# INSURER LITIGATION MANAGEMENT AND BILLING GUIDELINES

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## 1. Introduction

Once upon a time lawyers and insurance companies enjoyed a symbiotic relationship. Insurance defense work was the life blood of many law firms. In turn insurance companies depended on stable connections with a handful of trusted firms to defend their insureds. Defense lawyers and adjusters shared a goal of managing each case to a successful conclusion for the insured, whether by settlement or trial. Defense lawyers took necessary actions in the legal arena, always keeping in mind the economics of each case. Adjusters were intimately involved in the facts of their cases and often performed investigative functions or completely handled settlement negotiations. Defense lawyers and adjusters worked as a team, regularly communicating with one another about the progress of the case and consulting on strategy. Everyone was on the same page. Second-guessing was a rarity. Trust was the hallmark of these relationships. In return for a steady volume of work, law firms worked at reduced rates. Legal bills were rarely questioned, and most insurers paid bills promptly – often within thirty days.

Did this utopia ever really exist? Undoubtedly this memory is an idealized one. There were always some lawyers who took advantage and overbilled, and always some adjusters who sought to cast blame on lawyers when cases didn't turn out exactly as predicted. Insurers began imposing litigation management and billing guidelines to address perceived abuses. These

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measures themselves raised new problems and in many instances drove a wedge between defense counsel and insurers. This paper examines the evolution of these guidelines and their treatment in the courts and in ethics opinions.

## 2. Genesis of the Cost-Cutting Rationale

One popularly-held view is that insurers were forced to create litigation management and billing guidelines in reaction to widespread abuses and even fraudulent billing practices by attorneys. Insurers complained that they had been perceived by defense counsel and by insureds as a deep pocket, and that this view of an unlimited defense fund led to wasteful defense spending.[2] According to one author:

> When insurers and other consumers of legal services first began to look closely at the attorneys' fees and costs for the services for which they have been paying, they frequently became distressed by what they saw. In fact, what they discovered oftentimes shook their confidence. In many instances, they uncovered evidence of overstaffing, duplication of effort, hidden profit centers, lack of direction, unreasonable charges and simple inefficiency. As a result, these consumers began to carefully examine the legal fee invoices, staffing levels, and the method of compensation for the services provided. Clients began to view the billable hour as a method of compensation which provided a disincentive for attorneys to dispose of cases quickly and efficiently.[3]

Another view has it that insurance companies found themselves in an economic hole as a result of other unrelated factors and determined that defense costs were the easiest place to achieve savings to improve the bottom line. Under this view, insurers received generous returns

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[2] Patrick M. Anthony, *Insurance Defense Litigation: The Ethics and Legality of Insurance Policies That Impose Cost Guidelines on Attorneys Hired by the Insurer to Defend Insurance Claims*, 79 U. Det. Mercy L. Rev. 97, 99 (2001).

[3] Paula-Jane Seidman, *A Continuing Crisis: Casualties on Both Sides in the Unholy War Between Insurers and the Defense Bar Over Issues of Staff Counsel, Legal Audits and Billing Guidelines, in* Insurance Law: Understanding the ABCs 2000 at 483 (PLI Litig. & Admin. Practice, Course Handbook Ser. No. H0-006F).

on their investments in the 1980s, but by the beginning of the 1990s this income had dropped sharply. The competitive market for insurance had driven insurance premiums to new relative lows. Proponents of this view believe that many insurance companies had ceased meaningful underwriting and pursued premium generation at all costs. Unable to raise premiums, insurance companies turned to controlling legal costs as a means of cutting expenses.[4]

3. Types of Management and Billing Guidelines

Guidelines employed by insurers come in a variety of shapes and sizes. Here is a list of some common types:

- Litigation team. The law firm must specify the individuals who will be working on the case, typically a partner, an associate, and a paralegal. The insurer will not pay for work done on the file by anyone else.

- Allocation of tasks. Each task on the file should be performed by the lowest person on the totem pole who is qualified to perform the task.

- Time records. Time must be recorded contemporaneously in units of one-tenth of an hour. Each task must be separately described in its own time entry. Descriptions must not be vague. Some insurers require the entry of billing codes.

- Form reports. Defense counsel are required to fill out standardized forms at various stages in the litigation, whether or not it is feasible at the appointed time to supply meaningful information.

- Budgeting. Defense counsel must provide a detailed budget. The budget is not simply a bottom line budget of cost through trial. Rather the budget is broken out by stage of the case and types of activities. Defense counsel may be

[4] Amy S. Moats, *A Bermuda Triangle in the Tripartite Relationship: Ethical Dilemmas Raised by Insurers' Billing and Litigation Management Guidelines*, 105 W. VA. L. REV. 525, 528 (2003). Wayne J. Baliga, *Litigation Management's Impact on the Insured, Insurer and Legal Counsel, in* Insurance Law: Understanding the ABCs 1999, 196 (PLI Litig. & Admin. Practice, Course Handbook Ser. No. H0-005F).

required to notify the insurer before exceeding the budget, and may not get paid if the budget is exceeded without permission. Predicting the future of a case is difficult and defense counsel may spend hours trying to come up with something realistic. Time spent in budgeting may not be billable.

- Clerical tasks. Insurers will not pay for work that they deem to be clerical. For example, they may not pay for a paralegal to keep a file organized.

- Limitation on legal research. Either any type of legal research must be pre-approved by the insurer, or legal research in excess of three hours on any given topic must be pre-approved.

- Travel time. Either insurers will not pay travel time at all, or will only pay for travel time at a reduced rate.

- Intra-office conferences. Insurers will not pay for any intra-office conferences or, alternatively, insurers will only pay for the time of one attorney participating in the intra-office conference.

- Cost items. Insurers will not pay for certain costs such as computerized legal research charges, long-distance telephone calls, overnight delivery services, and others. Insurers refuse to pay or limit payment for faxing, copying and scanning costs.

- Pre-approval of discovery. Defense counsel may not propound discovery or attend depositions without pre-approval by the insurer.

- Pre-approval of motion practice. Defense counsel may not prepare motions without pre-approval by the insurer.

- Pre-approval of trial preparation. Defense counsel may not prepare for trial without pre-approval by the insurer.

- Limitation on personnel. No more than one attorney may attend a deposition, court appearance, or even trial unless pre-approved.

- Revisions. Insurers will not pay for either proof-reading or revisions, especially when done by someone other than the original author.

4. Professional Rules of Conduct Implicated

Courts, lawyers, and bar associations have expressed concern that compliance with litigation management and billing guidelines may run afoul of certain ethical rules governing attorney conduct. The most commonly cited problematic rules are 1.7, 1.8, and 5.4 of the ABA Model Rules and their state counterparts.

Rule 1.7 generally prohibits conflicts of interest. 1.7(a)(2) states that a conflict of interest exists if there is a significant risk that the representation of one client will be materially limited by the lawyer's responsibilities to another client.

Rule 1.8 more specifically prohibits a lawyer from accepting compensation for representing a client from one other than the client unless there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship.

Rule 5.4 states that a lawyer shall not permit a person who employs or pays the lawyer to render legal services for another to direct or regulate the lawyer's professional judgment in rendering such legal services.

When applying the Model Rules, it is important to determine whether defense counsel has one client or two. Many states consider that both the insurer and the insured are clients. At one time this was the prevailing rule. Currently, however, the more favored view is that the insured is the lawyer's sole client.[5] Under either rubric, strict adherence to some of the guidelines presents an ethical challenge at least under Rules 1.8 and 5.4.

In 2001, the American Bar Association issued Formal Ethics Opinion 01-421. The opinion concluded that, "lawyers representing insured clients must not permit the client's

[5] Patrick M. Anthony, *Insurance Defense Litigation: The Ethics and Legality of Insurance Policies That Impose Cost Guidelines on Attorneys Hired by the Insurer to Defend Insurance Claims*, 79 U. Det. Mercy L. Rev. 97, 105-06 (2001).

insurance company to require compliance with litigation management guidelines the lawyer reasonably believes will compromise materially the lawyer's professional judgment or result in her inability to provide competent representation to the insured."

5. Reaction of the Bar and Insurers

Beginning in the late 1990s and continuing into the 2000s courts and ethics committees issued opinions by the score along the lines of ABA Opinion 01-421. While recognizing that insurers have a legitimate interest in controlling costs, these opinions expressed concern that insurer guidelines had in some instances gone too far and could unduly interfere with the attorney-client relationship. One Texas judge expressed that concern colorfully:

> Whether insureds are getting the value and the level of representation they are paying for deserves serious, thorough study. I do not mean to imply that all insureds are entitled to a "Cadillac" defense when all they paid for is a "Chevrolet." My concern, however, is that because of recent market changes in insurance defense practice, some insureds who have paid for a "Chevrolet" defense are getting a "Yugo" defense."[6]

Many insurers on the other hand questioned the motivation of ethical challenges to their guidelines. Some in the insurance industry, "view[ed] these opinions as Trojan horses within which economic protectionism of defense lawyers by defense lawyers is being cloaked in the language of legal ethics."[7]

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[6] *State Farm Mut. Auto. Ins. Co. v. Traver*, 980 S.W.2d 625, 634 (Tex. 1998) (concurring and dissenting opinion by Justice Gonzalez).

[7] Michael D. Morrison & James R. Old, Jr., *Economics, Exigencies and Ethics: Whose Choice? Emerging Trends and Issues in Texas Insurance Defense Practice*, 53 BAYLOR L. REV. 349, 353 (2001). For a more complete explanation of the view that the guidelines do not create ethical dilemmas *see* Charles Silver, *When Should Government Regulate Lawyer-Client Relationships? The Campaign to Prevent Insurers from Managing Defense Costs*, 44 ARIZ. L. REV. 787 (2002).

Professor James Fischer in his article *Insurer Policyholder Interests, Defense Counsel's Professional Duties, and the Allocation of Power to Control the Defense*, 14 CONN. INS. L.J. 21 (2007), proposed to reconcile the concerns of insurers and defense counsel as follows:

> A workable, albeit rough, rule of thumb here is that counsel should accept and follow instructions from the insurer, and disregard contrary instructions from the policyholder, to the extent (1) the insurer's instructions are consistent with the insurer's right to control the defense; (2) the implementation of the insurer's instructions do not require counsel to commit an illegal act or violate the professional codes, as illuminated by the lawful delegation of control over the attorney to the insurer by the policyholder; and (3) the implementation of the insurer's instructions would not cause counsel knowingly to assist the insurer in breaching a duty owed by the insurer to the policyholder.[8]

In Professor Fischer's view, the delegation of control in an insurance policy legitimately affects the relationship between defense counsel and the policyholder. The policyholder is provided a defense, but the policyholder has lawfully delegated control of that defense to the insurer.

6. Landmark opinion in Montana

In 2000, the Montana Supreme Court issued a landmark opinion on insurer litigation management and billing guidelines: *In re Rules of Professional Conduct and Insurer Imposed Billing Rules and Procedures*, 2 P.3d 806 (Mont. 2000). The case was a declaratory judgment action brought by several Montana insurance defense law firms, who asked the Montana Supreme Court whether an attorney could ethically abide by insurer guidelines "which impose conditions limiting or directing the scope and extent of the representation of his or her client, the insured."[9]

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[8] Fischer, 14 CONN. INS. L.J. AT 72.

[9] A second question regarding third party audits was also posed and answered. The subject of billing audits is closely related to litigation management and billing guidelines, but is beyond the scope of this paper.

The court focused on the requirement of prior approval in guidelines and quoted St. Paul's language as typical:

> Motion practice, discovery and research are items that have historically caused us some concern and which we plan to monitor closely. While we foresee very few differences of opinion, we require that defense counsel secure the consent of the claim professional prior to scheduling depositions, undertaking research, employing experts or preparing motions.

As the foundation for its holding the court examined at length whether defense counsel has two clients (the insurer and the insured) or one (only the insured). The court rejected the notion that the interests of the insured and the insurer usually coincide. "These arguments gloss over the stark reality that the relationship between an insurer and insured is permeated with potential conflicts."[10] The court stated that the Rules of Professional Conduct apply to all cases involving attorneys and clients, refusing to recognize an exception in the tri-partite relationship. "[W]e reject the suggestion that the contractual relationship between insurer and insured supersedes or waives defense counsels' obligations under the Rules of Professional Conduct."[11] The court concluded that the insured is the *sole* client of defense counsel.

Having established that defense counsel has only one client, the court rejected the insurers' argument that attempted to justify guidelines as guards against overpriced or unnecessary services:

> We conclude that whether the requirement of prior approval seldom results in denials of authorization for defense counsel to perform legal services begs the question whether the requirement of prior approval violates the Rules of Professional Conduct. Without reaching the issue here, moreover, we caution further that a mere requirement of consultation may be indistinguishable, in its interference with a defense counsel's

[10] *In re Rules of Professional Conduct*, 2 P.3d at 813.

[11] *Id.* at 814

> exercise of independent judgment and ability to provide competent representation, from a requirement of prior approval. Further, the entitlement of insurers not to pay for overpriced or unnecessary services, which Petitioners do not dispute, also begs the question whether the requirement of prior approval violates the Rules of Professional Conduct.
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> Finally, Respondents argue that their billing and practice rules do not interfere with defense counsels' freedom of action. As previously discussed, they suggest that when an insurer denies approval for particular actions that defense counsel propose, nothing prevents defense counsel from exercising their independent judgment and doing the very thing for which the insurer has denied approval. We reject Respondents' underlying dubious premise that the threat of withholding payment does not interfere with the independent judgment of defense counsel. The very action taken by Petitioners in seeking declaratory relief in the present case is a blunt repudiation of that speculative premise. Further, if the threat of withholding payment were quite as toothless as Respondents suggest, we doubt that they would make such a threat, let alone that they would expressly incorporate it in their billing and practice rules.[12]

In conclusion, the court held that defense counsel in Montana who submit to the requirements of prior approval violate their duties under the Rules of Professional Conduct to exercise their independent judgment and to give their undivided loyalty to insureds.

In a nod to the concerns of insurers, the court added:

> We caution, however, that this holding should not be construed to mean that defense counsel have a "blank check" to escalate litigation costs nor that defense counsel need not ever consult with insurers. Under Rule 1.5, M.R. Prof. Conduct, for example, an attorney must charge reasonable fees. See Rule 1.5, M.R. Prof. Conduct (providing in part that " [a] lawyer's fees shall be reasonable"). Nor, finally, should our holding be taken to signal that defense counsel cannot be held accountable for their work.[13]

7. DRI Guidelines

[12] *Id.* at 814-15.

[13] *Id.* at 814.

Rather than stand by and allow the tensions between insurers and defense counsel to further intensify, DRI and a group of insurers in an admirable cooperative effort sought to develop a set of standard guidelines that would address the concerns of both groups. These guidelines are posted on the DRI site at http://www.dri.org.

The DRI Guidelines acknowledge that they are not meant to supersede the Rules of Professional Responsibility. They eliminate the requirement of prior approval, but do state that defense counsel should consult with the insurer before undertaking certain tasks. In the event of disagreement, the final decision remains with the independent professional judgment of defense counsel. The guidelines ask that law firms staff cases efficiently, but do not require certain types of staff for specific functions. The guidelines also allow for intraoffice conferences provided the conference is necessary to the case.[14]

The DRI Guidelines represent a reasonable compromise between the legitimate concerns of defense counsel and insurers and have been adopted by a number of insurers.

## 8. Conclusion

Did our fairy tale have a happy ending? Insurer guidelines have, in most instances, been modified so as to comport with ethical rules governing attorney conduct. Currently many firms continue to prize insurance defense work, willingly complying with insurer guidelines. Whether guidelines have achieved their goal of reducing litigation costs and whether the quality of defense provided to insureds has been affected remains to be empirically demonstrated.

[14] For further discussion of the guidelines *see* MICHAEL F. AYLWARD, RICHARD R. EURICH, PAUL M. MORETTI, & JEFFREY D. WOOLF, MASSACHUSETTS MOTOR VEHICLE TORTS: LIABILITY AND LITIGATION (2010), Chapter 5: Outside Defense Counsel: Relationship With Insured and Insurer.