneys and their departments also can lead to increased exposure.

Case examples

In Miller v. McDonald, the bankruptcy trustee sued nine officers on several counts, including breach of fiduciary duty, negligent misrepresentation, and aiding and abetting fraud. One of these corporate officers was both Vice President and General Counsel of World Health Alternatives, Inc. He moved to dismiss the claims against him on the basis that he neither participated in, nor had any knowledge of, the alleged fraudulent conduct.

The Bankruptcy Court held that the GC could be held accountable even if he did not know about the fraud or did not personally participate in the fraud. The Court found that he was potentially liable for failing to implement and utilize an internal monitoring system to ferret out false SEC filings; for negligently failing to review the truthfulness of press releases; for failing to prevent incidents of corporate waste (even though the GC received no personal benefit from the expenditures); for failing to address

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alleged fraud; and for other bad behavior that might result in a professional malpractice claim under state law.

In conjunction with the nation's financial crisis, newspapers have been filled with stories and accounts of the involvement of in-house attorneys for major corporations in large scale security litigation.

But it is not just high level securities claims that can result in malpractice claims or lawsuits against employed lawyers.

In Keller v. Loews Corp., an in-house lawyer brought a wrongful termination claim against his employer based on religious discrimination. His employer counterclaimed against him for breach of his fiduciary duty, alleging that his pleadings included confidential information he learned while acting in-house.

While the counterclaim was initially dismissed in the lower court, the appellate court reinstated the breach of fiduciary duty claim, ruling that an in-house attorney, even though an *"at will"* employee, "owes his employer-client a fiduciary duty.

A February 9, 2011 newspaper article reported on a legal malpractice claim brought by a tire manufacturer against its defense counsel in a product liability lawsuit after a verdict against the manufacturer in the underlying personal injury case in Illinois. The article reported that the defendant attorneys asserted a counterclaim against two lawyers employed by the manufacturer, alleging that they *"actively participated in litigation decisions"* and that they contributed to any *"alleged foul-ups"*.

Employed Attorney Insurance

In-house attorneys often believe that they are provided coverage under their employers' D&O policies. These policies, however, often have a *"professional services"* exclusion. Even if there is no such exclusion, although the general counsel might be a director or officer of the company, some D&O policies may limit coverage for other employees in the legal department. In addition, D&O policies often contain an "insured versus insured" exclusion that would limit claims by other employees against in-house counsel for recommendations and advice provided.

Simply put, D&O policies are not designed to cover professional services. They are designed to cover the officers, the directors, and the entity under limited circumstances. In-house counsel and their employers cannot rely on the D&O policy to protect their interests.

In light of these exposures, corporations may want to consider obtaining employed attorney insurance as a complement to D&O coverage. It can fill the gaps by providing coverage for claims against non-officer attorneys and staff, for pro bono legal services and incidental moonlighting services, for the costs of a disbarment and similar administrative proceedings, and for internal claims that would otherwise be excluded by the "insured versus insured" provisions in a D&O policy.

These policies protect both the individual attorney and the corporation in that they minimize the dilution of the D&O limit, reimburse the company for its costs in indemnifying the attorneys for defense costs, provide an affirmative grant of coverage, and avoid the expenditure of resources in the event a claim is made. Clearly, such coverage can help avoid surprises or uncertainties when a claim is made.

Attorneys in private practice are aware of the need to maintain malpractice insurance. A move in-house does not eliminate exposure or the common-sense benefits of such coverage. While a claim by the corporate employer client is less likely, claims against in-house attorneys by third parties are on the rise. For the same reason that insurance is maintained on corporate exposures, coverage for in-house counsel tailored to the corporate insured may be a necessity rather than a choice.

[1]*Miller v. McDonald (In re World Health Alternatives, Inc.)*, 385 B.R. 576, 2008 Bankr. LEXIS 1012, 49 Bankr. Ct. Dec. 235 (Bankr. D. Del. April 2008).

[2]*Keller v. Loews Corp.*, 69 A.D.3d 451; 894 N.Y.S. 2d 376 (1st Dep't 2010).

[3]*Madison St. Clair Record*; February 9, 2011.

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Steven L. Young is a Partner in Wilson Elser's White Plains office. For more information, please contact Steve at 914.872.7252 or steven.young@wilsonelser.com.

Thomas F. Quinn is a Partner in Wilson Elser's New Jersey office. For more information, please contact Tom at 973.735.6036 or thomas.quinn@wilsonelser.com