

**DELAWARE STATE BAR ASSOCIATION  
COMMITTEE ON PROFESSIONAL ETHICS**

Opinion 2011-1  
November 16, 2011

This opinion is merely advisory and is not binding on the inquiring attorney or the Court or any other tribunal.

**Nature of the Inquiry**

The inquirer, a Delaware attorney, seeks guidance on the issue of whether, during settlement of a matter, it is ethical for a lawyer to propose, demand, or agree, to personally indemnify or satisfy any and all claims by third persons as to settlement funds.

**Conclusion**

The Committee is of the opinion that any agreement by a lawyer to personally satisfy or indemnify any claims to the settlement funds made by a third party is made in violation of Rules 1.7(a)(2) and 1.8(e) of the Delaware Lawyers' Rules of Professional Conduct ("DLRPC").<sup>1</sup>

**Background Facts**

Lawyers who represent plaintiffs in civil actions, such as personal injury or medical malpractice often represent clients who have incurred substantial medical bills as a result of their injuries. In many cases, a settlement agreement provides an outcome beneficial to both parties.

The settlement funds received by lawyers on behalf of their clients are subject to many considerations, both practical and ethical. It may take months or years to reach settlement and clients may be in dire need of a quick disbursement of funds from the settlement proceeds. Often, under the terms of a settlement agreement, the lawyers' payment for their services on the case will be taken from the settlement funds and the clients must satisfy, by payment in full or in compromise, all valid liens out of the clients' share of the settlement proceeds. In some cases, these third party liens may not yet be known, valid, or identified at the time a settlement

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<sup>1</sup> The Committee is not alone in finding such agreements unethical under one or both of these rules of professional conduct. Advisory opinions from eleven (11) other jurisdictions addressing this issue have also found such agreements to be unethical. *See, e.g.*, Supreme Court of Ohio Board of Comm'rs on Grievances and Discipline Op. 2011-1 (Feb. 11, 2011); Bd. of Prof'l Responsibility of the Supreme Court of Tennessee Formal Ethics Op. No. 2010-F-154 (Sept. 10, 2010); Ass'n of the Bar of the City of New York Comm. on Prof'l and Judicial Ethics Formal Op. 2010-3 (2010); Adv. Comm. of the Supreme Court of Missouri Formal Op.125 (Nov. 13, 2008); Ethics Adv. Comm. of the South Carolina Bar Ethics Adv. Op. 08-07 (Aug. 22, 2008); Illinois State Bar Ass'n Adv. Op. 06-01, 2006 WL 4584284 (July 2006); Arizona Ethics Op. 03-05 (August 2003); Kansas Bar Ass'n Ethics Op. 01-05 (2001); North Carolina State Bar Ass'n Op. 228 (July 26, 1996); Florida Ethics Op. 70-8 (Revised Apr. 23, 1993); State Bar of Wisconsin Formal Ethics Op. E-87-11 (1987); State Bar of California Formal Op. No. 1981-55 (1981).

agreement is reached. However, if a lawyer's client refuses, or is unable to repay a lien (for example, because the client has spent his or her share of the properly distributed settlement funds), it is possible that a lien holder may make a claim, or file suit, against any releasees for payment of such liens. Ordinarily, the recourse of the releasees would be against the claimant who signed the settlement agreement and agreed to indemnify or hold the releasees harmless against any and all liens claims.

The desire of the releasees not to be involved in subsequent litigation over liens after settlement of the underlying claims has increasingly led releasees to request or demand that, in addition to an agreement with the claimant to hold releasees harmless or indemnify them against such claims as a condition of settlement, the claimant's attorney also enter into such an agreement with releasees. These requests present significant problems.

Further complicating the issues, various amendments to the Medicare and Medicaid laws and related regulations of the United States ("US") arguably create new and enhanced rights of the US to have priority in proceeds arising out of a personal injury settlement, and/or to create a lien in those settlement proceeds. *See generally* 42 U.S.C. § 1395; 42 C.F.R. § 411.37 (hereinafter, the "Medicare Amendments").

The Medicare Amendments further impose upon the "primary payer" or "entity that receives payment from a primary payer" an obligation to reimburse the US for any payments made to the claimant upon notice. 42 C.F.R. § 411.22. The genesis for these Medicare Amendments is that the US pays medical bills and related expenses relating to the injury of a claimant, on an upfront and on-going basis. After a pot of money has been created through a personal injury settlement, the US desires to recoup monies it paid to the claimant out of the settlement proceeds.

Therefore, the "primary payer" is often an insurance company. Naturally, an insurance company does not wish to be found liable for a reimbursement obligation to the US, and the various insurance companies who find themselves confronted with this situation have therefore attempted to insulate themselves and/or transfer their obligations by requiring plaintiff's counsel to indemnify the insurance company.

This opinion is intended to address the ethical concerns associated with a lawyer's personal agreement to indemnify. This opinion does not address legal issues involved in the disbursement of settlement funds.

### **Discussion**

Entering into a personal indemnification agreement by a lawyer is, essentially, an agreement by the lawyer to provide financial assistance to the client. The lawyer is undertaking an obligation to pay the client's bills. A lawyer who undertakes an obligation of this nature creates a significant risk that the representation of that client will be materially limited by the lawyer's personal interest, in violation of DLRPC 1.7(a)(2).

Further, an obligation to pay the client's bills is in direct conflict with DLRPC 1.8(e). Because a lawyer would be in violation of the DLRPC if the lawyer entered into a personal indemnification agreement, any proposal or demand made by a lawyer that requires another lawyer to enter into such an agreement would constitute knowing assistance or inducement of a colleague to violate the DLRPC, in violation of DLRPC 8.4(a).

(1) DLRPC 1.7(a)(2)

The mere request that a lawyer agree to indemnify releasees against lien claims creates a potential conflict of interest between the claimant and the claimant's lawyer. A lawyer's refusal to accede to a request for personal indemnification as a condition of settlement may, at best, involve compromise or concessions resulting in the removal of such terms or, at worst, prevent the client from completing a settlement that the client desires. DLRPC 1.7(a)(2) states, in pertinent part, that:

(a) [A] lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if: ... (2) there is a significant risk that the representation of one or more clients will be materially limited ... by a personal interest of the lawyer.

If a lawyer's personal indemnification is required as a condition of settlement, a lawyer may, for example, recommend that the client reject an offer that may be in the client's best interest, because it would potentially expose the lawyer to liability for hundreds of thousands of dollars in lien expenses, or the litigation costs associated with those expenses. In such a case, any required or requested personal indemnification from the lawyer as a condition of settlement creates a significant risk of material limitation of the representation of the client.

If a client explicitly wishes to settle the case for a certain amount and the lawyer's personal indemnification is a condition of settlement a direct conflict of interest arises. Under DLRPC 1.2(a), "A lawyer shall abide by a client's decision whether to settle a matter." Therefore, once a client has decided to settle a case, the lawyer has a professional obligation to effectuate that goal. Any reluctance to incur personal liability, or concessions made to avoid potential personal liability, will conflict with the lawyer's professional obligation to complete the settlement as directed by the client.

The Committee recognizes that DLRPC 1.7(b) provides exceptions to DLRPC 1.7(a)(2). However, even if a situation arises in which the significant risk of a conflict of interest under DLRPC 1.7(a)(2) can be ameliorated, an agreement that contains a lawyer's personal indemnification would still be in violation of DLRPC 1.8.

(2) DLRPC 1.8(e)

Delaware lawyers are expressly prohibited from providing this type of financial assistance to their clients. DLRCPC 1.8(e) states:

A lawyer shall not provide financial assistance to a client in connection with pending or contemplated litigation, except that: (1) a lawyer may advance court costs and expenses of litigations, the repayment of which may be contingent on the outcome of the matter; and (2) a lawyer representing an indigent client may pay court costs and expenses of litigation on behalf of the client.<sup>2</sup>

Since, under DLRC 1.8(e), a Delaware lawyer may not provide financial assistance to a client by paying, or advancing, the client's medical expenses before or during litigation, a Delaware lawyer may not agree, voluntarily or at the client's or releasee's insistence, to guarantee, or otherwise accept ultimate liability for, the payment of those expenses. Any insistence on the part of a client that the lawyer accept a settlement offer containing such a condition would also therefore require the lawyer to withdraw from representation, because any such insistence would put the lawyer in violation of DLRC 1.16(a)(1), which states, in pertinent part, that, "a lawyer shall not represent a client, or, where representation has commenced, shall withdraw from the representation of a client if... the representation will result in violation of the rules of professional conduct...."

(3) DLRPC 1.15

Rule 1.15, Safekeeping property, states as follows:

"(a) A lawyer shall hold property of clients or third persons that is in a lawyer's possession in connection with a representation separate from the lawyer's own property. Funds shall be kept in a separate account maintained in the state where the lawyer's office is situated, or elsewhere with the consent of the client or third person. Funds of the lawyer that are reasonably sufficient to pay bank charges may be deposited therein; however, such amount may not exceed \$500 and must be separately stated and accounted for in the same manner as clients' funds deposited therein. Other property shall be identified as such and appropriately safeguarded. Complete records of such account funds and other property shall be kept by the lawyer and shall be preserved for a period of five years after the completion of the events that they record."

While the decisional case law may not be entirely uniform, there is substantial legal precedent for the proposition that a lawyer is liable for wrongful release of settlement proceeds under certain factual circumstances, whether pursuant to Rule 1.15 or general principles of breach of fiduciary duty. See e.g., *Western States Insurance Co. v. Olivero*, 283 Ill. App. 3d 307, 670 N.E.2d 333 (3d Dist. 1996) (plaintiff's lawyer directly liable to third party subrogation claimant where lawyer wrongfully released funds); *Aetna Cas. & Sur. Co. v. Gilreath*, 625 S.W. 2d 269, 274 (Tenn. 1981) (lawyer civilly liable to a non-client where he delivers to his client funds that he knows belong to a third party); *Greenwood Mills, Inc. v. Burris*, 130 F.Supp.2d 949 (Dist. Central Tenn. 2001); *Accord* IL. Adv. Op. 06-01, 2006 WL 4584284 (lawyer representing a plaintiff is ethically obligated to identify funds due to a lien or subrogation claimant and to

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<sup>2</sup> There are two narrow exceptions to DLRPC 1.8(e), neither of which is implicated when an attorney enters into a personal indemnification agreement

ensure that those funds are properly paid); City of New York Committee on Professional and Judicial Ethics, Opinion 2010-3 (similar ruling).

The Medicare Amendments and Rule 1.15 provide the legal/factual context in which the Delaware attorney contacted the Committee for an opinion. Indeed, certain of the advisory opinions cited in footnote 1 of the Opinion apply the Rules of Professional Conduct in this specific context. It is therefore important to observe that nothing in the Opinion should be construed to derogate from the lawyer's obligations under Rule 1.15(a) or other subsections of Rule 1.15 with respect to third parties. Notwithstanding the lack of a written indemnification agreement, a Delaware attorney may still be liable for wrongful disbursement of funds.