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BD&J

Journal of Consumer Attorneys Associations for Southern California
ADVOCATE

October 2021



Emerging ethical considerations with indemnification and liquidated-damages clauses in PI settlement agreements

THINK TWICE ABOUT SIGNING RELEASES IN SETTLEMENT AGREEMENTS THAT INCLUDE LIQUIDATED DAMAGES OR INDEMNIFICATION PROVISIONS

The Los Angeles County Bar Association's Professional Responsibility and Ethics Committee Ethics Opinion Number 532 is an important decision that will influence the way we practice law. As explained below, plaintiff's attorneys must practice due caution when signing releases, especially those including indemnity or liquidated damages provisions.

Medical treatment and right to reimbursement

Plaintiffs in personal-injury cases often seek medical treatment on a lien basis, or otherwise seek financial assistance from

third parties to provide medical services. These third parties may include Medicare, Medi-Cal, Medicaid, ERISA plans, workers' compensation carriers or other private healthcare-insurance providers. These providers, accordingly, have claims to repayment of those obligations from any settlement or judgment the plaintiff receives. Consequently, after a personal-injury case concludes and the plaintiff is awarded compensation, these third-party providers may assert a statutory or contractual right of reimbursement claim if payment is not received.

In many cases, an indemnification provision is standard and relatively

innocuous in a release – provided *only the plaintiff* agrees to indemnify the opposing party. Recently, however, there has been an emerging trend in personal-injury litigation where the releasees are now requiring that *plaintiff's counsel* directly indemnify the defendant(s) and their representatives against any and all potential claims or actions brought against them by third parties (e.g., Medi-Cal, Medicare, Medicaid) related to recovery on a lien after the underlying case concludes.

As a prophylactic measure to shield themselves from liability and mitigate risk of any post-settlement claims for

reimbursement, defense attorneys and/or insurance company representatives often include a provision in the settlement-and-release agreement requiring that both the plaintiff *and* the plaintiff's counsel indemnify them in the event of such third-party reimbursement claims. Defendants and their representatives recognize that, as a general rule of practice, plaintiffs' lawyers are a more reliable and viable source of indemnity relative to their clients.

This inclusion of indemnity provision requiring plaintiffs' lawyers to indemnify defendants against third-party reimbursement claims has generated a wealth of ethical considerations that we, as plaintiffs' attorneys, must be mindful of when closing out our cases. In short, plaintiffs' lawyers should refrain from entering into indemnity agreements because every ethics committee that has taken up the issue has found that this practice violates myriad rules of professional conduct.

Indemnity as a condition of settlement

As stated above, settlement-and-release agreements regularly include indemnification clauses, confidentiality clauses, and liquidated-damages clauses in addition to other provisions. Indemnity clauses are provisions in the release that discharge a party from liabilities or consequences stemming from some specified actions (or inaction) of the other party or parties.

From the plaintiff's point of view, unless there is a compelling reason to provide indemnity, most plaintiffs would be better served to sidestep the issue altogether. However, in today's climate, it seems as if indemnification clauses are part and parcel of personal-injury settlement-and-release agreements. But before indiscriminately agreeing to an overly broad and all-inclusive indemnity provision, a plaintiff (and his or her counsel) would be wise to ensure the following items of concern are properly addressed:

1. Reasonable cap on the coverage level of the indemnity;

2. Narrow the scope to only those damages arising from the occurrence at issue;
3. Narrow the scope to only those damages arising by or through the plaintiff.

From the defense perspective, there is a logical and compelling interest in ensuring that a resolution of a case is full and final, and that the defendant(s) will not be subject to later claims or legal action stemming from the underlying settled matter. Practically speaking, with hospital liens, Medicare, Medicaid and other medical liens potentially implicated in personal injury cases, defense counsel will almost certainly require that an indemnification provision be included in any settlement and release agreement.

Agree to disagree?

The real conundrum exists, in large part, because many releases require an indemnity by plaintiff's counsel on behalf of the plaintiff for any future liability due to claims made by Medicare, Medicaid, an ERISA plan or other private health insurer from reimbursement. The reason for inclusion is that the defendant or the insurer "do not want to be exposed to lien or subrogation claims made after a settlement is seemingly concluded." (Douglas R. Richmond, *Indemnification Provisions in Personal Injury Settlement Agreements as Ethics Traps*, <https://news.bloomberglaw.com/us-law-week/indemnification-provisions-in-personal-injury-settlement-agreements-as-ethics-traps> (Nov. 2012).)

The inclusion of these sweeping indemnification clauses in personal-injury releases raises some important and often overlooked issues that plaintiff's attorneys must now address.

1. First, in reaching a settlement in a personal-injury action, can plaintiffs' attorneys agree to defend and indemnify the other party and their representatives from claims brought against them by third parties for failure to satisfy outstanding lien obligations or otherwise reimburse

third parties for medical services rendered in connection with the personal injury matter?

2. On the other side of the coin, the issue is, is it ethical and proper for defense counsel or the defendant's insurance representative to require that plaintiffs' counsel agree to indemnify the defendant against claims made by third parties such as Medicare, Medicaid, Medi-CAL and other health insurance providers for reimbursement.

Notwithstanding the fact that plaintiff's counsel is not a party to the personal-injury lawsuit, it would behoove plaintiffs' counsel to avoid signing releases altogether, especially those where he or she is agreeing to an indemnity. Simply put, a lawyer or law firm that personally signs an indemnity is taking on a liability for the plaintiff that almost certainly violates California State Bar Ethics Rules prohibiting a lawyer from providing financial assistance to his or client.

California Rule of Professional Conduct, rule 1.8.5

Rule 1.8.5 of the California Rules of Professional Conduct ("CRC") is instructive on whether or not a plaintiff's lawyer is permitted to offer financial assistance to a client through an indemnification agreement.

Rule 1.8.5(a) says, "A lawyer shall not directly or *indirectly* pay or agree to pay, guarantee, or represent that the lawyer or lawyer's law firm will pay the personal or business expenses of a prospective or existing client." (Emphasis added.)

In the context of an indemnification provision that ensures that a lawyer or law firm will defend and indemnify the other party and/or its representatives from claims brought by third parties related to reimbursement for medical services rendered, it can conceivably (and persuasively) be argued that by

making this assurance, plaintiff's counsel has improperly provided financial assistance to a client – albeit indirectly.

A brief examination of nationwide ethics opinions reveals that “[e]very state ethics board considering the issue has found that it violates multiple Rules of Professional Conduct for a plaintiff’s lawyer to agree to indemnify the defendant’s insurer against debts that are owed by the plaintiff or to be paid from the settlement proceeds.” (Edward E. Robinson & Sarah F. Kaas, *Medicare Liens and the Ethics of Attorney Indemnification*, *The Prairie Barrister*, Vol 19, No. 3 (2013).)

With respect to the indemnification provisions discussed herein, an attorney’s guarantee of indemnity would act to establish a financial interest between the attorney and client that reaches beyond the scope of payment of attorney’s fees or reimbursement of costs associated with advancing the case, and would effectively be providing Plaintiff a credit – the very type of financial assistance contemplated and prohibited by CRC rule 1.8.5.

California Rule of Professional Conduct rules 1.7(b) and 2.1

Further adding to the complexity, an agreement by plaintiff’s counsel to provide indemnity may result in a direct conflict of interest between plaintiff and plaintiff’s counsel. Rule 1.7(b) forbids a lawyer from representing a client “if there is a significant risk the lawyer’s representation of the client will be materially limited by the lawyer’s responsibilities to or relationships with another client, a former client or a third person, or by the lawyer’s own interests.” (Emphasis added).

Read in conjunction with CRC rule 2.1 which requires that in

representing a client, “a lawyer shall exercise independent professional judgment and render candid advice,” CRC rules 1.7(b) and 2.1 can be read to forbid an attorney from agreeing to enter into the indemnification agreement because it creates or could create an actual conflict between the attorney’s interests and the interests of his or her client.

If entering the agreement to indemnify would create an inherent conflict and thus compromise the attorney’s independent professional judgment as articulated in CRC rule 2.1, then the lawyer cannot ethically proceed with that course of action.

California State Bar rule 8.4

While we have thoroughly examined a plaintiff’s lawyer’s inability to agree to an indemnity provision in a personal injury action, defense counsel should also be keenly aware of the potential ethical implications in requiring indemnity clauses in a settlement and release agreements.

California State Bar rule 8.4(a) establishes that it is professional misconduct for a lawyer to “violate these rules, the Star Bar Act, knowingly assist, solicit, or *induce another to do so*, or do so through the acts of another.” (Emphasis added.) As we have already discussed, a plaintiff’s lawyer’s agreement to indemnify under the facts and circumstances contemplated herein would be violative of CRC rules 1.7(b), 1.8.5 and 2.1, and potentially various other rules of professional conduct. As such, per the plain reading of State Bar rule 8.4(a), a defense lawyer who proposes the indemnity language in the release or requires that a plaintiff’s lawyer sign such an indemnity agreement would seemingly violate California State Bar rule 8.4(a), which prohibits a lawyer from soliciting or inducing a violation of the rules of Professional Conduct or the State Bar Act.

LACBA Professional Responsibility and Ethic Committee Opinion No. 352 conclusions

The Los Angeles County Bar Association Professional Responsibility and Ethics Committee has categorically and unequivocally opined that indemnification provisions requiring a plaintiff’s counsel and/or law firm to indemnify the other party against such claims for lien recovery are unethical and, ultimately, sanctionable.

In its summary the Committee’s Opinion No. 532 reasoned:

1. Plaintiff’s counsel in a personal-injury action may not enter into an agreement to defend and indemnify defendants, defense counsel or their liability insurers against an action brought against them by third parties such as Medicare or health insurers, to recover a debt plaintiff may owe the third parties. First, such an agreement is prohibited as an improper payment of the client’s personal and business expenses under rule 1.8.5(a). Second, such an agreement would create a conflict of interest between the lawyer and the client by compromising the lawyer’s exercise of independent professional judgment and, even if the lawyer nevertheless could continue the representation under rule 1.7(b), the lawyer would remain barred from agreeing to indemnify by rule 1.8.5(a). Third, rule 1.16 (a)(2) would require the lawyer to withdraw if the client were to demand that the lawyer provide the indemnification.
2. Because plaintiff’s counsel’s agreement to such an arrangement would violate the rules of professional conduct, defendant’s counsel’s demand that plaintiff’s counsel agree to indemnify defendants and their agents would violate rule 8.4(a), which prohibits a lawyer from soliciting or inducing a violation of the Rule of Professional Conduct for the State Bar Act. (Los

Angeles County Bar Association Professional Responsibility and Ethics Committee, Opinion No. 532, p.1 (Dec. 2019).)

Liquidated-damages clauses – silence is golden

Although appearing less frequently than indemnification clauses, liquidated-damages clauses are also starting to be frequently included in personal-injury settlement-and-release agreements. A liquidated-damages clause is a provision wherein the parties to a contract agree, in advance, on the amount of damages that one party will receive in the event of a breach of the contract. When crafted and deployed properly, these liquidated-damages provisions can serve valuable purposes – namely, ensuring confidentiality and complete adherence to the terms of the agreement.

In many situations, defense counsel will include a provision for liquidated damages for a breach of confidentiality and/or non-disparagement on the part of the plaintiff. From the plaintiff's vantage point, there is little to no incentive to agreeing to confidentiality or non-disparagement language in a release, but nevertheless, it is often included in a personal-injury settlement-and-release agreement as a non-negotiable, "make it or break it" proviso.

From the defense counsel's perspective, many corporate defendants steadfastly contend that confidentiality clauses are inextricable parts of the settlement agreement as they protect private facts, trade secrets or nuanced aspects of their company's internal business operations from being disclosed to the public, and in turn, harming or compromising the integrity of their businesses. Whatever side of the seat that you sit on, it is clear that liquidated-damages clauses are inserted as an incentive to keep the plaintiff silent regarding the material terms of the agreement and, further, as a protective measure to guard the defendant from disclosure of potentially embarrassing or harmful information.

Civil Code section 1671 generally provides that contractual liquidated-damages provisions are unenforceable if the terms do not reflect a reasonable estimate of the potential future damages under the circumstances that existed at the time the contract was formed. Additionally, California courts have routinely held that a liquidated-damages clause is an unenforceable penalty unless: (1) the harm caused by the breach is not capable of sufficient estimation; and (2) the amount of liquidated damages put forth is a reasonable forecast of just and conscionable compensation. If a liquidated-damages provision is disproportionate to the anticipated damages and is nothing more than a penalty whose primary objective is to secure performance of the contract in and of itself, it would almost certainly be adjudged as unenforceable. (Michael R. Farrell, *The National Law Review: Accession When a Discounted Payoff Agreement Becomes and Unenforceable Penalty*, <https://www.natlawreview.com/article/assessing-when-discounted-payoff-agreement-becomes-unenforceable-penalty> (March 2019).)

While liquidated-damages clauses are becoming in vogue in the context of personal-injury cases, it is hard to imagine a real-life situation where a liquidated-damages provision as part of a personal-injury settlement release would be appropriate, and ultimately, enforceable. This is especially true since courts have routinely recognized the difficulty in measuring damages for failing to honor a confidentiality agreement. (See, e.g., *Crowne Investments, Inc. v. United Food and Commercial Workers* (M.D. Ala. 1997) 959 F.Supp. 1473, 1480.)

Attorney signature spaces

Once again, prudent plaintiff's lawyers should refrain from being a signatory to the settlement-and-release agreement altogether. In practice, however, I have encountered countless settlement-and-release drafts with a signature space reserved for plaintiffs' counsel. While I have witnessed plenty

of attorneys sign the releases without hesitation or protest, I would consider this poor practice, and at a minimum, an attorney should consult with ethics counsel before placing his or her "John Hancock" on any settlement agreement.

Although many defense counsel offer pushback in this respect, there is virtually no legally grounded justification for requiring a lawyer to sign a release in connection with representing a plaintiff in a personal-injury action. The plaintiff's attorney was hired to handle the *plaintiff's case*, and any resolution of the matter is between the litigants and/or opposing parties. Generally, the attorneys are not parties to the case nor are they receiving any compensation delineated in the settlement agreement. As such, plaintiffs' attorneys should insist that the reserved signature space be omitted from the agreement altogether.

This holds true even if an attorney is signing the release solely as to "form and content." Although an attorney may attempt to approve the release as to form and content only, the attorney may still be held liable for numerous State Bar violations. For example, in *Monster Energy Co. v. Schechter* (2019) 7 Cal.5th 781, the California Supreme Court held that counsel's signature approving a settlement agreement, even exclusively as to form and content, still leaves the possibility that the attorney or law firm may be bound by *all of the terms* of the release, including any confidentiality, liquidated damages, and indemnification clauses. If the parties make the intent clear in the language of the agreement that the attorneys should be bound by the terms of the release as well, then signing even as to form and content is sufficient to approving the entire agreement which, in turn, would bind the attorney to all the terms specified in the settlement and release agreement.

Conclusion

Getting a draft of a settlement-and-release agreement in your inbox should bring about a sigh of relief because the

case is nearing the finish line. But signing a poorly drafted release agreement could actually signal the very beginning of protracted and costly legal battles and professional-responsibility challenges.

As a practice pointer, plaintiffs' attorneys should altogether refuse to sign settlement-and-release agreements unless

there is a compelling or other legally justifiable reason to do so. Defense counsel should also be leery of initiating the discussion and leave it to the actual parties to the action to resolve the disputes between or among themselves. There are plenty of other worthwhile battles to fight.

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