Control of Settlement by Third Party Paying the Lawyer’s Fees

By the NHBA Ethics Committee
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The Ethics Committee received an inquiry from an attorney who is a member of a law firm which has been approached by a labor union. A member of the union is becoming involved in litigation in which the union does not have a direct interest, but which the union feels may establish a legal precedent which could be of broad interest to its membership. Accordingly, the union wishes to pay for the inquiring attorney to represent the individual member in this litigation. The union recognizes, however, that it may expend a substantial amount of money for this representation and end up not with a final judicial determination of precedential value to the union’s membership but with a prejudgment settlement favorable only to the individual member. The union, therefore, proposes conditioning its payment for legal services by either requiring that the case may not be resolved by the member without the union’s prior permission or that the member be required to reimburse the union for all legal expenses incurred if the matter is settled prior to final judicial resolution. This article addresses the issues raised by this inquiry, as well as the broader issues raised by the analogous insurance defense context.

Subject to the specific conditions set forth in New Hampshire Rules of Professional Conduct Rules 1.8(f) and 5.4(c), a lawyer may accept compensation from an individual or entity other than the lawyer’s client for provision of legal services to the client. Rules 1.8(f) and 5.4(c). Such third party payors have traditionally included insurers, providers of pre-paid legal services, employers, and unions. Rule 1.8(f) provides:

A lawyer shall not accept compensation for representing a client from one other than the client unless:
(1) the client consents after consultation;
(2) there is no interference with the lawyer’s independence of professional judgment or with the client-lawyer relationship; and
(3) information relating to representation of a client is protected as required by Rule 1.6.

Rule 5.4(c) provides:

A lawyer shall not permit a person who recommends, employs, or pays him or her to render legal services for another to direct or regulate his or her professional judgment in rendering such legal services.

This Committee has previously stated on a number of occasions that, subject to the specific requirements set forth in Rules 1.8(f)(1) through (3) and 5.4(c), the payment by one individual or entity for legal services provided to another individual or entity is permissible. E.g., New Hampshire Ethics Opinions Annotated 1985-86/3 and 1990-91/5 (payment by insurer for representation of the insured); New Hampshire Ethics Opinions Annotated 1988-89/17 (payment by a pre-paid legal services program for legal services provided to a program participant); New Hampshire Ethics Opinions Annotated 1991-92/9 (payment by a nonprofit corporation for representation of individual members of the corporation); and New Hampshire Ethics Opinions Annotated 1989-90/9 (concerning lawyer employee leasing).

Under all such Rule 1.8(f) and 5.4(c) arrangements, it is generally the person who is receiving the lawyer’s services who is the lawyer’s client and not the individual or entity paying for those services, and the allegiances and duties required not only by Rule 1.8(f) and 5.4(c) but by all of the Rules of Professional Conduct are owed to that client. E.g., New Hampshire Ethics Opinions Annotated 1990-91/5; 1991-92/9; 1989-90/9; ABA Formal opinion 282 (1950); Wolfram, Modern Legal Ethics § 8.8.2, pp. 444 (1986).

In general, the payment by an organization such as a union to a lawyer to represent one of its individual members in litigation is permissible as long as the member consents after consultation, there is no interference with the lawyer’s independence of professional judgment or with the lawyer’s attorney-client relationship with the member, client confidences are protected as required by Rule 1.6, and all other applicable rules governing the attorney-client relationship are adhered to. Rules 1.8(f) and 1.2(a). Thus, while the Rules of Professional Conduct do not preclude the ability of a client to contract with another for payment of legal fees, they do prohibit the lawyer from undertaking representation of that client where to do so would result in a violation of
these mandates. It should be noted that it would be difficult for a lawyer to accept representation if he/she intended to represent the union or unrelated matters simultaneously with representation of the union member. This would create the potential for serious conflict.

In the inquiry received by the Committee, one of the union’s proposals was that it enter into a contract with the member to pay the member’s legal fees. It is proposed that the contract between the union and its member would require the member to reimburse the union for legal fees expended if the member elected to settle the litigation prior to final judicial determination. The Committee believes that, as long as such a contractual arrangement for payment of legal fees between a third party and the client is reached prior to the commencement of the lawyer’s representation and does not involve the lawyer as a party to that contract, the lawyer is not prohibited from undertaking the representation. As a matter of contract, the agreement to repay legal fees to the third party if the client, against the wishes of the third party, chooses to settle is not prohibited by the Rules of Professional Conduct. Of course, the lawyers agreement to provide legal services is subject to the Rules of Professional Conduct.

A more difficult question is presented by the other possible arrangement set forth in the pending inquiry. The inquiring attorney has asked if it would be permissible for the union to impose a condition that the union’s prior approval must be obtained before the litigation may be settled.

This Committee has previously concluded that an attorney should reject a conditional offer of payment by a third party and accept a fee from that third party “only if it is paid unconditionally” and of Rule 1.8(f) is honored in all respects. New Hampshire Ethics Opinions Annotated 1985-86/4. That opinion involved the husband in a divorce action who wished to pay the legal fees of the wife on condition that the wife and the wife’s attorney turn over all documents in their possession or control concerning the husband’s business affairs. The Committee concluded that the attorney should reject such a conditional offer of payment and accept payment of the fee by the husband only if made unconditionally and otherwise in conformity with Rule 1.8(f).

The condition proposed by the union, which would require the client to gain the permission of the third party paying the client’s legal fees before settling the client’s litigation, must be considered carefully because of the prohibition of Rules 1.8(f) and 5.4(c), and Rules 1.2(a) (client controls representation), 1.7(b) (representation may not be limited by responsibility to a third party), and 2.1 (lawyer shall exercise independent professional judgment). While the mere substitution of the decision making authority of the third party for that of the client is not prohibited by the Rules (consider, for example, the common insurance provision which authorizes the insurer to control litigation strategy), the condition cannot be such that it infringes on the lawyer’s independent judgment. If a condition, such as proposed by the union here, is to be used, the lawyer who is to represent the member should not be involved in the negotiation of the agreement with respect to the condition, and must remain independent of the union. Conditions which would interfere with the lawyer’s independent professional judgment and/or the attorney-client relationship would be in direct violation of Rules 1.8(f) and 5.4(c).

**Insurance Carrier as Payor**

In the insurance context, the insurance contract usually provides that the carrier pays legal fees of the insured under the duty to defend clause of the applicable policy. Insurance defense counsel are usually retained from a panel of defense counsel used on a regular basis by the carrier. Because of the existing relationship between the carrier and defense counsel, an ethical issue arises because of counsel’s own interest in retaining the carrier’s good will. In addition, confusion is sometimes caused by common, but imprecise statements of lawyers to the effect that the lawyer “represents” the insurance company.


Payment of fees by the carrier does not violate Rule 1.8(f) so long as the three conditions contained in the rule are met. of these, the critical condition will usually be the second, “no interference with the lawyer’s
independence of professional judgment or with the client-lawyer relationship.”

A lawyer shall not represent a client if the representation of that client may be materially limited . . . by the lawyer’s own interests, [subject to certain consent limitation].

There are some situations in which, because of the lawyer’s desire to maintain the carrier’s good will, the representation of an insured could be materially limited by the lawyer’s relationship to the insurer. These would include: (a) defense under a reservation of rights, (b) defense of alternate claims one with coverage and one without coverage, (c) defense of claims in excess of the policy limits, and (d) defense of multiple insureds. Where such a “material limitation” exists, the lawyer should avoid the conflict by declining the representation or expressly limiting the scope of his representation. For example, the lawyer should avoid becoming involved in coverage discussions and leave resolution of such problems to others. Such limitation of representation is permitted under Rule 1.2 if the client consents after consultation. Often, insureds will obtain separate counsel for these excluded conflict situations.

Occasionally, circumstances may arise where there is a dispute between the insurer and the insured on settlement or litigation strategy. In such circumstances, the defense lawyer must maintain his independent advice to the insured. If he/she is unable to do so because of his relationship with the carrier, the lawyer should withdraw from representation. Of course, the lawyer is precluded from representing the carrier adversely to the insured. *State Farm Mutual v. Armstrong Extinguisher Service, Inc.* 791 F. Supp. 799 (D.S.D. 1992).

With respect to settlement issues, because a carrier is obligated to consider settlement offers in good faith, and good faith may require review of trial counsel’s analysis of the merits of the case, carriers frequently ask for counsel’s evaluation. Since the carrier’s and insured’s interests in settlement may be conflicting, the giving of such an opinion also has the potential for being a conflict situation. However, the Committee believes that the rendering of a sincere analysis and evaluation is proper, and is not different from a lawyer’s duty to do so in any other case. Counsel has the duty to inform and consult with the insurer in a timely manner on all matters relating to the action except for privileged matters which might be relevant to coverage disputes. See *Employers Insurance of Wausau v. Seeno Construction Co.* 692 F.Supp. 1150 (N.O. Cal. 1986) aff’d 945 F2d 284 (9th Cir. 1991) for an analysis of the role of independent counsel. The Committee believes this function is within the rules so long as the lawyer’s interest does not “materially limit” the representation under Rule 1.7.

In conclusion, any situation where control of litigation decisions rests with a third party (one other than the client or lawyer) presents the potential for conflicts and breaches of the Rules of Professional Conduct. Accordingly, agreements which allocate control of litigation decisions must be drafted with these conflicts and the proscriptions of the Rules in mind. The representation of each party by a lawyer (other than the lawyer retained to litigate the matter) in the negotiation of the agreement is recommended.

**Endnotes**

1. In the now famous *Cumis* decision, the California Supreme Court established that in a conflict situation, such as defense under a reservation of rights, the insurer must provide independent counsel to represent the insured. *San Diego Navy Federal Credit Union v. Cumis Insurance Society Inc.* 162 Cal. App. 3d 358, 208 Cal. Rpt 494 (1984). The obligation to provide independent counsel in conflict situations has since been codified in California Civil Code Title 13.5 §2860.