To: Dan Sumner, General Counsel

From: Mark Watts, Senior Counsel

Date: October 23, 2020

Re: Captive Firm Issues

EXECUTIVE SUMMARY

Citizens Property Insurance Corporation (Citizens) has been presented with the question of whether in-house counsel may represent Citizens in first party litigation and insureds in third party claims. This question must be answered with regard to the Florida Bar's concern that in-house counsel for insurance companies may facilitate the unauthorized practice of law by the insurer. The Bar's concern about the unauthorized practice of law relates to the Florida common law rule that a corporation (other than a professional corporation) cannot practice law and cannot represent itself in legal matters pro se. The Florida Supreme Court has ruled that a corporation cannot practice law through attorney employees where non-attorney directors and officers of the corporation direct and control the nature and delivery of the legal services provided.

Florida has never explicitly stated that a corporation cannot practice law on its own behalf through use of an attorney employee. It has recognized, however, that there is a difference between a corporation that employs an attorney "primarily to further a course of business" and one engaged to "practice of law" (i. e. to litigate cases on behalf of itself and others). States that have ruled directly on this issue have held that a corporation cannot represent itself through attorney employees in litigated matters because the attorney employee is a corporate agent. The act of the attorney employee is the act of the principal corporation and, therefore, the unlicensed corporation is practicing law despite the fact it is doing so through an attorney employee. Because corporations cannot practice law, and to protect the professional independence of in-house counsel, commercial insurance companies in Florida use the captive law firm model in which a separate law firm with separate facilities and separate employees is created and funded by the insurer. The attorneys in these captive law firms, like those created by State Farm in Florida, do not report to non-attorney managers in the regional claims office, but have a separate reporting legal hierarchy to avoid control of the legal practice by non-attorney managers.

If Citizens' in-house counsel are to represent Citizens in first party lawsuits and its insureds in third party litigation, at a minimum Citizens will need to create, fund, and staff a separate captive law firm.

DISCUSSION

The question to be examined is whether in-house counsel can represent Citizens in litigation related to claims disputes brought against it by Citizens' insureds or defend its insureds in 3rd party actions? In reviewing this subject consideration should be given to the fact that Citizens is a governmental entity of the State of Florida that performs activities like those of a market-place insurer. As such, Citizens' enabling statute has set forth processes which require Citizens to maintain the highest ethical standards. It is not the purpose of this memorandum to examine the ethical issues that could arise for Citizens as a governmental entity based upon the use of in-house counsel in breach of contract and liability litigation matters.

IN-HOUSE COUNSEL AND UNAUTHORIZED PRACTICE OF LAW CONCERNS

The examination of insurance carrier self-representation must include an examination of two proposed Florida Bar Professional Ethics Committee Opinions which proved so controversial that protests from the insurance industry led the Florida Bar Board of Governors to reject them despite the fact that they were not binding but only advisory in nature. See *Bar Governors Reject Three Insurance Ethics Opinions,* Fla. Bar News, January 1, 2001. These opinions were FL Eth. Op. 99-3, and 99-4. (Respectively Op. 99-3, and 99-4).

Op. 99-3 held that an attorney is ethically prohibited from entering into an agreement with an insurance company to represent insureds where the attorney's independent professional judgment and the client's rights will be affected by restrictive billing practices imposed by the insurance company. This proposed opinion stated:

> [T]he Committee is concerned that restrictions [brought about by an improper fee arrangement] which affect the attorney's independent professional judgment may also **rise to the level of unlicensed practice of law by the insurer.** An attorney may not assist the unlicensed practice of law under Rule 4-5.5. Although it is not within the scope of the Committee's authority to decide such legal questions, the Committee refers this issue and also encourages anyone who is interested to request an opinion from the Unlicensed Practice of Law Committee.

Op. 99-3 (emphasis added). Note that in Op 99-3, the Bar is concerned about an insurer engaging in the unauthorized practice of law through its *outside counsel*.

Op. 99-4 deals with the question of whether it is ethical for a salaried employee attorney of an insurance company to represent insureds in litigation matters. The opinion notes that there are generally two ways in which insurance carriers utilize salaried employee attorneys to represent insureds in litigation though it referred to both methods as variations of the captive law firm approach. In the first method, an attorney who is a direct employee of the insurance company defends the insured. The second method and the one which is more generally thought of as the "captive law firm approach" is one in which "the insurer engages attorneys, pays them on a salaried basis, and pays the expenses necessary for them to open and operate an office that appears to the public to be an independent law firm. In essence, the insurer sets up an 'outside' counsel and then assigns defense of its insureds to this 'law firm.'" Op. 99-4 (throughout the rest of this memorandum the phrase "captive law firm" will refer to what Op. 99-4 calls the "second method").

Op. 99-4 then goes on to list the Rules of Professional Conduct (Rule(s)) implicated when an attorney salaried by an insurer undertakes to represent an insured. Those Rules are 4-1.7 (conflicts of interest); 4-1.8(f) and 4-5.4(c) (professional independence of the lawyer); and 4-5.5(b) (assisting nonlawyers in the practice of law). The issue of the unauthorized practice of law and professional independence are foremost when in-house attorneys represent insurers and insureds in litigation matters. Regarding the unauthorized practice of law Op. 99-4 states:

> Finally, Florida lawyers are prohibited from assisting nonlawyers in conduct constituting the unlicensed practice of law. Rule 4-5.5(b). While it is not within the province of this Committee to determine whether certain conduct constitutes the unlicensed practice of law, we invite anyone interested in requesting an advisory opinion as it relates to this question to contact The Florida Bar's Unlicensed Practice of Law Committee.

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Op. 99-4. Both Op. 99-3 and 99-4 discuss the unauthorized practice of law by insurance companies and this ethical consideration relates to the historic ban in Florida prohibiting corporations from practicing law. At this juncture the issue regarding the unauthorized practice of law by a corporation will be examined.

A CORPORATE ENTITY MAY NOT PRACTICE LAW IN FLORIDA

The law in Florida is unequivocal; a corporation cannot represent itself pro se in court. *Nicholson Supply Co. v. First Federal Savings & Loan Ass'n of Hardee County,* 184 So.2d 438 (Fla. 2d DCA 1966); See also *Szteinbaum v. Kaes Inversiones y Valores,* 476 So.2d 247 (Fla. 3d DCA 1985); *Punta Gorda Pines Dev., Inc. v. Slack Excavating, Inc.,* 468 So.2d 438 (Fla. 2d DCA 1985); *Hub Financial Corp. v. Olmetti,* 465 So.2d 618 (Fla. 4th DCA 1985); *Daytona Migi Corp. v. Daytona Automotive Fiberglass, Inc.,* 417 So.2d 272 (Fla. 5th DCA 1982)*; Angelini v. Mobile Home Village, Inc.,* 310 So.2d 776 (Fla. 1st DCA

1975). This rule applies even when the corporation has only one shareholder. *Southeastern Associates, Inc. v. First Georgia Bank,* 362 So.2d 967 (Fla. 1st t DCA 1978) *Richter v. Higdon Homes, Inc.,* 544 So. 2d 300 (Fla. 1st DCA. 1989).

While the foregoing cases confine their discussion to corporations proceeding pro se through non-attorney directors, officers and agents, a corporation also cannot practice law through any of its employees even if those employees are licensed attorneys. In *Florida Bar v. Consolidated Business and Legal Forms, Inc.,* 386 So. 2d 797 (Fla. 1980), the Florida Supreme Court held that a corporation cannot practice law even through corporate employees who are licensed attorneys. The Court stated:

> [The corporation] through its non-lawyer officers maintains a degree of control over the legal services it furnishes through its lawyer employees for the purpose of maintaining cost efficiency and profits. The manner in which the lawyer employees are compensated encourages the lawyer to conduct a high-volume turnover of clients in order to increase his income. The use of standardized forms is encouraged or mandated and the lawyer's time spent in court is organized to limit the time of his absence from the . . . office where one of the lawyer's primary functions is client intake.

Id. at 798. Accord, *Florida Bar v. We the People Forms and Service Center of Sarasota, Inc.* 883 So.2d 1280 (Fla. 2004) (corporate entity cannot practice law where it controls the legal services furnished through its attorney employees). The Court in *Consolidated* permanently enjoined the corporation from engaging in its former business which amounted to the unauthorized practice of law. In Op. 99-4 the Florida Bar cited *Consolidated* to support its concern that an insurer's use of salaried employees could aid in the insurer's engaging in the unauthorized practice of law. The opinion also cited *In re Rules Governing Conduct of Attorneys in Florida,* 220 So.2d 6 (Fla. 1969). In this ruling the Florida Supreme Court chose *not to adopt* a rule which stated:

> An attorney employed in a master-servant or employer-employee relationship by a lay agency, such as a bank, savings and loan association, trust company or insurer, shall not render in the scope of his employment legal services on behalf of or in the name of customers, patrons or insureds of the lay agency unless it shall clearly appear that the sole financial interest and risk involved is that of the lay agency.

Focusing on the third-party representation issues, the Court stated that defense counsel, whether in-house or outside, would have the same ethical issues regarding conflicts if the interests of insurer and insured diverged. It is, however, interesting to note that the Court quotes with approval the insurance industry's argument that "the legal responsibility placed on the insurance company give[s] pointed verification to the fact that the interest involved in defense of liability suits is primarily and ultimately the interest of the insurance company. . . .It is the insurance company's interest, as an entity, that [any] lawyer represents . . ." *Id.* at 8. The Florida Supreme Court takes note that claims are ultimately

the financial interest of the insurer and this reality undercuts many of the distinctions that might be made between first and third-party claims in that both are "ultimately the [financial] interest of the insurance company." Another important aspect of the Court's ultimate rejection of the proposed rule is that by failing to adopt it, Florida did not clarify its position regarding whether an insurance corporation can represent itself pro se in litigation through attorney employees. It must be noted that this opinion does not address the unauthorized practice of law issues that so concerned the Bar in Op. 99-3 and 99-4 and focuses mainly on conflicts issues.

That a corporation may not engage in the practice of law is embedded in either the common law or statutory law of many states. The reasons underlying this rule appear to be two-fold. First, only those with a license may practice law. Second, a corporation can never be licensed to practice law because it cannot attain the educational and character requirements necessary to obtain a law license. *State v. Bailey Dental Co*., 234 N.W. 260, 262 (Iowa 1931); *American Ins. Ass'n v. Kentucky Bar Ass'n*, 917 S.W.2d 568, 571 (Ky. 1996) (stating that a corporation "cannot obtain a license to practice law, since it is wholly incapable of acquiring the educational qualifications necessary to obtain such license, nor can it possess in its corporate name the necessary moral character required therefor"); *State Bar v. Arizona Land Title & Trust Co*., 366 P.2d 1, 10 (Ariz. 1961) (the extensive and rigid requirements which must be met to hold a license to practice law cannot be satisfied by a corporation).

As one court stated:

> The practice of law is open only to individuals proved to the satisfaction of the court to possess sufficient general knowledge and adequate special qualifications as to learning in the law and to be of good moral character. . .Only a human being can conform to these exacting requirements. Artificial creations such as corporations or associations cannot meet these prerequisites and therefore cannot engage in the practice of law.

State Bar Ass'n v. Connecticut Bank & Trust Co., 140 A.2d 863, 870-71 (Conn. 1958). Many courts have ruled that even if the employee of the corporation rendering the legal service is a licensed attorney, that attorney-employee is an agent acting on behalf of the corporation such that the corporation is practicing law without itself having a license. The corporation cannot be given the benefit of the employee's law license in that manner. One court has stated:

> The fact that [corporations] in some instances [hire as an employee] **a regularly licensed attorney to prepare necessary legal papers and conduct the trial of a suit does not make their conduct legal. One cannot do through an employee or an agent that which he cannot do by himself. If the attorney is in fact the agent or employee of the lay agency, his acts are the acts of his principal or master. .** . If the attorney

> be in fact the agent or employee of a layman, his act is that of the layman (his principal).

Nelson v. Smith, 154 P.2d 634, 640 (Utah 1944) (emphasis added); *Connecticut Bank and Trust Co*., 140 A.2d at 870-71 ("As [a corporation] cannot practice law directly, it cannot do so indirectly by employing competent lawyers to practice for it"). *J. H. Marshall & Associates, Inc. v. Burleson*, 313 A.2d 567 (D.C. App. 1973) (if a corporate act constitutes the practice of law it is the unauthorized practice of law regardless of whether the acts complained of are done by a layman or a licensed attorney) (citations omitted). These, and cases like them, recognize that a corporation is an entity separate from its directors, officers, agents, and employees but must at the same time act through these agents. When an agent acts on behalf of the corporation, it is a corporate act. When the agent's act is that of practicing law, the corporation is practicing law.

Attorneys can practice in corporation style structures known as Professional Associations or P.A.s in Florida. See Fla. Stat. § 621.07 and Rule 4-8.6. All members of the entity must be licensed attorneys and the corporate structure does not protect an attorney member's personal assets if that attorney malpractices. Fla. Stat. § 621.07 states:

> [The handling attorney shareholder of the professional association] shall be ***personally liable*** and accountable . . .for negligent or wrongful acts or misconduct committed by that [attorney shareholder], or by any person under that person's direct supervision and control, while rendering professional service on behalf of the corporation or limited liability company to the person for whom such professional services were being rendered. . .

The professional corporate form is not a method to limit the personal liability of an attorney who commits wrongful conduct but rather a mechanism to allow attorneys to take advantage of IRS tax deductions that were available to corporate entities but that were not available to sole proprietors and partnerships. See. *In re Florida Bar,* 133 So. 2d 554 (Fla. 1961).

THE ACCEPTANCE TO CAPTIVE LAW FIRMS

As evidenced above, Florida recognizes the rule that non-professional, general commercial corporations cannot practice law. One court has stated that a non-professional corporation should not be allowed to practice law because it is a "hydra-headed entity and its shareholders are insulated from personal responsibility." *Szteinbaum v. Kaes Inversiones y Valores,* 476 So.2d 247 (Fla. 3rd DCA 1985). Though Florida has never explicitly stated that a corporation cannot practice law on its own behalf if using an attorney employee, it has recognized that there is a difference between a corporation that employs an attorney "primarily to further a course of business" and one engaged to "practice of law" (i. e. to litigate cases on behalf of itself and others.) *Consolidated,* 386 So. 2d at 798. This distinction is highlighted in Op. 99-3 and 99-4. In Op. 99-3 the Florida Bar warns that restrictive fee arrangements coupled with stringent

guidelines regarding how a case is handled may "arise to the level of unlicensed practice of law by the insurer." Op. 99-3. Further, employee attorneys of insurers "may be assisting nonlawyers [i.e. insurance corporations] in conduct constituting the unlicensed practice of law." Op. 99-4. Aiding in the unauthorized practice of law is an important concern that is in addition to the inherent ethical issues regarding an attorney's independent judgment and the duty of loyalty and confidentiality to a client. *Id*. The concerns raised in Op. 99-3 and 99-4 have solidified the use of, or led to the adoption by insurance corporations of the captive law firm model.

The captive law firm model is designed to separate counsel from the control of the claims department and non-attorney managers. The necessity for this structure is illustrated by the factual background of *Mourad v. Automobile Club Ins. Ass'n., 465 N.W. 2d 395* (Mich. App. 1991) disapproved of on other grounds by *Phillips v. Butterball Farms Co.*, 531 N.W. 2d 144 (1995).[1] Though the case involves a wrongful discharge suit, the factual background of the case shows the problems inherent in employing in-house counsel to perform litigation services without properly utilizing the captive law firm model. Mourad was the head of Automobile Club Insurance's (Auto Club) in-house legal department which represented the Auto Club in first party matters and the Auto Club's insureds in third party matters. He was demoted from that position by the Auto Club's Claims Director who supervised him and who replaced Mourad as head of legal with a non-attorney senior claims adjuster. Mourad ultimately resigned from the Auto Club arguing that his demotion was retaliatory and that he was constructively discharged from his employment by the Auto Club. Though the written opinion does not go into specifics, Mourad alleged in his lawsuit that his demotion came as a result of his refusal "to comply with. . . unethical and illegal orders from [the Claim Director and other non-attorney claims personnel] . . . [Mourad] further claimed that had he complied with such orders and instructions he would have violated the Code or Professional Responsibility . . ." The court ultimately held that Mourad could maintain an action for breach of his employment contract based on retaliatory demotion and constructive discharge stemming from his refusal to accede to orders which would have violated the Code of Professional Conduct. The Auto Club's improper conduct cost the company $1,000,000 in damages, the verdict the court upheld on appeal.

Mourad illustrates the problem of using in-house counsel in a setting where that counsel is simply another employee of the insurer. *Mourad* presents an overt set of circumstances and the acts of Auto Club lack much in the way of subtlety, but one should not fail to realize that influence and pressure on an attorney's professional independence can come in much subtler ways. Having direct contact with in-house attorneys can lead to pressure on the attorneys exerted by claims' staff walking into the attorneys' office to cajole the

[1] In *Mourad,* the court ruled that someone wrongfully terminated could not receive damages for emotional distress. *Phillips* disapproved of this aspect of the *Mourad* holding and further applied wrongful discharge principals to at will employment.

attorney to handle a case in a particular way. A claim director could use access to a supervisory attorney to put pressure on subordinate attorneys to handle litigation matters in the manner preferred by the claim director whether such handling is altogether fitting and proper. Because of threats both overt and subtle on in-house counsels' professional judgment and independence, the American Bar Association (ABA) and commentators have counseled the creation of independent and ethically proper in-house counsel operations. See generally Douglas Richmond, *Lost in the Eternal Triangle of Insurance Defense Ethics*, 9 GEORGETOWN JOURNAL OF LEGAL ETHICS 475 (1996). Distilled to its basic points an in-house counsel operation should be set up to:

- Adhere to the Rules of Professional Conduct.
- Be independent from the claims department.
- Have a separate identifiable Staff Counsel department and office space with its own set of files and administrative staff and support system, with lines of supervision and control by senior lawyers and not lay managers.
- Have persons responsible for employment review and promotion of staff counsel personnel be staff counsel managing lawyers and operational managers within the staff counsel department.
- Facilitate the exercise of independent professional judgment by staff counsel.

Id. at 518-19. See also ABA Standing Committee on Ethics & Professional Responsibility, Formal Opinion 03-430, *Propriety of Insurance Staff Counsel Representing the Insurance Company, and Its Insureds; Permissible Names for an Association of Insurance Staff Counsel*, July 9, 2003. The captive law firm model closely adheres to this independent and ethically proper in-house counsel operation.

State Farm in Florida, for example, has created captive law firms throughout the state, each with separate names and separate facilities, (though the attorneys are required to inform clients regarding the firm's relationship with State Farm). State Farm employee litigation attorneys cannot access claims files directly and are treated like outside visitors when they access the local State Farm claims office which is itself housed in its own facility. Only employees directly engaged in providing legal services work at the captive firm's facilities. More important, State Farm litigation attorneys are not supervised by non-lawyer managers working in the local regional claims' office but rather they report to a regional counsel separate from local non-attorney managers. Captive law firms are clearly structured to assuage the ethical concerns raised in Op. 99-3 and 99-4 and to avoid any appearance that the insurer itself is practicing law on behalf of itself and its insureds as is prohibited by Florida law.

Regarding the corporate practice of law, states have reacted differently to the captive law firm model. Some have enacted special exceptions by rule or statute that allow an insurer to use in-house counsel to handle trial work. See e. g. Md. Code Ann., Bus. Occ. & Prof. § 10-206 (b)(3) (stating that the prohibitions on corporations' practicing laws do not apply to "an insurance company while defending an insured through staff counsel."). Other states find a rationale in contract law for the captive law firm model. Tennessee, for example, has an explicit statute that prohibits any "corporation [from] engaging in the practice of the law." Tenn. Code Ann. § 23-3-103. Despite this the Tennessee Supreme Court allowed an insurer's in-house counsel to defend an insured because the insurer was contractually obligated to provide a defense. *In re Youngblood,* 895 SW 2d 322 (Tenn. 1995). Still other states do not allow captive firms and require insurers to retain outside counsel for trial work. *American Ins. Ass'n v. Kentucky Bar Ass'n*, 917 S.W.2d 568, 571 (Ky. 1996) (stating that "a corporation cannot obtain a license to practice law, since it is wholly incapable of acquiring the educational qualifications necessary to obtain such license, nor can it possess in its corporate name the necessary moral character required therefor.") (citations omitted).

Florida, as has been demonstrated, and California allow the captive law firm model thus approving its separation of claim operations and house counsel See e. g. Cal. State Bar Standing Comm. on Professional Responsibility and Conduct, Formal Op. 1987-91 (after first noting that a corporation could not practice law, the committee went on to state that an attorney-employee may represent an insured if "appropriate safeguards" [as with a captive firm] are taken).

Captive law firms elicit different responses and find different justifications from jurisdiction to jurisdiction. Their use, however, is by and large the safest approach an insurer can utilize to avoid allegations of the unauthorized practice of law and protect counsel's professional independence. When properly implemented, they remove lawyers from the influence and control of non-lawyers and better ensure adherence to the confidentiality and loyalty duties placed on a lawyer by the Rules of Professional Conduct. If Citizens' in-house counsel were to litigate cases on behalf of Citizens and/or its insureds, it will be necessary to establish a captive law firm to avoid the appearance that Citizens itself is practicing law. Citizens is a unique entity that embodies a special public trust. It should not in any way risk the taint of the unauthorized practice of law and to avoid this possibility, at a minimum, the captive law firm approach should be utilized.

CONCLUSION

The Florida Bar has expressed ethical concerns regarding the unauthorized practice of law by insurers where representation guidelines restrict attorney autonomy and where in-house counsel represent insurers in litigated matters. These concerns are based on Florida's common law prohibition against corporations practicing law. The ethical concerns raised by in-house counsel representing insurance corporations and/or

insureds has been assuaged by the adoption of the captive firm model. In this model, a separate law firm is created, staffed, and funded by the insurer and a separate hierarchy is created so that attorneys will not have to report to or be supervised by non-attorney supervisors. Based on Citizens' uniqueness as an entity, any taint of the unauthorized practice of law must be avoided and, at a minimum, Citizens should utilize a captive law firm if it is determined that in-house counsel should handle litigated matters.