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TROUBLE AT HOME

In California, an employer cannot sue an in-house attorney employee for malpractice negligence arising from acts that are within the scope of employment

ALTHOUGH in-house lawyers have an attorney-client relationship with their employers and in-house counsel and outside counsel owe the same duties to their clients, cases decided under California law demonstrate that an employer cannot sue its in-house lawyer employee (or other employees) for malpractice or negligence arising from the acts (or omissions) of the in-house lawyer that are within the scope of the employee's employment. The doctrine of respondeat superior renders an employer's claim of liability for the professional negligence of in-house counsel unavailable. It appears that employers must respond to in-house counsel who commit malpractice in the course of their employment the same as they would treat any other employee who caused damage or injury to the employer—suing in-house counsel for malpractice is simply not an option.

There can be no doubt that an attorney-client relationship is created when a nonattorney employer hires an in-house lawyer, and that outside counsel and in-house lawyers have the same duties to their employer clients. Among these duties are the duty of loyalty and the duty of confidentiality.[1] Lawyers are bound not to reveal or disclose the confidential information of a client,[2] but in addition lawyers are required 1) to avoid the representation of adverse interests,[3] 2) not to limit the lawyer's liability to the client, [4] and 3) to communicate with the client and keep the client reasonably informed about significant developments relating to the representation.[5]

Although the duties are the same, the exposure for in-house attorneys and outside attorneys breaching duties or committing malpractice are very different. California courts have recognized the similarity of the obligations. In citing *General Dynamics Corporation v. Superior Court*,[6] the court in *Gutierrez v. G & M Oil Company, Inc.*,[7] stated that "The important thing about *General Dynamics* for our purposes is that there is no way one can read it without coming away with this basic thought: In-house attorneys employed as attorneys for their employer do indeed have an attorney-client relationship with their employers."[8] The court in *Gutierrez* also cited *PLCM Group v. Drexler*,[9] in which it was held that both in-house counsel and outside counsel are "bound by the same fiduciary and ethical duties to their clients."[10]

These notions were further reinforced by the *Gutierrez* court's application of provisions relating to certain procedural

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requirements of litigation contained in Section 473 of the California Code of Civil Procedure to in-house lawyers. In applying Section 473, the court stated: "There is nothing in Section 473 that suggests corporations or other business entities who elect to have an in-house lawyer represent them in litigation should be at some disadvantage vis-à-vis the negligence of their attorneys that would not apply when they elect to retain outside counsel."[11]

Despite the similarity of the obligations and duties of in-house counsel and outside counsel, employers do not have the same recourse against in-house counsel for malpractice that is available against outside counsel. However, one possibility for an employer to recover for the malpractice of an employee attorney can be found in Section 2865 of the California Labor Code, which provides that "[a]n employee who is guilty of a culpable degree of negligence is liable to his employer for the damage thereby caused to the employer." Section 2865 has seldom been cited on the issue of malpractice liability. Notwithstanding the fact that in-house counsel and outside counsel have the same duties to their clients, there is a paucity of appellate authority, both in California and in other states, on the issue of whether an employer has the ability to sue their in-house counsel for professional negligence.[12]

Cahuenga Partners

A recent unpublished decision, *1538 Cahuenga Partners, LLC v. Jacqueline M. Fabe,*[13] which covers a number of issues, including whether an employer can sue its in-house counsel employee for malpractice, surveyed the landscape relating to the ability of employers to sue employees. In sustaining a demurrer to a malpractice claim, the *Cahuenga Partners* court rejected the argument that Section 2865 permits an employer to sue an employee for negligence.

Specifically, *Cahuenga Partners* strongly rejected two cases, *Division of Labor Law Enforcement v. Barnes* and *Dahl-Beck Electric Company v. Rogge*,[14] both of which were cited by the employer for what the court of appeal declared to be "the rather startling proposition that a corporate employer may sue its in-house counsel for malpractice."[15] In rejecting these two cases, the court of appeal pointed out that "[i]n the nearly 50 years since *Barnes* was decided, it has only been cited by one other court as support for the proposition that an employer may sue an employee for negligence"[16] and that "[n]o court has cited *Dahl-Beck* in the 41 years since it was decided for the proposition that an employer may sue an employee for negligence."[17]

The *Cahuenga Partners* court was thus unwilling to accept the proposition that a corporate employer may sue its in-house counsel for professional negligence, stating that "Cahuenga offers no reasoned argument why we should interpret the term 'culpable degree of negligence' in Section 2865, for the first time since its enactment in 1937, to include the professional negligence of in-house counsel" and indicating that no other credible authority exists in support of such a position.[18]

Respondeat Superior

Under the well-established doctrine of respondeat superior in the law of agency, the principal (an employer) is responsible for the actions of its agents (employees) in the course of employment. The court in *Harris v. Oro-Dam Constructors*[19] stated that "Although in a sense Respondeat Superior imposes strict liability upon the employer, its foundation is the imputation of the employee's fault to the employer because of the special relationship between them."[20] Citing several cases only one of which was a California appellate decision,[21] the court in *Harris* stated that "activity 'within the scope of employment' is the pivot of the employer's responsibility, but the pivoting action responds to two primary inquiries: (1) the activity's benefit to the employer's enterprise and (2) his right to control it."[22]

It is certainly clear that in-house counsel for a corporation is an employee and agent of that corporate employer, and so long as any wrongful acts by the in-house lawyer occur in the scope of employment, the doctrine of respondeat superior applies and the employer is vicariously liable to third parties harmed by the lawyer's conduct. Relying on this tenet, the *Cahuenga Partners* court concluded that an employer does not have the capacity to and cannot sue its employee in-house counsel for professional negligence, because the doctrine of respondeat superior makes the employer responsible for the negligence of the employee lawyer.

Any analysis of the issue should take into account that there is the ethical prohibition found in Rule 3-400(A) that lawyers may not prospectively limit their liability to the client for malpractice which states that an attorney shall not: "(A) Contract with a client prospectively limiting the member's liability to the client for the member's professional malpractice." However, notwithstanding the fact that there appears to be no liability imposed on in-house counsel for malpractice, in addition to relying on the current legal standards applicable to in-house lawyers, cautious attorneys may seek, in advance, to contractually limit potential exposure to their employer client. While they cannot accomplish this objective by entering into an agreement with their employer client, there may be a way for the in-house lawyer to achieve this additional protection.

Notwithstanding the provisions of Rule 3-400(A) and without violating any duties thereunder, in-house counsel may obtain contractual indemnification from a nonclient, such as an entity or individual affiliated with the employer,[23] but for which the in-house lawyer does not perform any services and has not previously represented in an attorney-client capacity. While this is not a proven method, there seems to be no prohibition.

Under Labor Code Section 2802, an employer is required to indemnify an employee "for all necessary expenditures or losses incurred by the employee in direct consequence of the discharge of his or her duties…including reasonable costs and attorney's fees." However, Section 2802 only applies to general employer-employee relationships and to third-party claims against the employee and has been held not to apply to claims by an employer against its own employees. Therefore, if an employer were to sue an employee attorney for malpractice and the employee is ultimately held liable for malpractice, the employee attorney will not be able to recover for the cost of defending the action brought by the employer. The court in *Cahuenga Partners* rejected the defendant's assertion that she could be indemnified for expenses incurred in a suit her own employer filed against her, although the court found that the employer was responsible to indemnify her for expenses in a third-party suit against her.

In *Nicholas Laboratories, LLC v. Chen,*[24] the court held that Labor Code Section 2802 does not require an employer to reimburse its employee for attorney fees incurred in the employee's successful defense of the employer's action against the employee. After the employer filed a complaint against its employee, the employee responded with a cross-complaint, claiming that he was entitled to indemnification under Section 2802 of the Labor Code for the expenses and attorneys' fees he incurred in defending himself against claims that related to his service as an employee or agent of the employer plaintiff. The court of appeal rejected the employee's rationale for attorney fees, stating "Labor Code 2802 is applicable to third party claims against an employee, but not as to claims by an employer against its own employees."[25] In so ruling, the court of appeal cited *Cassady v. Morgan, Lewis & Bockius LLP,* which held:

> Section 2802…requires an employer to indemnify an employee who is *sued by third persons* for conduct in the course and scope of his or her employment, including paying any judgment entered and attorney's fees and costs

MCLE Test No. 258

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1. An attorney-client relationship is created when a nonattorney employer hires an in-house lawyer.
True.
False.

2. Outside counsel and in-house lawyers are bound by the same fiduciary and ethical duties to their clients.
True.
False.

3. Labor Code Section 2865 provides that employees who are guilty of a culpable degree of negligence are liable to their employers for the damage.
True.
False.

4. Labor Code Section 2865 has been found to support the imposition of malpractice liability on in-house counsel.
True.
False.

5. An employer may not, pursuant to Code of Civil Procedure Section 473, seek relief from a court from a judgment, dismissal, order, or other proceeding taken against it as result of a mistake of its in-house counsel.
True.
False.

6. Liability for the malpractice of an in-house attorney is imputable to the employer of the in-house attorney by virtue of the doctrine of respondeat superior.
True.
False.

7. An outside counsel may not prospectively limit his or her liability to a client for malpractice.
True.
False.

8. An in-house attorney may not prospectively limit his or her liability to a client for malpractice.
True.
False.

9. Labor Code Section 2802 requires an employer to indemnify an employee for necessary expenditures or losses incurred by the employee in direct consequence of the discharge of his or her duties, including reasonable attorney fees and costs.
True.
False.

10. Labor Code Section 2802 has been held to apply to claims by an employer against its own employees.
True.
False.

11. If an employer were to successfully sue an in-house attorney for legal malpractice, Labor Code Section 2802 would allow the employee attorney to recover from the employer the costs of defending the action.
True.
False.

12. Labor Code Section 2802 has been found to require an employer to pay the fees and costs incurred in an employee's affirmative litigation against the employer.
True.
False.

13. An employer may sue an in-house attorney for legal malpractice.
True.
False.

14. Employers generally obtain legal malpractice insurance to protect them from the potential malpractice of their in-house attorneys.
True.
False.

15. Historically, a client's power to discharge an attorney has been absolute.
True.
False.

16. A client's power to discharge an attorney is not subject to any limitation as a matter of public policy.
True.
False.

17. In the context of a wrongful termination of an in-house attorney, a client's power to discharge an attorney is not absolute.
True.
False.

18. An in-house attorney may assert a claim for wrongful discharge against his or her employer based upon his or her status as a whistleblower.
True.
False.

19. A retaliatory discharge claim may be available to in-house attorneys when the ethical norms of the Rules of Professional Conduct conflict with an illegal demand of the attorney's employer.
True.
False.

20. Being a whistleblower automatically absolves an in-house attorney from his or her ethical duty to maintain client confidences.
True.
False.

MCLE Answer Sheet #258

TROUBLE AT HOME

Name _____

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ANSWERS

Mark your answers to the test by checking the appropriate boxes below. Each question has only one answer.

1.	☐ True	☐ False
2.	☐ True	☐ False
3.	☐ True	☐ False
4.	☐ True	☐ False
5.	☐ True	☐ False
6.	☐ True	☐ False
7.	☐ True	☐ False
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9.	☐ True	☐ False
10.	☐ True	☐ False
11.	☐ True	☐ False
12.	☐ True	☐ False
13.	☐ True	☐ False
14.	☐ True	☐ False
15.	☐ True	☐ False
16.	☐ True	☐ False
17.	☐ True	☐ False
18.	☐ True	☐ False
19.	☐ True	☐ False
20.	☐ True	☐ False

> incurred in defending the action.…As long as the employee is acting within the scope of his or her employment, the right to indemnity is not dependent upon a finding that the underlying action was unfounded. [26]

In addressing the employee's argument that statutory indemnification is owed if the employee successfully defends the employer's claim, the court in *Nicholas Laboratories* acknowledged that "[n]o court has directly addressed this precise issue." The court of appeal went on to state that the employee's "interpretation of Section 2802 conflicts with the common understanding of the word 'indemnify' as applied to litigation (i.e. an obligation to pay for judgments suffered and/or expenses incurred in a lawsuit brought by a third party against the indemnitee, not a one-sided attorney fee provision in a dispute between the indemnitor and the indemnitee)."[27]

Two federal cases discussed in *Nicolas Laboratories* come closer than any California case in addressing the issue relating to indemnification by the employer. In the first of these cases, *O'Hara v. Teamsters Union Local No. 856*,[28] employees were successful in their claim for indemnification under Section 2802 for costs in defending a lawsuit by a third party, notwithstanding a cross-claim by the employer seeking indemnification for defending and settling the third-party action on the grounds that the employees' actions had been illegal. The employees also succeeded in obtaining indemnification for fees and expenses incurred in enforcing their claims against the employer. The court in *O'Hara* held that defending against an employer's claim can (at least in some circumstances) provide the basis for indemnification under Section 2802. However, the court in *Nicholas* distinguishes this case because it "involved an underlying third party claim that was the basis for the monetary dispute between the parties over who was required to indemnify whom."[29]

The second federal case, *Freund v. Nycomed Amersham*,[30] held that an employee who

Wrongful Termination of In-House Counsel

IN addition to not being subject to malpractice claims by their clients, in-house lawyers differ from outside lawyers in other respects. As the California Supreme Court observed in 1972 in the case of *Fracasse v. Brent,* "a client should have both the power and the right at any time to discharge his attorney with or without cause."[1] In fact, this is still technically a true statement. However, developments in employment law and the law of public policy have placed limits on a client business's absolute right to discharge its in-house lawyer.

This principle was recognized by the same court in 1994 in its decision in *General Dynamics Corporation v. Superior Court*.[2] The case arose out of the 1991 termination of Andrew Rose, an in-house attorney in the employ of General Dynamics. When Rose sued General Dynamics for wrongful termination, the company demurred, asserting that because Rose had been employed as an in-house attorney he could be fired for any reason or for no reason based upon the principles enunciated in *Fracasse*.[3] When *General Dynamics* came before the court, it acknowledged that the principle it had enunciated 22 years earlier as an absolute in *Fracasse* best fit a traditional form of the attorney-client relationship that was fundamentally different from what existed in the modern world of in-house lawyers. The court reasoned:

> The sources of contract and tort claims in wrongful termination cases are analytically distinct from the circumstances confronting the contingent-fee plaintiff that propelled our analysis in Fracasse. Given these disparate origins, it is unlikely that the client's undoubted power to discharge the attorney at will is one that can be invoked under all circumstances without consequence.[4]

The court recognized that an unqualified immunity from any liability for terminating in-house counsel would be inconsistent with both the implied and in-fact contractual limitations that underlie the principles of wrongful termination law as well as the underlying fundamental public policies that underlie antidiscrimination law and statutory rights to collective bargaining. The *General Dynamics* court concluded that "an in-house attorney may pursue a wrongful discharge claim for damages against his corporate employer *even though* a judgment ordering his reinstatement is *not* an available remedy."[5]

In declaring the right of an employer to terminate in-house counsel at will to be subject to limitations based upon considerations of fundamental public policy, the court stated:

> [T]he in-house professional may be trapped between a laudable desire to further the goals of the client-employer and restrictions on conduct imposed by the ethical norms prescribed by the Rules of Professional Conduct. Of course, the potential for such a dilemma is common to outside counsel as well. But, unlike their in-house counterparts, outside lawyers enjoy a measure of professional distance and economic independence that usually serves to lessen the pressure to bend or ignore professional norms. Here again, the distinguishing feature of the in-house attorney is a virtually complete dependence on the good will and confidence of a single employer to provide livelihood and career success.[6]

By extension, therefore, the court found that the in-house attorney's right to be a whistleblower and to pursue a claim of retaliatory discharge as the circumstances require should be protected if and when an attorney's adherence to his or her professional ethical responsibilities place them at odds with his or her in-house employer.[7]

The court sought to balance the right under common law of an in-house attorney to pursue a claim for wrongful or retaliatory discharge with the professional ethical obligations of an attorney to maintain client confidences. In achieving this balance, the court made it clear that an in-house attorney is not absolved from the ethical obligation to maintain client confidences.

> Except in those rare instances when disclosure is explicitly permitted or mandated by an ethics code provision or statute, it is never the business of the lawyer to disclose publicly the secrets of the client. In any event, where the elements of a wrongful discharge in violation of fundamental public policy claim cannot, for reasons peculiar to the particular case, be fully established without breaching the attorney-client privilege, the suit must be dismissed in the interest of preserving the privilege.[8]

Thus, while public policy may permit in-house attorneys to sue former employers for wrongful discharge, it does not resolve the ethical dilemmas attorneys may face in doing so.**—D.B.P., E.B., & J.A.O.**

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[1] Fracasse v. Brent, 6 Cal. 3d 784, 790-1 (1972).
[2] General Dynamics Corp. v. Superior Court, 7 Cal. 4th 1164 (1994).
[3] Fracasse, 6 Cal. 3d 784 (1972).
[4] General Dynamics, 7 Cal. 4th at 1175.
[5] *Id.* at 1177 (emphasis in original).
[6] *Id.* at 1182.
[7] *Id.* at 1186.
[8] *Id.* at 1190.

successfully sues an employer for wrongful termination is not entitled to recover attorney fees in that action under Section 2802, stating, "As the language of the statute makes clear, [Section] 2802 is designed to indemnify employees for the legal defense costs when they are sued for actions arising out of their employment.…It does not require an employer to pay the fees to support an employee's affirmative litigation against the employer."[31]

The court in *Nicholas* stated that "any interpretation of Section 2802 which would allow the statute to become a unilateral attorney fee statute in litigation between employees and employers would be incompatible with that larger body of law."[32] The court concluded that attorney fees incurred by the employee in defense of an employer's claim do not fall within the domain of Section 2802 of the Labor Code, stating:

> We are not persuaded that the Legislature, in drafting Section 2802, intended to depart from the usual meaning of the word 'indemnify' to address 'first party' disputes between employers and employees. The Legislature could have specifically provided in Section 2802 that attorney fees incurred defending an action by the employer were recoverable by a prevailing employee. The fact that the Legislature did not do so suggests disputes between employers and employees are subject to the ordinary rules applying to the recovery of attorney fees in California litigation.[33]

It is interesting to note that malpractice insurance is not generally available to cover claims by employers for professional negligence against in-house lawyers. Malpractice liability insurance generally covers the negligence of a lawyer to clients and third parties and does not cover intentional torts or punitive damages.[34] Moreover, employment practices liability insurance provides coverage for wrongful acts arising from the employment process, with the most frequent types of claims covered being wrongful termination, discrimination, sexual harassment, and retaliation. Some insurance carriers, such as Chubb, provide a form of employment practices liability insurance for law firms, which offers coverage for punitive damages and claims by partners. It is unclear as to whether the coverage extends to protections for in-house counsel.

Although an attorney-client relationship exists between in-house lawyers and their employers, in which the in-house lawyers owe the same duties to their employers as outside counsel owe to their clients, the few relevant California cases demonstrate that an employer cannot sue its in-house lawyer employee (or other employees) for malpractice negligence arising from the acts or omissions of the in-house lawyer that are within the scope of the lawyer's employment. Furthermore, it appears that employers are not required to indemnify in-house counsel (or other employees) under Section 2802 of the Labor Code for expenses incurred by the in-house lawyer in a suit filed by his or her employer, successful or not. Thus, an employer may not hold its in-house counsel responsible for professional negligence through claims for damage. Instead, employers should look to follow traditional employment-related alternatives to in-house lawyers whose errors cause injury to the employer. ■

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[1] Bus. & Prof. Code §6068(e)(1) imposes the duty on an attorney to "maintain inviolate the confidence, and at every peril to himself or herself to preserve the secrets, of his or her client."
[2] Cal. Rules of Prof'l Conduct R. 3-100.
[3] Cal. Rules of Prof'l Conduct R. 3-310.
[4] Cal. Rules of Prof'l Conduct R. 3-400.
[5] Cal. Rules of Prof'l Conduct R. 3-500.
[6] General Dynamics Corp. v. Superior Court, 7 Cal. 4th 1164 (1994).
[7] Gutierrez v. G & M Oil Co., Inc., 184 Cal. App. 4th 551 (2010).
[8] *Id.* at 559.
[9] PLCM Group v. Drexler, 22 Cal. 4th 1084 (2000).
[10] *Id.* at 1094.
[11] Gutierrez, 184 Cal. App. 4th at 561.
[12] *See* Mallen & Smith, Legal Malpractice §26:8 (2014).
[13] 1538 Cahuenga Partners, LLC v. Jacqueline M. Fabe, et al., No. B222023 (2d Dist., Div. 8 Jan. 5, 2012).
[14] Division of Labor Law Enforcement v. Barnes, 205 Cal. App. 2d 337 (1962); Dahl-Beck Elec. Co. v. Rogge, 275 Cal. App. 2d 893 (1969).
[15] 1538 Cahuenga Partners, LLC v. Jacqueline M. Fabe, et al., 2012 WL 19519, at *16 (2d Dist., Div. 8 Jan. 5, 2012).
[16] *Id.* at *17.
[17] *Id.*
[18] *Id.*
[19] Harris v. Oro-Dam Consts., 269 Cal. App. 2d 911 (1969).
[20] *Id.* at 915.
[21] Standard Oil Co. v. Anderson, 212 U.S. 215, 220-21 (1909); Robinson v. George, 16 Cal. 2d 238, 244 (1940); Gosset v. Simonson, 243 Or. 16, 411 P. 2d 277, 279-82 (1966).
[22] Harris, 269 Cal. App. 2d at 915.
[23] The Fourth District Court of Appeal, in *Brooklyn Navy Yard Congregation Partners, L.P. v. Superior Court,* 60 Cal. App. 4th 248 (1997) confirms the general rule that a corporate affiliate is a distinct entity except in limited circumstances, including those in which one corporation is the alter ego of the other.
[24] Nicholas Labs., LLC v. Chen, 199 Cal. App. 4th 1240 (2011).
[25] *Id.* at 1246.
[26] *Id.* at 1247 (citing and adding emphasis to Cassady v. Morgan, Lewis & Bockius LLP, 145 Cal. App. 4th 220, 230 (2006)).
[27] Nicholas Labs., 199 Cal. App. 4th at 1248.
[28] O'Hara v. Teamsters Union Local No. 856, 151 F. 3d 1152 (1998).
[29] Nicholas Labs., 199 Cal. App. 4th at 1250.
[30] Freund v. Nycomed Amersham, 347 F. 3d 752 (2003).
[31] *Id.* at 766.
[32] Nicholas Labs., 199 Cal. App. 4th at 1251.
[33] *Id.*
[34] *See* Ins. Code §533.