

KENTUCKY BAR ASSOCIATION
Ethics Opinion KBA E-368
Issued: July 1994

Since the adoption of the Rules of Professional Conduct in 1990, the Kentucky Supreme Court has adopted various amendments, and made substantial revisions in 2009. For example, this opinion refers to Rule 1.7 and the comments, which were amended and renumbered. Lawyers should consult the current version of the rules and comments, SCR 3.130 (available at <http://www.kybar.org>), before relying on this opinion.

Background: Insurers have attempted to institute a number of measures to “control costs.” In some states insurers have attempted to provide defense services directly through salaried lawyer-employees. This is not permitted in Kentucky, for in addition to the obvious conflicts of interest that would be presented by such an arrangement, the practice would violate the law governing unauthorized practice. See KBA U-36; Tenn. Op. 93-F-132; Gardner v. NC State Bar, 341 S.E.2d 517 (1986). Insurers have also attempted to “restrict the budget” for the defense of insured clients. In E-331 (1988) we noted how such limitations could result in ethical problems for the lawyer, and unfairly impact the insured. Compare Bevevino v. Saydjari, 76 F.R.D. 88 (S.D.N.Y. 1977), aff’d 574 F.2d 676 (2d Cir. 1978). We also discussed contingent fees for defense counsel in civil cases in E-359, and approved of the concept with some caveats. This brings us to the latest question of this genre, to-wit:

Questions: (1) May a lawyer enter into a contract with a liability insurer in which the lawyer or his firm agrees to do all of the insurer’s defense work for a set fee. (2) Regardless of the answer to the first question, may the lawyer agree to accept cases from the insurer with the understanding that the attorney will be responsible for all expenses of litigation (experts, court reporters, etc.) without expectation of reimbursement from the insurer.

Answer: No to both questions.

References: Rules 1.7(b) and 1.8(e), (f), and (j); KBA Es-331, 340 and 342.

OPINION

Rule 1.7(b) provides that “[a] lawyer shall not represent a client if the representation of that client may be materially limited by the lawyer’s responsibilities to another client or to a third person, or by the lawyer’s own interests, unless: (1) the lawyer reasonably believes the representation will not be adversely affected; and (2) the client consents after consultation.”

We reiterate our view that the insured is defense counsel’s clients, and not the insurer. See KBA Es-331 and 340. Cf. Rule 1.7 Comment (9). We emphasize the fact that this is not a case in which a lawyer is striking a bargain or reaching an agreement with a particular client

regarding a particular case, cases or body of work. Furthermore, we start with the proposition that the lawyer's duty to the insured client arises from the attorney-client relationship. It is not governed by or limited by the terms of the insurance contract.

Rule 1.8(f)(2) provides that “[a] lawyer shall not accept compensation for representing a client from one other than the client unless... [among other things, the client consents and]...there is no interference with the lawyer's independence of professional judgment or with the lawyer-client relationship.”

It is not clear from the question whether the lawyer is being asked to take all of an “insurer's” cases in a given geographical area for a fixed sum, or whether the fixed fee is a maximum amount payable for each case referred to the lawyer by the insurer regardless of its complexity or the needs of the particular insured client. However, we need not chase after possible variations, for in either case we gather that the arrangement between the lawyer and insurer would be made without the consent of the insured and give rise to the following ethical concerns.

The obligation to defend is an independent duty or promise of the insurer under the insurance contract. See Grimes v. Nationwide, 705 S.W.2d 926 (Ky. APP 1985). Yet, here the insurer wants to continue to promise the insured a defense in the contract of insurance, while limiting the extent of its undertaking in a side contract between the insured's lawyer and the insurer to which the insured is not a party. Compare E-331 (1988). Furthermore, the lawyer is placed, by the insurer (a third person paying for the lawyer's services), in a position of conflict vis-a-vis the insured client. To some extent the lawyer becomes the insurer; and lawyer stands to gain by limiting the services rendered to the client. See Rules 1.1 and 1.2, as well Rule 1.7(b). Admittedly, a potential for similar conflict is inherent in other lawyer-client arrangements; but here the insured client will have no control over the choices that will be made.

The same concerns loom large when we consider the second question. The insurer (purporting to stand in the shoes of the client insured) is requiring the lawyer to absorb litigation expenses in every case, as a condition of employment - to advance litigation expenses without the insurer having any liability to repay these advances under any circumstances. In a sense, the insurer is requiring the lawyer to buy the client's legal work, and buy a position in the litigation adverse to the interests of the client. The lawyer will earn a fee or not, or the size of the fee will be affected, depending on the lawyer's ability to cut costs. This is the same problem we encountered in E-331 (limited budget for the defense presenting ethical concerns). Furthermore, we have refused to approve of similar arrangements in other contexts under well understood rules precluding the lawyer from obtaining a prohibited interest in a litigation. See, Rule 1.8 (e) and (j), and E-342 (1990) (a lawyer may not agree to take a commercial creditor's collection cases on a contingent fee basis with the understanding that the lawyer will absorb the litigation expenses in every case, regardless of the outcome of the case, as this would violate Rules 1.8(e) and (j)). We are unwilling to make an exception for insurance companies.

Note to Reader

This ethics opinion has been formally adopted by the Board of Governors of the Kentucky Bar Association under the provisions of Kentucky Supreme Court Rule 3.530 (or its predecessor rule). The Rule provides that formal opinions are advisory only.