

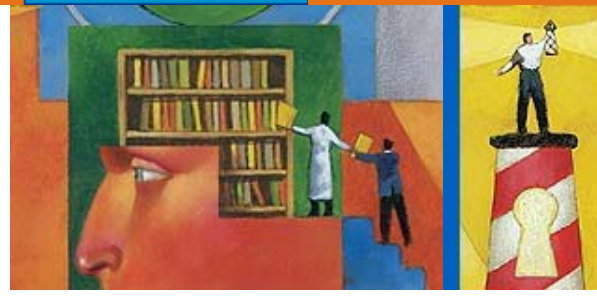


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## Professional Liability Risk and Insurance Coverage for In-House Counsel *Association Law & Policy, September 2008*

**By:** *Robert M. Portman and Stephanie A. Cason*

In-house counsel for nonprofits may find themselves the targets for a variety of liability claims from both inside and outside their place of employment, but they are typically not protected by their employers' insurance policies. In-house counsel should work with their employers to expand coverage or seek separate insurance to protect themselves from potential liability.

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In-house counsel for nonprofits face professional liability risk from a variety of potential claimants, including their employer, other employees, members of the association, chapters, donors or corporate sponsors, state and federal regulators, and other third parties. Claims against in-house counsel can include general malpractice, fraud, breach of fiduciary duty, corporate governance violations, defamation or slander, discovery errors, disciplinary actions, or any number of claims related to moonlighting or pro bono work. In-house counsel in nonprofit organizations may be surprised to find they are not protected against such claims by the insurance policies of their employer. A company's directors and officers (D&O) liability insurance policy typically will not cover in-house counsel at all; or, if it does, claims by third parties or by the client against in-house counsel may be specifically excluded from coverage. In-house counsel should be aware of these possible insurance gaps and work with their employer to take steps to ensure that D&O coverage will apply and/or obtain separate professional liability insurance to protect them from potential liability.

### Nature of Liability Risk

In recent years, in-house counsel have faced claims of liability from several sources. The potential liability for claims brought against in-house counsel may be of a higher concern in the for-profit world with issues involving Securities and Exchange Commission (SEC) and Sarbanes-Oxley Act<sup>1</sup> reporting requirements, internal governance standards, and duties owed to company shareholders. In-house counsel have been targets of investigations and/or prosecutions in almost every recent corporate financial scandal. On the for-profit side, in-house counsel have been the subject of claims relating to "stock options backdating, fraud, discovery abuses, lying to investors and auditors, insider trading, litigation misconduct, violations of securities laws, Medicare and Medicaid fraud, ...corporate governance violations, intellectual property and trade secret issues as well as general allegations of legal malpractice."<sup>2</sup> Although there appear to be few such actions against in-house counsel for nonprofits, it is not difficult to imagine similar liability risks arising based on advice provided by such attorneys.

In-house counsel may find themselves in the uncomfortable position of being sued by their own client,

i.e., their for-profit or nonprofit employer. Claims by the in-house counsel's own employer may arise because the employer has relied on advice given by the attorney regarding a contract, employment decision, regulatory compliance issue, or other similar situation that ended up costing the organization money or putting it in legal jeopardy. While such situations typically do not result in a suit by a nonprofit employer against its general counsel or other staff attorneys, it can occur, and in-house counsel should be aware of the possibility.

In-house lawyers for nonprofits, such as trade associations, professional societies and charitable organizations, are also exposed to suits by a variety of third parties. Third parties bringing claims can include fellow employees, members or chapters, regulatory bodies, program beneficiaries, and others. In these actions, the in-house counsel may be named either individually or in conjunction with the employer client.

Claims involving compliance with the Sarbanes-Oxley Act have created a large area of liability for in-house counsel of publicly traded companies. In-house counsel usually are heavily involved in many aspects of a company's compliance with the Sarbanes-Oxley Act and are now required to report any evidence of a material violation of securities law or a breach of fiduciary duty "up the ladder."<sup>3</sup> Failure to fulfill these duties can create personal liability concerns for counsel.

While publicly-traded companies face greater obligations under Sarbanes-Oxley, nonprofits do have some obligations under the statute, and other Sarbanes-Oxley-like duties may be imputed through common-law fiduciary obligation and fraud theories. Thus, there may be potential liability risk for in-house counsel who fail to properly advise their nonprofit employers about these obligations.

In-house counsel may also face claims by members or donors to nonprofits alleging that their dues or donations were improperly handled or that in-house counsel failed to disclose negative information they knew about the condition of the association. Likewise, in-house counsel for nonprofits with state or regional chapters may create liability risks for themselves if they provide advice to such entities or are responsible for group tax returns or other filings and are negligent in carrying out such duties.

Recent changes to the rules of electronic discovery have created increased duties and potential liability for in-house counsel, whether in for-profit or nonprofit organizations. In 2006, the Federal Rules of Civil Procedure were amended to provide that Electronically Stored Information (ESI) is discoverable and must be preserved and produced just as paper documents are produced.<sup>4</sup> Rule 26(a) as amended now requires parties to voluntarily and timely identify or produce ESI in their possession or control which they intend to use to support their claims or defenses. Therefore, in-house counsel must be able to preserve, locate, gather, review, and duplicate ESI in order to produce it. This requires the creation of a reliable system to manage files and documents, which smaller associations may have limited funds to create. A failure to produce ESI may pose a liability risk to in-house counsel.

A terminated employee may also choose to bring suit against in-house counsel. Claims of wrongful termination or defamation against the nonprofit may also name the counsel as liable where in-house counsel has assisted in investigations of an employee, such as with claims of sexual harassment, that then lead to termination. Even providing a bad reference to an employee may open in-house counsel up to claims of negligent misrepresentation or slander.

In many instances, in-house counsel may be engaged in multijurisdictional practice while performing their duties of employment. In 2002, the American Bar Association (ABA) modified Rule 5.5 of the Model Rules of Professional Conduct, which permits in-house counsel to provide legal services across the United States on behalf of their employers regardless of the state in which they are licensed to practice law.<sup>5</sup> Not all states have adopted the model ABA language, and attorneys should be cautious about knowing what types of legal services they can provide in particular jurisdictions. Violations of multijurisdictional practice rules may lead to claims of negligence or disciplinary actions against an in-house counsel's license. Clients or third parties who relied on advice or documents produced by an attorney practicing in a jurisdiction in which s/he is not authorized to practice may bring a claim of negligence if the advice or documents later turn out to be inaccurate or incorrect. Attorneys may also face disciplinary actions in such cases.

In-house counsel also face potential liability for activities outside of the scope of their employment such as pro bono work and moonlighting activities. Pro bono work may be a requirement of a counsel's employment or it may be work done completely independent of his or her employment. In either case, this work can create a wide range of liability for in-house counsel. "Moonlighting" services provided to coworkers, friends, and family outside the scope of an attorney's employment may also expose an in-house counsel to malpractice claims.

## Options for Coverage

There is no across-the-board answer for how to protect against potential claims against in-house counsel. Each individual's circumstances must be evaluated to determine the appropriate choice based on the potential for liability and the cost of additional coverage. In the first instance, in-house counsel should make sure they are eligible for indemnification by their employers against any claims against them arising within the scope of their employment. The bylaws and policies for most nonprofits should specifically cover in-house counsel, as well as officers, directors, employees (generally), and agents.

In addition to indemnifying their in-house attorneys, nonprofits may either attempt to increase the likelihood that D&O coverage will apply to their in-house counsel, obtain additional insurance in the form of Employed Lawyers Professional Liability Insurance (ELPL), or engage in a combination of both actions.

D&O policies may only provide limited coverage for employees who are not officers or directors of an organization. In-house counsel is often not specifically listed as an officer or director in an association's governing documents. Associations should check their D&O policies and determine how best to cover their in-house attorneys. In-house counsel should specifically be listed as an "insured" within the policy to increase the possibility that D&O insurance will cover them. Additionally, in some cases the organization may be able to purchase a special endorsement that extends D&O coverage to its in-house counsel.

D&O policies are not specifically designed to deal with claims of malpractice, disciplinary proceedings, claims brought by the employer against the in-house counsel, or work performed while moonlighting or engaging in pro bono work. In many cases, D&O policies specifically exclude professional services, which would eliminate coverage for legal activities performed by an in-house counsel. Even if the D&O policy is silent on this issue, an insurance company may still argue that professional services are not included within covered "wrongful acts" if a claim is brought. Thus, insurance companies may be willing to pay a claim based on the conduct of an in-house counsel if it is unrelated to providing legal advice, but not if it arises out of such advice. For example, the organization might be covered for allegations of harassment against an in-house attorney for making improper sexual comments but not for legal advice he or she gives the organization about such issues. Associations should evaluate how "wrongful acts" or similar terms are defined within the policy to determine whether in-house legal advice is covered.

D&O policies also often have exclusions for claims by an "insured" versus an "insured." These exclusions prohibit coverage for claims between two entities covered by the same D&O policy. While associations may not often be suing their own in-house counsel, there are situations where these claims arise. In the case the association itself or a director or officer does bring a claim against counsel, D&O insurance will typically provide no coverage to the in-house counsel.

Another option to provide coverage to in-house counsel is for an association to purchase a separate professional liability insurance policy designed specifically to cover in-house counsel. These policies, referred to as Employed Lawyers Professional Liability (ELPL) insurance, have been in existence for a while, but have seen increased popularity in recent years as the liability risks for in-house counsel have escalated. These policies can be purchased alone or can be wrapped into D&O policies. ELPLs insure in-house counsel and their staff against claims of negligence, errors, omissions, breach of duty, misstatement, or misleading statements. A variety of insurance companies provide ELPLs.<sup>6</sup> Costs of these policies vary depending on the industry, the employer, potential liability, as well as a variety of other factors. In-house counsel and their employers need to evaluate whether it is cost effective to pursue this route of coverage.

In securing such coverage, the scope and cost of the policy must be evaluated. It is critical that all of the organization's in-house attorneys be covered, including any contract attorneys. Outside law firms have their own insurance and do not need to be covered on the nonprofit's ELPL insurance.

The scope of services covered by the insurance should be as broad as possible, but in any case should include "any act, error, omission, breach of duty, or misleading statements and defamation committed in the provision of legal or professional services performed on behalf of the organization."<sup>7</sup> The policy should also cover criminal proceedings, pro bono work performed at the direction of the organization, and moonlighting, if possible and not too costly. Even if moonlighting is not covered, incidental advice to coworkers should be covered, again if not too costly.

Typical exclusions for willful and wanton or fraudulent or criminal misconduct will likely apply to ELPL insurance. However, the insured in-house attorney should be eligible for a defense of such claims. The same principle should apply to claims by one's corporate employer, which are normally excluded from coverage but the attorney should receive a defense in such cases.

If ELPL insurance is purchased as excess coverage beyond what's available in the nonprofit's D&O policy, this should be clearly spelled out in the policy. In addition, the in-house attorney's nonlegal conduct will generally not be covered by the ELPL policy. This exclusion should be specifically mentioned as well.

While some of the additional protections for ELPL insurance could theoretically be added to the organization's D&O coverage, nonprofit employers will usually prefer not to use up their limits or jeopardize their insurability by mixing these coverages. In addition, as previously noted, D&O policies do not have the specific coverages offered by ELPL insurance for legal malpractice, disciplinary actions, claims brought by a corporate employer, pro bono or moonlighting claims.<sup>8</sup> Some ELPL policies may also cover claims such as false arrest or imprisonment, malicious prosecution, defamation, violation of right to privacy, and wrongful entry or eviction. Such claims are typically not covered by most D&O policies.<sup>9</sup>

## Conclusion

In-house counsel face increased potential liability from a variety of sources and steps should be taken to limit this risk. Attorneys should work closely with their nonprofit employers to determine what avenues of coverage are most appropriate based on their potential risks and costs. D&O policies should be evaluated to determine if coverage exists under these policies for in-house counsel. If necessary and appropriate, additional coverage in the form of ELPL insurance should be obtained

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[1] Sarbanes-Oxley Act of 2002, Pub. L. No. 107-201, 116 Stat. 754 (2002).

[2] See S. Friedman, "Road Map for In-House Counsel Insurance Coverage, New York Journal (Dec. 26, 2007) (available at <http://www.law.com/jsp/ihc/PubArticleIHC.jsp?id=1198231501642>).

[3] D. Bailey, "Corporate Counsel Insurance: Important Coverage for Exposed Lawyers," Bailey Cavaleri, LLC (available at <http://www.baileycavaleri.com/CM/Articles/BC.pdf>).

[4] See Fed. R. Civ. P. 26.

[5] Model Rules of Professional Conduct R. 5.5 (2002).

[6] Companies that advertise this type of insurance include: AIG, Chubb, Philadelphia Insurance Companies, Mercator Risk Services, among others.

[7] Friedman, *supra* n.1.

[8] See Friedman, *supra* n.1.

[9] See Bailey, *supra* n.3.

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