Are You in Good Hands: Is the Use of In-House Counsel Right for South Carolina Insurance Defense

Eric Montalvo
ARE YOU IN GOOD HANDS?:
IS THE USE OF IN-HOUSE COUNSEL RIGHT FOR SOUTH CAROLINA INSURANCE DEFENSE?

I. INTRODUCTION

There are few residents in South Carolina that do not fall into one of the following categories: vehicle owners, homeowners, business operators, or members of professional organizations. These groups have two characteristics in common: an overwhelming need for liability insurance and a need for a requirement within insurance policies that the insurer defend the insured against any liability claim covered by the policy. It has been estimated that up to thirty-five percent of the total amount paid out by liability insurance companies is attributable to legal fees. In an attempt to reduce costs and increase efficiency, some insurance companies have moved from the use of a referral system in insurance defense to the use of in-house counsel. The use of in-house counsel has added another layer of ethical complexity to insurance defense litigation. One Mississippi court has opined that the relationship between counsel, the insurer, and the insured has created problems that would "tax Socrates."4

In 2006, the South Carolina Bar Ethics Advisory Committee issued an advisory opinion that supported the use of in-house counsel in insurance defense litigation.5 As an advisory opinion, it is not binding authority in this state, but attorneys and insurance companies may rely on this opinion to either commence or continue the practice of employing in-house counsel. However, this reliance may be misplaced because South Carolina statutory law prohibits the corporate practice of law.6 In addition to state statute, the South Carolina Rules of Professional Conduct 5.4 (Rule 5.4) and 5.5 (Rule 5.5) require attorneys to maintain their professional

3. When referring to a "referral system" in this Comment, the author means the practice of an insurance company hiring an outside, independent attorney to represent the insured in defense of the liability claim.
4. When referring to "in-house counsel" in this Comment, the author means the practice of using attorneys that are salaried employees of the insurance company to defend liability claims against the insured.
7. Id.
independence and prohibit attorneys from practicing law in a manner that violates any South Carolina state law. The South Carolina Supreme Court has not addressed whether the use of in-house counsel in insurance defense litigation is an unauthorized practice of law; consequently, the court has not had the opportunity to interpret the South Carolina statute or Rules of Professional Conduct as applied to the use of in-house counsel. With the exception of South Carolina Code section 40-5-320, which deals with the corporate practice of law generally, there is no statutory authority that specifically regulates, approves of, or prohibits the practice of in-house counsel in insurance defense litigation. This Comment argues that, while the use of in-house counsel in South Carolina insurance defense litigation does not violate Rule 5.4, which requires professional independence, the South Carolina Supreme Court should ban the use of in-house counsel in insurance defense litigation as the unauthorized practice of law under section 40-5-320 and Rule 5.5. Further, the court should find any attorney representing an insured as in-house counsel of an insurance company to be in violation of Rule 5.5 for aiding in the unauthorized practice of law.

Part II of this Comment outlines the relevant South Carolina caselaw, as well as the basics of insurance defense. Part II also discusses in detail the statutory authority and the Rules of Professional Conduct that are implicated by the use of in-house counsel, specifically South Carolina Code section 40-5-320 and Rules 5.4 and 5.5. Part II concludes with a brief history of the more traditional referral system used in insurance defense litigation and explains how the restrictions placed on the referral system have led some insurance companies to use in-house counsel instead.

Part III of this Comment analyzes the application of the state law discussed in Part II to the use of in-house counsel. Specifically, it discusses whether the in-house counsel system violates the professional independence requirement of Rule 5.4. Based on ethics opinions from the American Bar Association and the South Carolina Ethics Advisory Committee, as well as persuasive South Carolina caselaw, Part III concludes that the use of in-house counsel does not violate Rule 5.4. Part III then discusses whether the use of in-house counsel constitutes the unauthorized practice of law by examining three opinions of other state supreme courts, which discuss the predominant views of the propriety of using in-house counsel: the broad permissive view, limited permission for insurance defense litigation, and a complete prohibition on the use of in-house counsel. Part III concludes with a determination that the South Carolina Supreme Court should prohibit the use of in-house counsel because the use of in-house counsel by the insurer to represent the insured should be deemed the corporate practice of law, which is specifically prohibited by South Carolina statute. Because the insurer is engaged in the unauthorized practice of law, any attorney acting as in-house counsel to represent an insured should be deemed to be aiding in the unauthorized practice of law in violation of Rule 5.5.

10. Id. R. 5.5(a).
12. See id.
II. BACKGROUND

A. The Referral System and Subsequent Shift to In-House Counsel

An analysis of the growing use of in-house counsel as a means of defending insurance claims requires an explanation of the insurance industry’s trend away from the use of the referral system toward the use of in-house counsel. The referral system is the most prevalent method by which insurance companies represent their insureds. However, the number of states that have had to address the issue of in-house counsel indicates that the practice is steadily increasing.

Under the referral system, once the insurer receives notice of a suit, it refers any legal action against an insured to an independent law firm with attorneys licensed to practice in South Carolina. After counsel has been assigned, the insurer will notify the insured and the retained counsel in writing. The attorney retained to represent the insured will then contact the insured to conduct an initial interview and provide an engagement letter setting forth the parameters of the attorney-client relationship. This letter clarifies the nature of the attorney’s relationship to the insured and to the insurer and provides assurances that the attorney will keep the insured informed through the remainder of the case.

The relationship formed between the insurer, insured, and counsel under the referral system has been described in different ways, including phrases such as the “tripartite relationship” and the “dual client doctrine.” Courts have used these...
descriptions in their attempts to determine whether the counsel has one client or two. Professor Nancy Moore has stated that either the one-client or the two-client view works satisfactorily under the current Model Rules of Professional Conduct but notes that “most courts and commentators seem willing to settle for something less than ‘ideal’ compliance . . . ” Professor Moore also expresses concern over the lack of guidance from the American Bar Association (ABA) but concedes that “some ‘flex in the joints’ [is] necessary] to accommodate the interests of both insurers and insureds.” Douglas Richmond also acknowledges that the relationships formed under the referral system are permissible under a dual client doctrine and that a dual client relationship can exist; however, he also notes that the attorney ultimately represents the insured’s interests and that the attorney’s


25. Id. at 270–73 (citing ABA Comm. on Ethics & Prof’l Responsibility, Formal Op. 96-403 (1996)) (noting the lack of resolution by the ABA as to whether in-house counsel represents the insured, or both the insured and the insurer); see also Randall, supra note 1, at 12 (noting that the Model Rules of Professional Conduct and Model Rules of Professional Responsibility are silent as to whether in-house counsel represents only the insured, or both the insured and the insurer).

26. Moore, supra note 15, at 302; see also Randall, supra note 1, at 3–4 (stating that when both the insurer and insured are considered clients, “the Model Rules of Professional Conduct permit a lawyer to accept direction, including direction aimed at minimizing costs, from the client insurer”).

27. Richmond, supra note 2, at 482.
actions should further those interests.\textsuperscript{28} When applied to the use of in-house counsel, the determination of whether the attorney has one or two clients becomes less important. The more important determination is whether the corporation is practicing law. Thus, the Rules of Professional Conduct do not invalidate the use of in-house counsel; the statutory ban on the corporate practice of law does.\textsuperscript{29}

In 2001, the ABA released a formal opinion that addressed the issue of an attorney’s professional independence in the context of insurance defense litigation.\textsuperscript{30} The opinion concluded that an attorney hired by an insurance company to represent its insured “must not permit the [insurer] to require compliance with litigation management guidelines . . . [that] will compromise materially the lawyer’s professional judgment.”\textsuperscript{31} Numerous state bar associations have come to the same conclusion: while an insurance company can require compliance with various administrative guidelines, the degree of control exercised cannot affect the substantive representation of the insured.\textsuperscript{32} The limitations on the degree of control that may be exerted by insurance companies has resulted in a new method of representation of the insured: the use of in-house counsel. From the point of view of insurance companies, the use of in-house counsel provides greater control over the conduct of the representation\textsuperscript{33} and its associated cost and allows them to defend claims in a more cost-efficient manner.\textsuperscript{34} From the point of view of the attorney

\begin{itemize}
  \item \textsuperscript{28} See infra Part III.C.
  \item \textsuperscript{29} ABA Comm. on Ethics and Prof'l Responsibility, Formal Op. 01-421 (2001).
  \item \textsuperscript{30} \textit{Op.}
  \item \textsuperscript{31} \textit{Op.}
  \item \textsuperscript{32} \textit{Op.}
  \item \textsuperscript{33} \textit{Op.}
  \item \textsuperscript{34} \textit{Op.}
\end{itemize}
employed as in-house counsel, the insurance company is able to exercise a greater
degree of control over the attorney.\textsuperscript{35} While the insurance company likely prefers
the use of in-house counsel, the company runs the risk of engaging in the
unauthorized practice of law.\textsuperscript{36} Further, the practice exposes the attorney to greater
scrutiny under Rule 5.4 and other provisions regarding confidentiality and conflicts
of interest.\textsuperscript{37}

\textbf{B. Rules of Professional Conduct and State Law Implicating the Use of In-
House Counsel}

While an attorney is bound by all the Rules of Professional Conduct when
representing a client,\textsuperscript{38} the area of insurance defense litigation requires special
attention to Rules 5.4 and 5.5, which address, respectively, professional
independence and the unauthorized practice of law. These rules also have a
significant impact with respect to two specific issues: (1) whether the control over
in-house counsel by the insurance company violates Rule 5.4 and (2) whether the
insurance company has engaged in the unauthorized practice of law in violation of
South Carolina Code section 40-5-320.

The professional independence of a lawyer that Rule 5.4 seeks to protect is
often at risk of being impaired in insurance defense litigation. Rule 5.4 states that
"[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."\textsuperscript{39} Rule 5.4 is different from
other provisions implicated by insurance defense litigation because the rule
contains no exception or process whereby waiver is authorized. Other provisions
regulating issues such as confidentiality,\textsuperscript{40} conflicts,\textsuperscript{41} and scope of representation\textsuperscript{42}
provide for exceptions to the rule as long as there is disclosure by the attorney and
consent by the client.\textsuperscript{43} Rule 5.4 does not provide for such an exception, foreclosing
any possibility that an attorney may not be bound by the basic rule. The comments
to this rule explain that the presence of a third party payor—the insurer—should not
affect the professional judgment of a lawyer.\textsuperscript{44} Rule 5.4 also addresses a lawyer’s
representation of a corporation’s clients; in the case of insurance defense litigation,

\begin{flushleft}
\textsuperscript{35} See Moore, supra note 15, at 296–97.
\textsuperscript{36} See discussion infra Part III.B.
\textsuperscript{37} See infra notes 39–47 and accompanying text.
\textsuperscript{38} S.C. APP. CT. R. 407, R. 5.2(a).
\textsuperscript{39} Id. R. 5.4(c).
\textsuperscript{40} Id. R. 1.6(a) ("A lawyer shall not reveal information relating to the representation of a client
unless the client gives informed consent . . .").
\textsuperscript{41} Id. R. 1.8(a) ("A lawyer shall not enter into a business transaction . . . adverse to the client
unless . . . the client is advised in writing . . . and . . . the client gives informed consent . . .").
\textsuperscript{42} Id. R. 1.2(c) ("A lawyer may limit the scope of the representation if the limitation is
reasonable under the circumstances and the client gives informed consent.").
\textsuperscript{43} See sources cited supra notes 40–42.
\textsuperscript{44} S.C. APP. CT. R. 407, R. 5.4 cmt. 1 (noting that any arrangement between a lawyer and the
lawyer’s employer “does not modify the lawyer’s obligation to the client”).
\end{flushleft}
the corporation’s client is the insured. Rule 5.4 prohibits lawyers from practicing in a corporation if “a nonlawyer owns any interest [of the corporation],” 45 “a nonlawyer is a corporate director or officer[,]” 46 or “a nonlawyer has the right to direct or control the professional judgment of a lawyer.” 47 Not only does Rule 5.4 heavily regulate and restrict the corporate practice of law and the use of in-house counsel generally, it also implicates the use of independent counsel to represent the insured. Presumably, independent counsel would also be required to maintain professional independence from the insurance company.

Rule 5.5 deals with the unauthorized practice of law and, as applied to insurance defense litigation, seeks to proscribe any actions by an attorney that aid in the unauthorized practice of law. Rule 5.5 states that “[a] lawyer shall not practice law in a jurisdiction in violation of the regulation of the legal profession in that jurisdiction.” 48 While Rule 5.5 largely deals with the practice of law by attorneys that are not admitted to the South Carolina Bar, 49 the provision quoted above would also apply to in-house counsel if a court determined that the use of in-house counsel violated any other state law. The most relevant South Carolina statute is South Carolina Code section 40-5-320, which prohibits the practice of law by corporations. 50 When read together, Rule 5.5 and section 40-5-320 present a major obstacle to any insurer seeking to employ in-house counsel in South Carolina.

III. THE INTERPRETATION OF RULE 5.4 IN SOUTH CAROLINA AND OTHER JURISDICTIONS

A. Application of Rule 5.4 to the In-House Counsel System of Insurance Defense

While Rule 5.4 does not specifically prohibit the use of in-house counsel to represent insureds, the degree of control that can be exercised by the insurer over the in-house counsel may be limited by Rule 5.4. 51 Under the more traditional referral system, the attorney runs less of a risk of violating Rule 5.4 because the attorney is not employed by the insurance company and the attorney must ultimately answer to the partners of the law firm, who must also abide by the restrictions of Rule 5.4. Under the in-house counsel system, acting in accordance

45. Id. R. 5.4(d)(1).
46. Id. R. 5.4(d)(2).
47. Id. R. 5.4(d)(3).
48. Id. R. 5.5(a).
49. See id. R. 5.5(b)-(d).
50. S.C. CODE ANN. § 40-5-320 (2001). This statute makes it unlawful for a corporation to “practice or appear as an attorney at law for a person other than itself” or “hold itself out to the public as being entitled to practice law, render or furnish legal services, advise or furnish attorneys or counsel, or render legal services in actions or proceedings.” Id. § 40-5-320(A)(1), (3). Violation of this section constitutes a misdemeanor and is punishable by a discretionary fine, up to three years imprisonment, or both. Id. § 40-5-320(B).
51. See supra notes 39–47 and accompanying text.
with Rule 5.4 becomes more difficult because the attorney is a direct employee of the insurance company and likely works for a nonlawyer.\(^{52}\) This Part discusses how the application of Rule 5.4 is different under the in-house system than under the referral system and how the application to in-house counsel may lead to a violation of Rule 5.4. The South Carolina Supreme Court likely will allow the use of in-house counsel if the court limits its analysis solely to Rule 5.4. While compliance with the rule is more difficult under the in-house system, an attorney faces the same ethical dilemma of maintaining professional independence under either the referral system or the in-house system.

1. **Guidance Provided by the ABA and the South Carolina Bar**

The most important influence on South Carolina’s interpretation of Rule 5.4 has been the ABA’s formal opinion on the use of in-house counsel in insurance defense litigation.\(^{53}\) In its opinion, the ABA concluded that the use of in-house counsel is permissible as long as there is disclosure by the attorney and the attorney exercises independent judgment.\(^{54}\) The ABA also found that a majority of jurisdictions approve of the use of in-house counsel\(^{55}\) and noted that proper representation is possible because “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.”\(^{56}\)

Consistent with the ABA’s findings, the South Carolina Ethics Advisory Committee released an opinion determining that the use of in-house counsel by an insurer is not a violation of Rule 5.4.\(^{57}\) The opinion states in relevant part that “once a case is selected and assigned to the lawyer, the [insurer] may not interfere with

---

52. See Jeffrey W. Stempel, *Embracing Descent: The Bankruptcy of a Business Paradigm for Conceptualizing and Regulating the Legal Profession*, 27 Fla. St. U. L. Rev. 25, 63, 105–06 (1999) (recognizing that in-house counsel run a greater risk of violating ethical obligations than their independently retained counterparts, especially the obligation to maintain their professional independence, because “[b]eing a good lawyer[] to the client . . . may not be in the in-house attorney’s best job interests”).


54. *Id.* at 1.

55. *Id.* at 3 n.9 (citations omitted).

56. *Id.* at 2 (citing ABA Comm. on Ethics & Prof’l Responsibility, Formal Op. 96-403 (1996)).


In determining whether the organization is attempting to direct, regulate, or interfere with the lawyer-client relationship, a distinction should be drawn between general organizational policies that identify the types of cases for which the organization is willing to provide representation and the strategy for handling particular cases. The [insurer] may properly establish policies that define the types of cases for which the organization will provide legal services, but once a case is selected and assigned to the lawyer, the [insurer] may not interfere with the objectives, strategy, or tactics for handling the cases. These matters are determined exclusively by the client and lawyer pursuant to the Rules of Professional Conduct.

*Id.* (quoting S.C. Bar Ethics Advisory Comm., Op. 02-04 (2002)).
the objectives, strategy, or tactics for handling the cases." 58 Similar to the opinion of the ABA, the South Carolina opinion implies that as long as attorneys comply with South Carolina’s Rules of Professional Conduct—particularly the provision requiring preservation of the attorney’s professional independence—the mere fact that the attorney is an employee of the insurer does not alone constitute the unauthorized practice of law. 59

A cursory reading of the South Carolina opinion offers comfort to both the insurer using in-house counsel and the attorney employed by the insurer. Upon closer examination, however, the opinion apparently expresses serious reservations about an insurer using in-house counsel. While the opinion approves of the use of in-house counsel generally, it also requires the attorney to maintain professional independence as required by Rule 5.4, putting insurers in an interesting position. 60 Insurers have increasingly begun using in-house counsel as a method of controlling the cost of litigation, 61 including limiting an attorney’s ability to conduct research, file certain motions, and hire expert witnesses; insurers may also prohibit these practices altogether. 62 Thus, it is difficult for an insurer to comply with the ethics opinion, allowing its in-house counsel to exercise professional independence but still control litigation costs, which is a major advantage of the in-house counsel system. The result of allowing an attorney to maintain professional judgment is an in-house attorney who performs the job in a similar fashion to an attorney hired under the referral system. The opinion also puts the attorney in an interesting position. If an attorney, as a condition of employment, attempts to secure professional independence through a written agreement, the insurer may not be willing to hire the attorney. 63 While this opinion provides some direction, it fails to provide a clear answer as to whether the use of in-house counsel is an unauthorized

58. Id.

59. Id.; see also S.C. App. Ct. R. 407, R. 1.8 cmt. 11 (Supp. 2006) (implying approval of the referral system in which the insurer acts as a third party payor on behalf of the insured as long as the attorney believes “that there will be no interference with the lawyer’s independent professional judgment.”). In a separate opinion, the South Carolina Ethics Advisory Committee endorsed the use of in-house counsel for non-profit organizations, as long as the attorney maintains his professional independence during the course of the representation in accordance with Rule 5.4. S.C. Bar Ethics Advisory Comm., Op. 02-04 (2002), available at http://www.scbar.org/member/opinion.asp?opinionID=565.


61. See Richmond, supra note 2, at 513 (“Salaried counsel are simply less expensive than outside counsel charging by the hour. Efficient claims handling can also reduce insurers’ costs. Theoretically, staff counsel can handle claims more efficiently by learning the particular liability lines the insurer writes and repeatedly applying that knowledge to claims in volume.”).

62. See Randall, supra note 1, at 2 (noting that guidelines such as “Standard Procedures for Outside Counsel,” “Litigation Management Guidelines,” and “Retention Policies” often “require the lawyer to obtain approval before performing various legal services, including staffing decisions, research exceeding a specified number of hours . . . . , selection and retention of experts, filing of motions, and in-firm conferences”).

63. A more interesting question, outside the scope of this Comment, is whether an insurer can terminate in-house counsel if the attorney takes actions that comply with the Rules of Professional Conduct but not with the insurer’s guidelines.
practice of law. Thus, it is necessary to examine the treatment of in-house counsel by the judiciary.

2. Judicial Application of Rule 5.4 in South Carolina

The South Carolina Supreme Court has not yet addressed the use of in-house counsel by an insurer. However, a South Carolina federal district court has dealt with the application of Rule 5.4 in the context of insurance defense litigation. In Twin City Fire Insurance Co. v. Ben Arnold-Sunbelt Beverage Co. of South Carolina, the court predicted that the South Carolina Supreme Court likely would not create a “per se disqualification rule” that would prohibit the representation of the insured by an independent attorney hired by the insurer under the referral system. In Twin City, the insured would not allow the attorney retained on his behalf by the insurance company to represent him based on the assumption that a per se conflict of interest existed or likely would exist in the future because of a reservation of rights asserted by the insurer. Specifically, the insured believed that the attorney would intentionally favor the insurance company by failing to vigorously defend any potential uncovered claims. The court declined to create a per se disqualification rule because such a rule would imply that when faced with a possible ethical dilemma, the attorney hired by the insurer would always choose to violate established ethical standards and act in the best interest of the insurer rather than the insured.

Underlying the court’s holding is the belief that an attorney will always strive to act in accordance with the Rules of Professional Conduct, specifically Rule 5.4, even in the context of insurance defense litigation. One possible reason for the federal district court’s refusal to create a per se rule is that it believed that the South Carolina Supreme Court would want to analyze each possible violation of Rule 5.4 individually. This preference for case-by-case, fact-intensive review is the reason why use of the referral system of insurance defense litigation is not a per se violation of Rule 5.4. Therefore, assuming that this ruling of the district court in Twin City is an accurate prediction of how the South Carolina Supreme Court would rule, presumably, the South Carolina Supreme Court would also find that use of in-house counsel by insurers is not a per se violation of Rule 5.4. This

65. Id. at 615. The court expressly acknowledged that the South Carolina Supreme Court “has not directly addressed the legal issues raised in this case” but acknowledged that it “must apply the law that it conscientiously believes would have been applied in the state court system.” Id. at 612 (quoting 19 CHARLES A. WRIGHT, ARTHUR R. MILLER & EDWARD H. COOPER, FEDERAL PRACTICE & PROCEDURE § 4507, at 126 (2d ed. 1996)) (internal quotation marks omitted).
66. Id. at 613. A reservation of rights is “a unilateral statement by an insurer in writing notifying the insured of its intention to continue with the defense while retaining the right to press all issues that could lead to a finding of non-coverage.” Id. at 612 n.3 (citing BLACK’S LAW DICTIONARY 1082 (7th ed. 1999)).
67. Id. at 613.
68. Id. at 614–15.
69. See id. at 615.
assumption is reasonable because the attorney’s professional independence will be threatened under either a referral system or an in-house system, as the insurer can exercise control over the attorney in either system. However, this assumption arguably ignores an important fact: the attorney, as in-house counsel, is an actual employee of the insurance company. Thus, the attorney’s professional independence should be guarded more vigorously under the in-house system.

B. Three Views Regarding Whether the Use of In-House Counsel Constitutes the Unauthorized Practice of Law

As concluded previously, the South Carolina Supreme Court likely would not find use of in-house counsel by insurers to be a per se violation of Rule 5.4. However, there are still two areas of South Carolina law that affect the in-house counsel system. First, Rule 5.5 prohibits an attorney from participating in a practice of law that is “in violation of the regulation of the legal profession in that jurisdiction.” Secondly, section 40-5-320 of the South Carolina Code prohibits the practice of law by corporations “for a person other than itself.” The court’s interpretation and application of Rule 5.5 and section 40-5-320 will ultimately determine whether an insurance company is participating in the unauthorized practice of law.

Unlike South Carolina, other state supreme courts have already addressed whether use of in-house counsel constitutes the unauthorized practice of law. A review of the decisions by these other courts reveals a jurisdictional split regarding the treatment of the in-house counsel. The diverging views can be grouped into three categories: broad acceptance of the use of in-house counsel and the corporate practice of law, limited permission of the use of in-house counsel solely for insurance defense litigation, and complete prohibition on the use of in-house counsel.

1. The Broad Permissive View

The broad permissive view essentially holds that insurance companies are not engaged in the corporate practice of law, and therefore, use of an in-house counsel system is permissible. States that have a statutory ban on the corporate practice of law have used this ban to strengthen Rule 5.5. However, if a court rules that an insurer’s use of in-house counsel does not qualify as the corporate practice of law, then any statutory ban will not apply. For example, the Missouri Supreme Court held in *In re Allstate Insurance Company* that an insurance company was not engaged in “the practice of law” or the “law business” under a system where its in-

---

70. See Stempel, supra note 51, at 41 (noting that the system of in-house counsel has made “lawyers less autonomous, perhaps to a degree that violates the professional paradigm”).
73. 722 S.W.2d 947 (Mo. 1987) (en banc).
house attorneys represented the insureds. In Allstate, the Missouri Advisory Committee brought an action against an insurer alleging a violation of state law which prohibited the practice of law by a corporation and a violation of the state’s Rules of Professional Conduct. The Missouri statute prohibiting the practice of law by corporations is similar to the South Carolina statute prohibiting the practice. Both state statutes prohibit the corporate practice of law but use slightly different language. The Missouri statute is more general because its language prohibits the practice of law by a corporation unless that corporation is a professional corporation, limited liability company, or a limited liability partnership organized and registered pursuant to specific Missouri statutes. In other words, the corporation must be a law firm to engage in the practice of law. The South Carolina statute is more specific because it states without qualification that no corporation may practice law for any person or entity “other than itself.” In addition, the attorneys in Missouri and South Carolina operate under the nearly identical Rules of Professional Conduct. Thus, an analysis of Rule 5.5 as applied to the Missouri statute likely would produce the same conclusion as an analysis of the rule in South Carolina, if a South Carolina court adopted a similar broad permissive view regarding the use of in-house counsel.

The Allstate court compared the use of in-house counsel to the use of referral systems and found no difference between the two. The court reasoned that if an insurer using the referral system is not engaged in the practice of law, then an insurer using in-house counsel is also not engaged in the practice of law. This reasoning by the court seems contradictory, as noted by Justice Rendlen’s dissent. Justice Rendlen rejected the reasoning of the majority and stated that the majority’s broad holding—that a corporation does not engage in the practice of law if it uses in-house counsel to represent its insureds—essentially abolishes the state statute and opens the door for any corporation to employ attorneys to represent its

74. Id. at 951 (citing Mo. Ann. Stat. § 484.010(1)–(2) (West 2004)).
75. Id. at 948–51 (citing Mo. Ann. Stat. § 484.020). Section 484.020 prohibits any “person[,] . . . association, partnership, limited liability company or corporation” from engaging in “the practice of law” or doing “law business.” Id. § 484.020(1). Violation of this prohibition constitutes a misdemeanor that is punishable by fine or civil suit. Id. § 484.020(2).
76. Allstate, 722 S.W.2d at 951 (citing Mo. Rules of Prof’l Conduct Rs. 4-1.7, 4-5.4 (1986)).
77. Compare Mo. Ann. Stat. § 484.020(1) (prohibiting any “person[,] . . . association, partnership, limited liability company or corporation” from engaging in “the practice of law” or doing “law business”), with S.C. Code Ann. § 40-5-320 (2001) (making it unlawful for a corporation to “practice or appear as an attorney at law for a person other than itself” or “hold itself out to the public as being entitled to practice law, render or furnish legal services, advise or furnish attorneys or counsel, or render legal services in actions or proceedings”).
81. Allstate, 722 S.W.2d at 950.
82. Id.
83. Id. at 951.
customers. The majority in Allstate also based its decision on the rulings of several jurisdictions permitting the use of in-house counsel. However, Justice Rendlen pointed out that those jurisdictions either did not have statutory prohibitions against corporations practicing law or had enacted a statutory exception for insurance companies.

The holding by the majority in Allstate seems untenable based on the specific facts of the case. Where a state legislature has expressly prohibited a corporation from practicing law, a ruling that directly contradicts that statute indicates that the judiciary is legislating from the bench and is intruding on the authority of the legislature. In holding an insurer’s use of in-house counsel to represent the insured did not constitute the practice of law at all, the court avoided the discussion of whether the use of in-house counsel constituted the unauthorized practice of law. Thus, the court arguably misinterpreted the prohibition on the corporate practice of law.

2. Creation of an Insurance Defense Exception

While some state legislatures have enacted a statutory ban on the corporate practice of law, other states prohibit the practice under common law but have chosen to create common law exceptions to the general rule. Cincinnati Insurance Co. v. Wills involved a personal injury action brought by two plaintiffs who had been injured by the insured. Once the injured parties learned that in-house counsel was representing the insured, they moved to have the insured’s counsel disqualified. Cincinnati Insurance moved to intervene and become a party to the action to effectively defend its use of in-house counsel. Unlike in Allstate, Indiana did not have a statutory ban on the corporate practice of law. Rather, Indiana’s ban on the corporate practice of law stemmed from the state’s Rules of Professional Conduct, specifically Rule 5.4, and state common law. Based on this precedent

84. Id. at 953 (Rendlen, J., dissenting).
85. Id. at 950–51 (majority opinion) (citations omitted).
86. Id. at 954–55 (Rendlen, J., dissenting) (citations omitted).
87. Id. at 951 (majority opinion).
88. 717 N.E.2d 151 (Ind. 1999).
89. Id. at 153.
90. Id.
91. Id.
92. Id. at 156.
94. Cincinnati, 717 N.E.2d at 157–58 (citing David Gleber, Attorney and Client—Unauthorized Practice of Law, 13 Notre Dame L. Rev. 289, 290 (1938)).
and the premise that insurers and insureds have similar interests, the court held that use of an in-house counsel system did not constitute the unauthorized practice of law and that an attorney employed as in-house counsel did not aid in the unauthorized practice of law. The court also relied on agency theory to justify the insurer’s use of in-house counsel to represent the insured in legal proceedings. Finally, the court reasoned that because the Rules of Professional Conduct did not expressly prohibit the use of in-house counsel, the practice should be permitted to continue unless and until the state’s citizens decide otherwise. Thus, the effect of the court’s ruling was to create a common law exception for the use of in-house counsel in insurance defense litigation.

The *Cincinnati* court’s conclusion seems an acceptable resolution to the problem of in-house counsel. By otherwise affirming the common law prohibition against the corporate practice of law, the court limited its holding to the use of in-house counsel in insurance defense litigation, noting that “there may be many other reasons why an employee-attorney may not concurrently represent both the employer and someone else, but the attorney’s status as an employee of an insurance company or any other legal entity is in and of itself no bar.” The court’s only obstacle was the common law it had fashioned, and the court had a right to alter the law in order to reach an equitable resolution. While the language of Rule 5.4 is helpful in resolving this issue, whether the use of in-house counsel violates Rule 5.4 does not provide an absolute answer and the issue must be resolved on a case-by-case basis. The only possible flaw in the court’s decision is its reasoning that the insured and the insurer have similar interests. Based on this statement, corporations besides insurance companies may now be able to argue that the similar interests of their clients justify their use of in-house counsel. However, as long as the rule remains grounded in the common law, courts can freely address specific situations as they arise.

95. *Id.* at 160.
96. *Id.* at 153.
97. *Id.* at 160 (citing *RESTATEMENT (SECOND) OF AGENCY* § 19 cmt. d (1958)) (“[W]here the law requires a [licensed professional], agency doctrine permits an unlicensed legal entity to employ licensed agents to perform those acts requiring a license.”).
98. *Id.* at 163. The court noted as follows:
   But this potential [for conflicts of interest] does not require the abandonment of mode of doing business that the insurer finds efficient and cost effective, and the insured knowingly accepts. Presumably[,] ultimately the marketplaces of ideas and premium charges will sort this out and strike a balance between claimed cost advantages and perceived desirability of wholly independent counsel.
99. *Id.* at 160.
100. *Id.*
101. See Walker v. Rinck, 604 N.E.2d 591, 594 (Ind. 1992) (“[I]t is the traditional role of the highest court of a state to determine [the state’s] common law . . . even if such determination results in an innovative growth of the common law.”).
102. See discussion supra Part III.A.2.
103. *Cincinnati*, 717 N.E.2d at 160.
3. Complete Prohibition on the Use of In-House Counsel

There are still other states that have a statutory ban on the corporate practice of law and whose supreme courts have chosen to enforce the statutes as written. In Gardner v. North Carolina State Bar,\textsuperscript{104} the North Carolina Supreme Court reviewed a state statute that prohibited the practice of law by a corporation\textsuperscript{105} and held that the use of in-house counsel by the insurer constituted the unauthorized practice of law.\textsuperscript{106} In Gardner, the petitioner was in-house counsel for Nationwide Insurance Company\textsuperscript{107} and sought review of two state bar ethics opinions stating that the use of in-house counsel by the insurer amounted to the unauthorized practice of law.\textsuperscript{108} In affirming the conclusions of the ethics opinions,\textsuperscript{109} the court disagreed with the petitioner’s “similarity of interest” argument that there was no unauthorized practice of law because the corporation was appearing and representing itself in its defense of the insured.\textsuperscript{110} The court severely criticized this reasoning, stating that because the attorney was acting in his official capacity as an employee of the corporation, the “acts [of the attorney] would thereby be the acts of [the corporation] itself.”\textsuperscript{111} The court went on to point out that “[t]he company itself is not the party to the action,” and “[a]ny judgments rendered are rendered against the insured, not against the company.”\textsuperscript{112} Furthermore, the court responded to the holdings of several other courts\textsuperscript{113} in finding that “the interests of the insurance company and the insured [are not] identical.”\textsuperscript{114} The court distinguished the case at bar from the persuasive authority cited by the petitioner, noting that those jurisdictions had statutes that created exceptions for insurance companies or had no statutory ban on the corporate practice of law at all.\textsuperscript{115} Thus, the court

\textsuperscript{104} 341 S.E.2d 517 (N.C. 1986).
\textsuperscript{105} N.C. GEN. STAT. § 84-5 (2007). The statute prohibits any corporation, by itself or through an agent, from practicing law, appearing in court on behalf of any person, giving legal advice, drafting legal documents, or otherwise holding “itself out in any manner as being entitled to do any of the foregoing acts.” Id. § 84-5(a). However, the statute does allow for attorneys to be retained by a corporation to represent the corporation “in any matter arising in connection with the course and scope of employment.” Id. § 84-5(b).
\textsuperscript{107} Id. at 518 n.1.
\textsuperscript{108} Id. at 518.
\textsuperscript{109} Id. at 523.
\textsuperscript{110} Id. at 520–21.
\textsuperscript{111} Id. at 520.
\textsuperscript{112} Id. at 521.
\textsuperscript{113} Id. at 521–22 (citations omitted).
\textsuperscript{114} Id. at 521.
\textsuperscript{115} Id. at 522 (citations omitted).
applied its own state law, which expressly prohibited the corporate practice of law, in accordance with “the policies expressed by [its] state legislature and the best interests of [its] state.”

Both Missouri and North Carolina had similar, if not identical, statutes prohibiting the practice of law by corporations, as well as similar Rules of Professional Conduct. However, the Allstate and Gardner courts came to opposite conclusions. The simplicity of the court’s reasoning in Gardner warrants a strong following by states with similar prohibitions on the corporate practice of law. Unlike the Allstate court, the Gardner court did not indulge in discussion of the legislature’s intent or determine that the legislature did not contemplate insurance defense litigation in its drafting of the statute. Nor did the Gardner court try to determine whether the use of in-house counsel creates a per se conflict of interest, or whether the insurer violated Rule 5.4 by restricting the attorney’s professional independence. The Gardner court saw the issue more directly: by utilizing in-house counsel to represent the insured, was the insurer practicing law in violation of the corporate practice of law statute? To the court, the answer was simple: “Since a corporation cannot practice law directly, it cannot do so indirectly by employing lawyers to practice for it.”

As demonstrated by the three different views taken by courts, there is no clear answer as to whether the use of in-house counsel constitutes the unauthorized practice of law. Each state’s determination relied on factors unique to each case: the Rules of Professional Conduct utilized by the state, the existence of a statutory ban on the corporate practice of law, and the specific factual circumstances. While this Comment does not intend to recommend a rule for all states, these cases do help advise which approach South Carolina should adopt regarding the use of in-house counsel in insurance defense litigation.

C. Which Approach Should South Carolina Adopt?

When the issue is finally addressed in this state, the South Carolina Supreme Court should follow the North Carolina Supreme Court’s opinion in Gardner and completely prohibit the use of in-house counsel. Based on the plain language of

116. Id.
120. But see id. at 951–53 (discussing issues of conflict of interest and professional independence).
121. Gardner, 341 S.E.2d at 520. The court saw the dispositive issues as “whether the [insurer] would be making an appearance at all” and “whether [the appearance by the insurer] would be a prohibited one.” Id.
122. Id. at 521 (quoting Seawell v. Carolina Motor Club, 184 S.E. 540, 544 (N.C. 1936)) (internal quotation marks omitted).
section 40-5-320, application of Rule 5.5, and the reasoning of the court in *Gardner*, the South Carolina Supreme Court should prohibit this practice and deem any attorney employed as in-house counsel to be aiding in the unauthorized practice of law. This conclusion is based on the similarity between North Carolina law to South Carolina law. Like North Carolina, South Carolina has substantially adopted the Model Rules of Professional Conduct, which means that Rule 5.5 requires the same ethical obligations for attorneys in either state. Also, both states have an unambiguous statutory ban on the corporate practice of law that deserves the enforcement of the court.

South Carolina has had a statutory ban on the corporate practice of law for over fifty-five years. The language of the 1952 statute is strikingly similar to the language of section 40-5-320, the current statute addressing the corporate practice of law. The existence of a virtually unchanged statutory ban on the corporate practice of law in South Carolina for the last fifty-five years strongly indicates that the South Carolina legislature does not want to grant corporations the ability to represent any person other than themselves in court. As the court in *Gardner* reasoned, “the acts [of the attorney] would thereby be the acts of [the insurer] itself.” If the South Carolina Supreme Court views in-house counsel as acting on behalf of the insurer, then the actions of the insurer and in-house counsel should be prohibited by section 40-5-320.

The South Carolina Supreme Court may consider holding in accordance with the *Cincinnati* court and carve out a specific insurance exception for the use of in-house counsel. The creation of such an exception could be based on economic efficiency: use of in-house counsel reduces costs for the insurer and thus, leads to lower premiums paid by South Carolina residents. The court could also create an exception because, as a common practice, the use of an in-house counsel system likely has worked to the satisfaction of the insured based on the lack of litigation of the issue. While these are valid justifications for creating an exception, the *Cincinnati* court’s reasoning should not be followed because there was no statutory

125. See supra text accompanying notes 104–16, 121–22.
128. S.C. Code Ann. § 56-142(a)-(b) (1952). The statute provided,

It shall be unlawful for any corporation or voluntary association to practice or appear as an attorney at law for any person other than itself in any court in this State or before any judicial body, [or] to make it a business to practice as an attorney at law for any person other than itself, in any of such courts . . . .

Id.

130. See supra notes 94–98 and accompanying text.
131. See supra text accompanying notes 33–34.
132. A search of South Carolina caselaw on Westlaw using the search terms in-house counsel, insurance, and professional conduct resulted in no state court opinions.
ban on the corporate practice of law in that case. In *Cincinnati*, the prohibition was a common law prohibition, so the court was free to create a common law exception.\textsuperscript{133} In South Carolina, the prohibition on the corporate practice of law is based on statute, not common law. Therefore, if there is to be an exception in South Carolina for the use of in-house counsel in insurance defense litigation, it should be created by the same branch of government that created the general statutory prohibition: the state legislature.

If the South Carolina Supreme Court adopted the reasoning of the Missouri Supreme Court in *Allstate* and permitted the use of in-house counsel because insurance companies do not practice law,\textsuperscript{134} there would be far-reaching negative implications on the practice of law in South Carolina. If the South Carolina Supreme Court reached the same conclusion as the *Allstate* court, it would effectively repeal section 40-5-320. Corporations could start practicing law by representing their customers in court and creating legal departments in each of their South Carolina corporate locations to represent customers on various legal issues. Such developments would have implications that are beyond the scope of this Comment but include adverse effects on small firms and solo practitioners and convoluted applications of the Rules of Professional Conduct.

IV. CONCLUSION

Insurance defense litigation presents unique issues regarding the ethical obligations for attorneys practicing in South Carolina. The primary concern is maintaining the professional independence of the attorney in order to ensure that every insured gets the best representation possible. However, insurers have an understandable desire to keep litigation expenses down. Policies like the use of in-house counsel that further this goal allow insurers to pass the savings on to South Carolina residents in the form of lower premiums and greater benefits. While improved service at a lower cost is an attractive goal, the progress towards that goal cannot involve a policy that violates existing state law. South Carolina statutory law currently prohibits the corporate practice of law, and this ban arguably prevents insurers from using in-house counsel to represent their insureds. South Carolina attorneys are also governed by Rule 5.5, which proscribes the practice of law in a manner that violates any law of the state. The duty of the South Carolina Supreme Court is to interpret the law. But when faced with an unambiguous, long-standing statute such as section 40-5-320, the court must enforce it as written. Thus, the court should prohibit the use of in-house counsel in insurance defense litigation.

*Eric Montalvo*

\textsuperscript{133} See supra text accompanying notes 99–103.

\textsuperscript{134} *In re Allstate Ins. Co.*, 722 S.W.2d 947, 951 (Mo. 1987) (en banc).