



February 2014

# An Ironic and Unnecessary Controversy: Ethical Restrictions on Billing Guidelines and Submission of Insurance Defense Bills to Outside Auditors

William G. Ross

Follow this and additional works at: <http://scholarship.law.nd.edu/ndjlepp>

### Recommended Citation

William G. Ross, *An Ironic and Unnecessary Controversy: Ethical Restrictions on Billing Guidelines and Submission of Insurance Defense Bills to Outside Auditors*, 14 NOTRE DAME J.L. ETHICS & PUB. POL'Y 527 (2000).

Available at: <http://scholarship.law.nd.edu/ndjlepp/vol14/iss1/15>

This Article is brought to you for free and open access by the Notre Dame Journal of Law, Ethics & Public Policy at NDLScholarship. It has been accepted for inclusion in Notre Dame Journal of Law, Ethics & Public Policy by an authorized administrator of NDLScholarship. For more information, please contact [lawdr@nd.edu](mailto:lawdr@nd.edu).

# **AN IRONIC AND UNNECESSARY CONTROVERSY: ETHICAL RESTRICTIONS ON BILLING GUIDELINES AND SUBMISSION OF INSURANCE DEFENSE BILLS TO OUTSIDE AUDITORS**

WILLIAM G. ROSS\*

## **INTRODUCTION**

Insurance defense lawyers, insurance companies, and holders of insurance policies are all likely to suffer much detriment and gain little benefit from recently imposed ethical restrictions on the use of billing audits and billing guidelines. During the past three years, a series of controversial opinions by the ethics committees of bar associations in twenty-four states and the District of Columbia have warned that insurance defense attorneys may violate their ethical duty to maintain client confidences by permitting independent legal auditors to review their bills at the request of insurance companies.<sup>1</sup>

---

\* Professor of Law, Cumberland School of Law of Samford University; A.B., Stanford, 1976, J.D., 1979, Harvard.

1. For a complete list, as of February 2000, see Ala. State Bar, Office of the Gen. Couns., Op. RO-98-02 (1998); Alaska State Bar Ass'n., Ethics Op. 99-1 (1999); Colo. Bar Ass'n Ethics Comm., Formal Op. 107 (1999); D.C. Bar Legal Ethics Comm., Op. 290 (1999); Fla. Bar Staff, Op. 20591 (1997); Haw. State Bar, Formal Op. 36 (1999); Ind. State Bar Ass'n Legal Ethics Comm., Op. 4 (1998) (on file with author); Ky. Bar Ass'n Comm. On Ethics, Ethics Op. E-404 (1998); La. Bar Ass'n Ethics Advisory Serv. Comm., Op. 164 (1998) (on file with author); Md. State Bar Ass'n Comm. on Ethics, Ethics Docket 99-7 (1999) (on file with author); Mass. Bar Ass'n Comm. on Prof'l Ethics, letter from Andrew L. Kaufman to Robert B. LaHait (1997) (on file with author); Miss. State Bar Ass'n Ethics Comm., Op. 246 (1999); Mo. State Bar Ass'n, Informal Op. 980124 (1998); Neb. State Bar Ass'n Advisory Comm., Advisory Op. Jan. 8 (1998) (on file with author); N.Y. State Bar Ass'n Comm. on Prof'l Ethics, Ethics Op. 716 (1999); N.C. State Bar Ass'n Ethics Comm., Formal Op. 10 (1998); Cincinnati (Ohio) Bar Ass'n Ethics & Prof'l Responsibility Comm., Ethics Inquiry 98-99-02 (1998) (on file with author); Or. State Bar Ass'n, Formal Op. 1999-157 (1999); Pa. Comm. on Legal Ethics and Prof'l Responsibility, Informal Op. 97-119 (1997); S.C. Bar Ass'n Ethics Advisory Comm., Op. 97-22 (1997); Tenn. Bd. of Prof'l Responsibility, Formal Op. 99-F-143 (1999); Utah State Bar Ethics Advisory Op. Comm., Op. 98-03 (1998); Vt. Bar Ass'n Comm. on Prof'l Responsibility, Op. 98-7 (1998); Va. State Bar Standing Comm. on Legal Ethics, Op. 1723 (1998) (on file with author); Wash. State Bar Ass'n., Formal Op. 195 (1999); Wisc. State Bar Comm. on Prof'l Ethics, Formal Op. E-99-1 (1999) [hereinafter, for example, Alaska]. For a recent overview of the controversy, see Debra

Moreover, bar officials in eleven states have contended that adherence to insurance companies' billing guidelines may unethically interfere with the professional judgment of attorneys.<sup>2</sup> Although no court has yet ruled on these issues, the Supreme Court of Montana is scheduled to issue a declaratory judgment concerning the ethical propriety of submission of insurers' legal bills to auditors and insurance defense counsels' adherence to billing guidelines.<sup>3</sup> A California court has dismissed for failure to state a claim an action against a legal auditing firm and several major insurance companies that alleged that the defendants committed unfair trade practices by imposing limitations on insurance defense fees.<sup>4</sup>

Restrictions on the use of audits and guidelines are ironic because they are likely to harm insureds, who are the very parties that they are intended to help. Discouragement of audits and guidelines should tend to impede efforts by insurance companies to control defense costs, which may increase premiums for policy holders. Although these restrictions might in some instances help to preserve confidential information about insureds and discourage interference with the professional judgment of attorneys, most of the ethics opinions pronounce restrictions which go far beyond what is needed to accomplish these goals.

These restrictions are also ironic because they may tend to discourage ethical billing practices. Although most insurance defense attorneys already presumably bill their time in an ethical manner, the discouragement of the use of guidelines and audits is likely to encourage the perpetuation of unethical practices

---

Baker, *You Charged How Much!: Insurers Hire Independent Auditors to Pick Apart Lawyers' Bills*, A.B.A. J., Feb. 1999, at 20.

2. See Ala., *supra* note 1; Colo., *supra* note 1; Fla. Bar Staff, Op. 20762 (1998); Ind. State Bar Ass'n Legal Ethics Comm., Op. No. 3 (1998); Iowa Sup. Ct. Bd. of Prof'l Ethics & Conduct, Op. 99-01 (1999); Mo., *supra* note 1; State Bar of Mont. Ethics Comm., Op. 900517 (1999); Tenn., *supra* note 1; Vt., *supra* note 1; Va., *supra* note 1; Wash., *supra* note 1; Wisc., *supra* note 1. This list was complete as of February 2000. A number of the state ethics opinions that do not address the question of whether billing guidelines interfere with the professional judgment of attorneys have considered the ethical propriety of billing guidelines that require the submission of legal bills to outside auditors. See e.g., Mass., *supra* note 1. Those opinions are really concerned with the auditing issue rather than with guidelines *per se*. Accordingly, this Article will address those opinions only in the discussion of the propriety of legal audits in Part III.

3. See *In re Rules of Prof'l Conduct & Insurer-Imposed Billing Rules and Procedures*, No. 98-612 (Mont. filed Nov. 4, 1998). Oral arguments were heard on September 28, 1999, and a ruling may have been rendered by the time that this article is published.

4. *Smith v. Law Audit Servs.*, No. 164543 (Cal. Super. Ct., County of San Francisco, filed Feb. 18, 1999).

among some attorneys. The perpetuation of abusive billing practices by even a small number of attorneys tends to diminish the public perception of all attorneys.

In addition to its irony, the controversy created by the ethics opinions is also unnecessary because there are readily available means for accommodating legitimate concerns about client confidences and professional independence that would not unduly restrict audits or billing guidelines. These safeguards, which are discussed below in Part III(D), should enable insurance defense attorneys to continue to submit their bills to legal auditors without risking violation of professional rules or ethics. Although all of the state ethics opinions recognize that the use of outside auditors and billing guidelines would be ethical if an attorney obtained the informed consent of the insured, many of the state opinions propose such high standards for consent as to make consent all but impossible.

#### I. THE NEED FOR LEGAL AUDITS AND BILLING GUIDELINES

The need for all types of companies to monitor the fees of outside counsel is particularly compelling because excessive billing is all too common among attorneys.<sup>5</sup> A taboo subject until only a decade ago, unethical billing is now a subject about which lawyers are speaking frankly and constructively. Two-thirds of the attorneys who responded to a survey in 1994-95 were personally aware of at least some instances of billing fraud, although relatively few believed that this was a frequent practice.<sup>6</sup> More than half of the lawyers said they believed that at least five percent of the time billed by lawyers in this country is padded.<sup>7</sup> Both inside and outside counsel in that survey indicated that large amounts of time for activities such as attorney conferences, research, drafting of documents, and travel were excessive.<sup>8</sup> Meanwhile, many attorneys continue to engage in such questionable practices as billing more than one client for work performed at the same time and billing for the time spent producing work product for an earlier client.<sup>9</sup>

Increasing recognition of the problem of unethical billing led to the ABA's promulgation of an opinion on billing ethics in

---

5. See, e.g., WILLIAM G. ROSS, *THE HONEST HOUR: THE ETHICS OF TIME-BASED BILLING BY ATTORNEYS* (1996); Lisa G. Lerman, *Lying to Clients*, 138 U. PA. L. REV. 659, 705-19 (1990).

6. See Ross, *supra* note 5, at 266, 270.

7. See *id.* at 266, 269.

8. See *id.* at 266, 270.

9. See *id.* at 79-88, 267, 271.

1993,<sup>10</sup> and a recent spate of criminal and disciplinary proceedings against lawyers for fraudulent billing.<sup>11</sup> Although judicial scrutiny of legal bills traditionally has occurred in decisions concerning statutory fee awards, courts have the right to examine the reasonableness of bills even in cases involving private payment of bills. As the United States District Court for the Southern District of New York declared in a decision early this year, "it is within the traditional authority of the courts to supervise the charging of fees for legal services to reflect the quantity and quality of services rendered."<sup>12</sup> As the court explained, "[a]ny award of attorney's fees, whether awarded pursuant to statute or contract, must be reasonable."<sup>13</sup>

Growing awareness of the problem of unethical billing, along with increasing recognition among corporations of the need to remain competitive through cost-cutting, has led to the development during the past fifteen years of a flourishing legal audit industry.<sup>14</sup> Many insurance companies now routinely submit their legal bills to legal auditors. As Douglas R. Richmond has explained:

Insurers . . . see legal auditing as a reasonable means of controlling their defense costs. Although they do not desire an adversarial relationship with their defense counsel, they must carefully mind their financial obligations to shareholders and policyholders. As clients, they have concluded—as is their right—that cost control is a critical element of responsible lawyering.<sup>15</sup>

The usefulness of outside auditors may have increased during the past two years as the result of state supreme court deci-

---

10. ABA Comm. on Ethics and Professional Responsibility, Formal Op. 93-379 (1993) (discussing billing for professional fees, disbursements, and other expenses).

11. See Lisa G. Lerman, *Blue-Chip Bilking: Regulation of Billing and Expense Fraud by Lawyers*, 12 GEO. J. LEGAL ETHICS 205 (1999). In Illinois, at least ten attorneys have been suspended from practice or disbarred for billing fraud during the past seven years. See James J. Grogan, Paper presented at the ABA 24th National Conference on Professional Responsibility 12-14 (May 28, 1988) (unpublished paper, on file with author); see also Michael D. Goldhaber, *Overbilling is a Big-Firm Problem Too*, NAT'L L.J., Oct. 11, 1999, at 1.

12. *Cutner & Assoc. v. Kanbar*, No. 97 Civ.1902(SAS), 1998 WL 104612, at \*3 (S.D.N.Y. Feb. 4, 1998).

13. *Id.*

14. See Ross, *supra* note 5, at 221-27. See also Claire Hamner Matturro, *Auditing Attorneys' Bills: Legal and Ethical Pitfalls of a Growing Trend*, 73 FLA. BAR J. 14, 14-19 (1999); Larry Smith, *A Profession in Transition: Auditors Expand Practice Amid Growing Criticism*, OF COUNS., Oct. 4, 1993, at 5-14.

15. Douglas R. Richmond, *Of Legal Audits and Legal Ethics*, 65 DEF. COUNS. J. 512, 525 (1998).

sions in Illinois and Texas which denied legal remedies to attorneys who were fired from law firms in retaliation for reporting violations of the Rules of Professional Responsibility.<sup>16</sup> In the Texas case, the court held that a law firm could dismiss a partner for making a good faith accusation of overbilling against another partner, without subjecting the law firm to damages in tort for breach of fiduciary duty.<sup>17</sup> The Illinois court held that an attorney could be dismissed for insisting that a law firm cease its practice of filing consumer debt collection actions in the wrong venue.<sup>18</sup>

Two dissenting justices in the Texas case aptly warned that the decision "sends an inappropriate signal to lawyers and to the public that the rules of professional responsibility are subordinate to a law firm's other interests."<sup>19</sup> Similarly, the dissenter in the Illinois case pointed out that the court's decision "serves as yet another reminder to attorneys . . . that, in certain instances, it is economically more advantageous to keep quiet than to follow the dictates of the Rules of Professional Responsibility."<sup>20</sup>

Although one would hope these decisions would not discourage the presumably honest majority of attorneys from continuing to follow ethical billing practices, these decisions, as the dissents suggest, are likely to exacerbate unethical conduct by attorneys already inclined toward dishonest billing. In addition to encouraging unethical billing in two of the nation's most populous states, they also may encourage misconduct in other states in anticipation of similar rulings elsewhere. Accordingly, these decisions make the need for legal auditors greater than ever before.

The need for legal audits may be especially high in the insurance industry, which is a major consumer of legal services and may have been the victim of a disproportionate amount of exces-

---

16. See *Jacobson v. Knepper & Moga*, 706 N.E.2d 491, (Ill. 1998); *Bohatch v. Butler & Binion*, 977 S.W.2d 543 (Tex. 1998); cf. *Wieder v. Skala*, 561 N.E.2d 105, 110 (N.Y. 1992) (an at-will attorney fired for reporting another attorney's misconduct stated a claim for breach of contract based on an implied duty to comply with the rules of the profession). For a sound critique of *Bohatch*, see Margaret Kline Kirkpatrick, *Partners Dumping Partners: Business Before Ethics in Bohatch v. Butler & Binion*, 83 MINN. L. REV. 1767 (1999). For a discussion of *Jacobson*, see Debra Cassens, *Attorney Can't Sue for Retaliatory Firing*, A.B.A. J., Apr. 1999, at 31.

17. See *Bohatch*, 977 S.W.2d at 545-47.

18. See *Jacobson*, 706 N.E.2d at 493.

19. *Bohatch*, 977 S.W.2d at 561 (Spector, J., & Phillips, J., dissenting).

20. *Jacobson*, 706 N.E.2d at 494 (Freeman, C.J., dissenting).

sive billing.<sup>21</sup> Economic pressures in the insurance industry have encouraged insurance companies to try to curtail excessive legal costs, both fraudulent and non-fraudulent.<sup>22</sup> The incentive to reduce legal bills is particularly acute because litigation costs are estimated to range from nearly thirty percent to nearly fifty percent of every claim dollar.<sup>23</sup> Moreover, some insurance defense lawyers may be tempted to pad their bills because insurance companies typically pay low rates for attorney services.<sup>24</sup>

One commentator has also suggested that overbilling in insurance defense cases is a legacy of the high interest rates of the 1980s, when insurance companies were willing to pay their attorneys for protracted litigation because the high returns that they earned on their investment income as they delayed payment of claims more than compensated for additional defense costs.<sup>25</sup> The willingness of insurance companies to pay more lavish legal bills attracted the services of large law firms, which used elaborate and sometimes wasteful case preparation procedures that insurance companies traditionally had shunned.<sup>26</sup> When interest rates plummeted during the 1990s, insurance companies began

---

21. See, e.g., ROSS, *supra* note 5, at 24-25; Lisa G. Lerman, *Scenes From a Law Firm*, 50 RUTGERS L. REV. 2153 (1998) (reporting confession of overbilling by attorney who worked for an insurance defense firm); James P. Schratz, *I Told You to Fire Nicholas Farber—Psychological and Sociological Analysis of Why Attorneys Overbill*, 50 RUTGERS L. REV. 2211, 2213, 2215 (1998). As an amicus brief in the Montana case has explained, the insurance industry has stood "at the forefront of the movement to more efficiently manage litigation. . . . Through its combined resources it remains one of the world's largest consumers of legal services." Brief for Amicus Curiae Legalgard, Inc. at 2, *In re Prof'l Conduct & Insurer-Imposed Billing Rules & Procedures*, No. 98-612 (Mont. filed Nov. 4, 1998).

22. In explaining the growth of legal auditing in the insurance industry, one commentator has observed:

The increasing economic pressure on liability carriers to keep costs down in a soft insurance market has led to profound changes in the insurance industry, including consolidation and mergers to achieve economies of scale as well as significant price competition to maintain premium bases. Even while premium dollars have become more scarce, insurers have suffered from rising loss adjustment expenses.

Brian S. Martin, *Audits of Law Firm Bills: The Issues Inside and Out*, INS. LITIG. REP., July 1, 1999, at 355 (footnote omitted).

23. See *id.* The use of legal audits in the industry was inspired in part by "[m]ounting litigation costs," which "led to higher policyholder premiums" and produced "[p]ublic clamor for cost-effective efficient disposition of litigation." Brief of Amicus Curiae Legalgard, Inc. at 2, *In re Prof'l Conduct* (No. 98-612).

24. See Darlene Ricker, *Greed, Ignorance and Overbilling*, A.B.A. J., Aug. 1994, at 66 (quoting James P. Schratz).

25. See Andrew G. Cooley, *Audits of Attorney Bills*, FOR DEF., Feb. 1998, at 21.

26. See *id.*

seeking means of reducing costs and found they could cut legal fees more easily than they could reduce indemnity or raise premiums.<sup>27</sup>

Cost-cutting campaigns by insurance companies have strained their relations with defense counsel. Some insurance defense counsel allege that carriers' concern with paring costs has encouraged diminution of the quality of legal services.<sup>28</sup> Insurance companies, however, have suggested that the ethics opinions are a thinly disguised means of circumventing reasonable efforts to curb costs through the use of guidelines and outside auditors.<sup>29</sup> Similarly, Jed Ringel, the president of Law

27. *See id.*

28. *See* Andrew G. Cooley, *Fee Audits: Coming Full Circle and Looking Down the Road*, FOR DEF., June 1999, at 53:

Veterans of the insurance defense business lament for the days when the outside defense lawyer and the insurance carrier had a strong professional relationship. That relationship was based on trust, not sharp bargaining. The shared trust tended to ensure that insureds got an adequate defense, the lawyer got paid a fair amount, and the insurer was satisfied, without any quibbling, that the lawyer had provided good service for a reasonable expenditure.

Those days are gone, and the defense lawyer now has a much more arm's length relationship with the carrier. Trust has been replaced with mercenary negotiations. In some companies' minds, outside counsel are the mere gallons of gas in the legal engine, completely fungible, with the only criterion being the hourly rate.

29. *See* Bruce R. Meckler & Mari Henry Leigh, *The Ethical Use of Outside Auditors and Billing Guidelines* (Nov. 12, 1998) (unpublished paper presented at *Annual Claims Exposition & Conference* in St. Louis, Missouri, on file with author) ("While many of these lawyers are *genuinely* concerned about the quality of legal services that insureds receive, others clearly are motivated by self-interest"); John S. Pierce et al., *Ethics or Economics?: The Ethics of Insurer-Imposed Billing Guidelines and the Propriety of Permitting Billing Statements to be Received by Third-Party Auditors 2* (Feb. 22, 1999) (unpublished paper presented at *Mealey's Conference on Attorney's Fees* in Phoenix, Arizona, on file with author):

Concerned about their economic state, . . . [insurance defense] associations have collectively formulated efforts to stage a coordinated assault on the insurance industry's litigation management programs. . . . Each of these . . . assaults is premised on the supposition that the implementation of these programs poses an "ethical" (not economic) dilemma.

*See also* Joint Brief of Respondents at 18, *In re Prof'l Conduct & Insurer-Imposed Billing Rules & Procedures*, No. 98-612 (Mont. filed Nov. 4, 1998):

The gist of Petitioners' complaints and the complaints of their *amici*—almost all of whom are themselves defense lawyers unhappy with scrutiny of their legal fees—is the allegation that certain claims management and cost-containment practices adopted by the Respondent insurance companies could cause defense counsel to violate their ethical duties to insureds.



Audit Services, a leading legal auditing firm, has suggested that insurance defense attorneys are using the ethical opinions to mask their opposition to insurers' efforts to control legal fees. According to Ringel, "[t]his is not an ethical issue. It's a marketplace issue."<sup>30</sup>

The growing practice of auditing insurance defense attorney bills has vexed many insurance defense attorneys.<sup>31</sup> Audits sometimes cause delay of payment from insurance companies, which traditionally have ameliorated the impact of their relatively low compensation by paying legal bills more promptly than other clients.<sup>32</sup> Moreover, the growth of legal auditing has forced insurance defense counsel to spend more time preparing, checking, and defending legal bills.<sup>33</sup> Although audits may have encouraged some insurance defense attorneys to turn to other areas of practice, the numbers are so small that this does not appear to be a significant problem for the insurance industry.<sup>34</sup>

Although insurance companies could avert the dangers of disclosure of confidential information as identified in the ethics opinions by employing in-house auditors to review legal bills, many insurers do not find this option to be satisfactory. In-house auditors may be more costly since they are full-time staff members or are claims adjusters who could more profitably be employed on other work. Moreover, inside auditors may lack the independence of outside auditors. In yet another irony, inside auditors may therefore have more incentive than outside auditors to recommend the economies that the ethics opinions contend will prejudice insureds.

There are no generally accepted accounting principles for legal auditing, and the methodology of legal auditors varies widely, as do their backgrounds and the types of services they provide.<sup>35</sup> Many legal auditors are lawyers and are quite familiar

---

30. Baker, *supra* note 1, at 23 (quoting Ringel).

31. See Lisa Brennan, *Outside Audits Draw Bar Dissent*, NAT'L L.J., Aug. 3, 1998, at A6; Anna Snider, *Firm Quits Client Over Outside Auditor*, N.Y. L.J., Apr. 9, 1999; Angela Wissman, *Insurance Defense Lawyers Feel the Squeeze*, MERRILL'S ILL. LEGAL TIMES, Sept. 1998, at 1.

32. See Wissman, *supra* note 31.

33. See *id.*

34. See Snider, *supra* note 31 ("the exodus has not been overwhelming"); Wissman, *supra* note 31 ("Top partners at insurance defense firms say they still want the files, because they enjoy the relationship they have with their clients, insurance companies offer a steady stream of work and carriers pay their bills.").

35. See Cooley, *supra* note 25, at 22; James P. Schratz, *Cross-Examining a Legal Auditor*, 20 AM. J. TRIAL ADVOC. 91, 93-99 (1996).

with the exigencies of managing litigation.<sup>36</sup> Although many legal audits are conducted retrospectively, an increasing number of clients are requesting so-called "front-end" audits, which are a management tool by which clients assess the cost-effectiveness of ongoing deployment of attorney resources.<sup>37</sup>

A properly conducted audit can benefit insureds as well as insurers by ensuring proper case management. As one insurance defense attorney has acknowledged:

The policyholder is better defended where there is diligent servicing of defense counsel bills. Often, the auditor's review of bills necessitates more particular consideration by the insurer of the work being performed by defense counsel, and prospectively, requires insurer input to the defense strategy. Even from the purely logistical perspective, outside auditors facilitate an insurer's provision of its duty to defend, much like CPA firms assist large corporations . . . . By these activities, the outside auditor aids the insurer in the management of the defense, particularly under recently prevalent insurance contracts that include insurance defense costs within limits.<sup>38</sup>

## II. THE TRIPARTITE RELATIONSHIP IN INSURANCE DEFENSE CASES

The question of the ethical propriety of the use of legal auditors and billing guidelines has arisen primarily in the context of insurance defense work because of the anomalous ethical position of insurance defense attorneys, who serve two masters—an insured and an insurance company, whose interests are not always the same. The practical and legal underpinnings of this so-called tripartite relationship among insureds, insurers, and insurance defense attorneys have been succinctly described by one commentary:

In a sense, the insurer pre-sells attorney's [sic] services to those who purchase its liability policy. The insurer creates the attorney-client relationships when it selects the attorney of its choice. The practice that the insurer controls the defense because of the provisions of its policy has been recognized as not only customary but also as legally proper. Such a contractual provision has been construed

---

36. See Ricker, *supra* note 24, at 65. Some of the state bar opinions are premised on the assumption that auditors to whom their opinions refer are not attorneys. See, e.g., Wisc., *supra* note 2.

37. See Ross, *supra* note 5, at 224.

38. David R. Anderson, *The Attorney-Client Privilege and Outside Auditors: Oil and Water?*, FOR DEF., June 1999, at 22, 27.

as consent by the insured for the insurer to select counsel for the defense. Some courts have said that the purchase of a liability policy containing such a provision is a prior consent by the insured to dual representation.<sup>39</sup>

Although insureds may reject the attorney selected by the carrier, such action may breach the insurance contract.<sup>40</sup> Similarly, most insurance contracts require the insured to cooperate with the insurer in the management of the insured's defense. The Fifth Circuit has stated that control by the carrier is virtually absolute where—as in most cases—the insurance coverage for the claim is adequate for payment of the entire claim.<sup>41</sup>

In permitting insurance companies a high level of control over claims litigation, courts have even upheld contractual provisions that have allowed insurers to settle claims over the objections of insureds.<sup>42</sup> As one commentator has pointed out, "[t]his relationship is unique. In no other area of the law are parties routinely represented by counsel selected and paid by a third party whose interests may differ from those of the individual or entity the attorney is defending."<sup>43</sup>

Courts generally presuppose, however, the absence of a conflict of interest. As the Supreme Court of Missouri has explained:

[Both the insured and its carrier] are interested in disposing of the case on the best possible terms. Only the insurer's money is involved. Even though the insured may be interested in minimizing liability and damages, perhaps because of apprehension about insurance coverage and rates, this concern introduces no conflict and there is no reason why the same lawyer may not represent both interests.<sup>44</sup>

At least until recently, "there has been somewhat of a consensus that a lawyer who represents an insured in an insurance defense case has two clients."<sup>45</sup> Courts generally have agreed that the insurance defense attorney represents the insurance company as well as the insured even when the claim against the

---

39. RONALD E. MALLIN & JEFFREY M. SMITH, *LEGAL MALPRACTICE* 488-89 (4th ed. 1996) (citations omitted).

40. *See id.*

41. *See Davenport v. St. Paul Fire & Marine Ins. Co.*, 978 F.2d 927, 931 (5th Cir. 1992).

42. *See id.* at 932.

43. Douglas R. Richmond, *Lost in the Eternal Triangle of Insurance Defense Ethics*, 9 GEO. J. LEGAL ETHICS 475, 476-77 (1996).

44. *In re Allstate Ins. Co.*, 722 S.W.2d 947, 952 (Mo. 1987).

45. Timothy W. Bouch & D. Jay Davis, *His Master's Voice: Just How Many Are There Anyway?*, PROF. LAW., May 1997, at 18, 20.

insured exceeds the amount of the insurance policy or goes beyond the scope of the policy.<sup>46</sup>

As Professor Charles Silver has pointed out, however, "the law of professional responsibility has never been entirely comfortable with the notion that defense counsel has two clients. Recognition of the company's status as a client is usually accompanied by the admonition that counsel must show special regard for the interests of the insured."<sup>47</sup> Accordingly, the prevailing law requires that "[d]efense counsel owes the same unqualified loyalty as if personally retained by the insured. The loyalty to the insured should be paramount since that client's defense is the sole reason for the attorney's representation."<sup>48</sup> As the New York Court of Appeals has declared, "the paramount interest independent counsel represents is that of the insured, not the insurer. The insurer is precluded from interference with counsel's independent professional judgment on behalf of its client."<sup>49</sup> Similarly, many of the state ethics opinions regarding submission of insurance defense bills to legal auditors have emphasized that the insurance defense attorney's principal duty is to the insured.<sup>50</sup>

Accordingly, the dual client theory has come under increasing scrutiny during recent years. Critics of the dual client theory have pointed out that defense attorneys are likely to subordinate their duties to the insured in order to satisfy the carriers who pay their fee and who are in a position to provide more work in the future.<sup>51</sup> Several states have modified it, at least in cases in which

---

46. See MALLIN & SMITH, *supra* note 39, at 487-89 (citations omitted).

47. Charles Silver, *Does Insurance Defense Counsel Represent the Company or the Insured?*, 72 TEX. L. REV. 1583, 1587 (1994).

48. MALLIN & SMITH, *supra* note 39, at 489-90 (case citations omitted).

49. *Feliberty v. Damon*, 527 N.E.2d 261, 267 (N.Y. 1988).

50. See, e.g., N.C., *supra* note 1 (the insured, rather than the insurance carrier, is the lawyer's primary client); Or., *supra* note 1, 1999 WL 521543, at \*1 ("Both the disciplinary rules and insurance law . . . require that an attorney hired by the insurer to defend the insured must treat the insured as 'the primary client' whose protection must be the attorney's 'dominant' concern.").

51. See, e.g., Robert E. O'Malley, *Ethical Principles for the Insurer, the Insured and Defense Counsel: The Eternal Triangle Reformed*, 66 TUL. L. REV. 511, 512 (1991). As one court observed:

Even the most optimistic view of human nature requires us to realize that an attorney employed by an insurance company will slant his efforts, perhaps unconsciously, in the interests of his real client—the one who is paying his fee and from whom he hopes to receive future business—the insurance company.

*United States Fidelity & Guar. Co. of N.Y. v. McConaughy*, 685 F.2d 932, 938 n.5 (8th Cir. 1978).

conflicts of interest have arisen between insurers and insureds.<sup>52</sup> The traditional dual representation theory, however, continues to prevail elsewhere. Many of the recent ethics opinions concerning the submission of insurance bills to auditors have likewise reiterated this dual representation doctrine, while others have regarded only the insured as the client.<sup>53</sup> Following state law, the Washington state opinion declared that "in Washington it is clear that legally and ethically the client of the lawyer is the insured."<sup>54</sup> Only in the rare instances in which a direct conflict of interest arises between the insurer and the insured do some states require an insurance company appoint independent counsel for the insured.<sup>55</sup>

The state ethics opinions concerning outside audits have relied heavily upon state judicial decisions and ethics opinions which have affirmed that an insured is a client of the insurance defense attorney. Some of these opinions state that the insured is the attorney's only client. For example, the Florida opinion relied upon other Florida ethics opinions in declaring that "an insurance defense lawyer's client is the insured, not the insurance company."<sup>56</sup>

A recent ABA ethics opinion acknowledged that "[t]he Model Rules of Professional Conduct offer virtually no guidance

---

52. See *Atlanta Int'l Ins. Co. v. Bell*, 448 N.W.2d 804 (Mich. Ct. App. 1989), *modified*, 475 N.W.2d 294 (Mich. 1991). In *Bell*, the court held that an insurance company could not maintain a malpractice action against an insurance defense attorney because no attorney-client relationship existed between the company and the lawyer, even though the company hired the lawyer, paid his fee, and was the principal victim of his alleged malpractice. See *id.* One treatise has described *Bell* as "an anomaly." MALLEN & SMITH, *supra* note 39, at 492. See also *Finley v. Home Ins. Co.*, 975 P.2d 1145 (Haw. 1998); *Safeway Managing Gen. Agency, Inc. v. Clark & Gamble*, 985 S.W.2d 166 (Tex. Ct. App. 1998); *Tank v. State Farm Fire & Cas. Co.*, 715 P.2d 1133 (Wash. 1986).

53. See, e.g., Colo., *supra* note 1; Wisc., *supra* note 1.

54. Wash., *supra* note 1, (visited Feb. 20, 2000) <<http://www.wsba.org/bog/pres/fo/fo195.html>> (citing *Tank*, 715 P.2d 1133; *Van Dyke v. White*, 349 P.2d 430, 437 (Wash. 1960)); see also *Cincinnati (Ohio)*, *supra* note 1 ("The insured, not the insurance company, is the client.").

55. This attorney is popularly known as "Cumis counsel," after the decision in *San Diego Navy Federal Credit Union v. Cumis Insurance Society*, 208 Cal. Rptr. 494 (Cal. Ct. App. 1984).

56. Fla., *supra* note 1, *available at* 17 TRIAL ADVOC. Q. 7, 8 (1998) (citing Fla. St. Bar Ass'n Comm. on Prof'l Ethics, Op. 97-1 (1997) (concluding that an attorney representing an insured could not follow the insurance carrier's instructions about filing a summary judgment motion when such instructions would be contrary to the insured's best interests); Fla. St. Bar Ass'n Comm. on Prof'l Ethics, Op. 81-5 (1981) (holding that an attorney could not withhold information regarding the settlement value of a case from the insured even if the insurer directed this)).

as to whether a lawyer retained and paid by an insurer to defend its insured represents the insured, the insurer, or both.”<sup>57</sup> According to this opinion, “[t]he Model Rules assume a client-lawyer relationship established in accordance with state law, and prescribe the ethical obligations of the lawyer that flow from that relationship.”<sup>58</sup> The opinion concluded, however, that when the insured is the client, either alone or jointly with the carrier, the Rules—rather than the insurance contract—govern the carrier’s attorney’s obligations toward the insured.<sup>59</sup>

The ethical duties that insurance defense counsel owe to an insured in a tripartite relationship, however, are specified with clarity in Rule 1.7(b), which provides:

A lawyer shall not represent a client if the representation of that client may be materially limited by the lawyer’s responsibility to another client or 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. When representation of multiple clients in a single matter is undertaken, the consultation shall include explanation of the implications of the common representation and advantages and risks involved.<sup>60</sup>

Furthermore, 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.<sup>61</sup>

Similarly, the Restatement (Third) of the Law Governing Lawyers, which was approved by the American Law Institute in 1998, provides:

(1) A lawyer may not represent a client under circumstances in which someone other than the client will wholly

---

57. ABA Comm. on Ethics and Professional Responsibility, Formal Op. 96-403 (1996).

58. *Id.*

59. *See id.* at 3.

60. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.7(b) (1998).

61. *Id.* Rule 1.8(f). Rule 1.6, as is explained in greater detail below in Part III(B), protects client confidences.

or partially compensate the lawyer for the representation, unless the client consents. . . .

(2) A lawyer's professional conduct on behalf of a client may be directed by someone other than the client when:

(a) the direction is reasonable in scope and character, such as by reflecting obligations borne by the person directing the lawyer; and

(b) the client consents to the direction. . . .<sup>62</sup>

As Professor Karon O. Bowdre has explained:

The attorney cannot forget that the relationship with the insured is that of attorney and client, just as if the insured hired and paid the attorney directly. The attorney, therefore, must adhere to the same ethical and fiduciary obligations due any client, which includes the duty to keep the insured informed about the proceedings.<sup>63</sup>

### III. LEGAL AUDITS DO NOT NEED TO INTERFERE WITH PROFESSIONAL JUDGMENT OR COMPROMISE PROTECTED COMMUNICATIONS

#### A. *Professional Judgment*

Some critics of the use of outside auditors have suggested that the use of such auditors may improperly interfere with the lawyer's exercise of professional judgment in violation of Rule 5.4(c) of the Model Rules of Professional Conduct, which provides that "[a] lawyer shall not permit a person who recommends, 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."<sup>64</sup> As Professor John Freeman has warned:

---

62. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 215 (Proposed Final Draft, No. 2, 1998). Although the ALI approved Proposed Final Draft No. 2 at its 1998 annual meeting, it appointed an ad hoc committee to ensure that the final version adequately reflects the membership's vote to add a "black-letter requirement that any direction of a lawsuit by a third person not interfere with the lawyer's independent judgment on behalf of the client" and that such direction be "reasonable in scope and character." Ronald E. Mallen, *Looking To the Millenium: Will the Tripartite Relationship Survive?*, DEF. COUNS. J., Oct. 1999, at 482-83. The final version had not been promulgated as of January 2000.

63. Karon O. Bowdre, *Conflicts of Interest Between Insurer and Insured: Ethical Traps for the Unsuspecting Defense Counsel*, 17 AM. J. TRIAL ADVOC. 101, 111 (1993).

64. MODEL RULES OF PROFESSIONAL CONDUCT Rule 5.4(c) (1998).

Unlicensed outsiders, untrained in the law and not subject to . . . disciplinary oversight, have no business trying to regulate how lawyers exercise their independent professional judgment on behalf of client-insureds. Decisions about how to handle a case are to be made by attorneys and clients and not by independent contractors hired to criticize lawyers and slash legal bills.<sup>65</sup>

According to Freeman, “[a] lawyer who allows his or her litigation strategy or tactics to be regulated by a nonclient outside auditor risks discipline for assisting in the unauthorized practice of law.”<sup>66</sup>

Although the issue of interference with professional judgment has tended to arise in the state ethics opinions in connection with the use of billing guidelines rather than in connection with the use of legal auditors, some of the opinions suggest that legal auditors interfere with the professional judgment. For example, the Cincinnati Bar Association’s opinion expresses “concern that allowing non-lawyers to make crucial decisions about motion practice, selection and retention of experts, and what constitutes necessary legal research” violates the ethical rule requiring attorneys to exercise their professional judgment.<sup>67</sup> Similarly, the Wisconsin opinion stated:

Depending upon the particular contract between the outside audit firm and the insurer, the audit company may be authorized to direct how the defense should be conducted to reduce costs, and these directions to defense counsel may relate to decisions about the nature of the professional services that are to be provided to insureds. The auditors also may have authority to disallow charges for legal services that the auditor deems to be inappropriate.<sup>68</sup>

Few if any legal auditors, however, dictate to lawyers how they should manage a case. Much of the advice that auditors provide is not remotely related to issues of professional judgment. For example, an attorney could not complain that a client was interfering with her professional judgment by following an auditor’s advice to the client to refuse to pay for mark-ups on

---

65. John Freeman, *Resolving Fee Disputes*, S.C. LAW., Feb. 2000, at 12.

66. *Id.* Professor Freeman likewise warns that “[t]he auditor who tries to dictate litigation strategy risks punishment for engaging in the unauthorized practice of law. The insurer who empowers the auditor risks liability for aiding and abetting the unauthorized practice of law.” *Id.*

67. Cincinnati (Ohio), *supra* note 1 (citation omitted).

68. Wisc., *supra* note 1, (visited Feb. 20, 2000) <<http://www.wisbar.org/ethop/formal/ethics99-1.html>>.



telephone calls, recycled work, or work that is performed at the same time that the client is performing billable work for another client—all of which are practices condemned by the ABA opinion on billing ethics.<sup>69</sup> Similarly, an attorney's professional judgment is not compromised by complaints that billing entries are too vague or that she lumped multiple activities into single entries; many courts have disapproved of these practices.<sup>70</sup>

To the extent, however, that auditors may influence the instructions that clients provide to attorneys about how to conduct litigation, the attorney is free to respond as he would respond to any other instructions from the client. If he disagrees with the instructions, he may remonstrate with the client and must withdraw from the case if he believes that he cannot act with independent judgment. While law firms tend to defer to the auditors' judgment,<sup>71</sup> there are numerous means by which attorneys can challenge a legal auditor's conclusions.<sup>72</sup> Contrary to the assumptions of the proponents of prohibitions on submission of insurance defense bills to legal auditors, there is no reason to suppose that legal auditors routinely try to slash bills in order to justify their fees. An auditor presumably would lose credibility if it encouraged a client to engage in penny-wise and pound-foolish practices which diminished the quality of the client's legal representation. Accordingly, auditors are generally careful, within reasonable limits, to defer to the billing judgments of attorneys. One legal auditor has explained: "The standard is reasonableness, not perfection. With 20/20 hindsight, it

---

69. See ABA Comm. on Ethics and Professional Responsibility, Formal Op. 93-379 (1993).

70. See, e.g., *Harper v. City of Chicago Heights*, No. 87C5112, 88C9800, 1999 WL 184173, at \*3 (N.D. Ill. Mar. 29, 1999) (striking four time entries for vagueness); *Tri-Star Pictures, Inc. v. Ungar*, 42 F. Supp. 2d 296, 305 (S.D.N.Y. 1999) (stating that courts have frowned on blocked time entries); *Kirsch v. Fleet Street, Ltd.*, No. 92 Civ. 932 (DLD), 1996 WL 695687, at \*5 (S.D.N.Y. Dec. 4, 1996) (disapproving of vague time entries).

71. As legal consultant John W. Toothman has explained, most firms "will very quickly cut 25 percent of the bill, especially if they think it will repair the relationship and keep your business." Maura Dolan, *When the Lawyer's Bill is Out of Bounds*, L.A. TIMES, July 16, 1994, at 1.

72. See Schratz, *supra* note 35, at 94-101. Mr. Schratz, himself a legal auditor, has advised lawyers to ask whether the auditors conducted an on-site review of the files; whether the auditors have sophisticated computer programs for reviewing the bills; and whether the auditors reviewed 100 percent of the billing entries, or merely sampled them. See *id.* Mr. Schratz has also advised lawyers to inquire about the auditors' experience and to obtain a copy of the audit report. See *id.* Although Mr. Schratz's has made his recommendations in the context of fee litigation, there is no reason why any audited attorney could not make the same inquiries.

is easy to identify departures from some theoretical ideal of how a project should have been managed. . . . Charges are unreasonable only when departures from the norm are persistent, pervasive or substantial."<sup>73</sup>

### B. *Disclosure of Confidential Information*

The state ethics decisions are based upon the state counterparts of Rule 1.6(a) of the American Bar Association's Model Rules of Professional Conduct, which provides in pertinent part: "A lawyer shall not reveal information relating to representation of a client unless the client consents after representation."<sup>74</sup>

The obligation imposed by Rule 1.6 is broader than the attorney-client privilege.<sup>75</sup> In contrast to the attorney-client privilege, which "protects only information revealed by the client to the lawyer in confidence," Rule 1.6(a) "protects all information relating to the representation of a client."<sup>76</sup> Similarly, Mr. Richmond has explained in his discussion of the recent state ethics opinions that "[t]he attorney-client privilege generally applies only if the communications at issue were intended to obtain legal advice or assistance, while a lawyer's duty of confidentiality under Rule 1.6 reflects the duty of loyalty to clients in addition to the principles underlying the attorney-client privilege."<sup>77</sup>

Rule 1.6(a) appears to bind insurance defense attorneys even when insurance companies—which are not bound by the

---

73. Bennett Feigenbaum, *How to Examine Legal Bills*, J. ACCT., May 1994, at 84, 86.

74. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.6(a) (1998).

75. As the Utah opinion points out with reference to Utah's rule, "Rule 1.6(a) is broader than the attorney-client privilege." Utah, *supra* note 1, 1998 WL 199533, at \*2.

76. *Id.* See also *id.* (quoting the comment to Rule 1.6(a):

The principle of confidentiality is given effect in two related bodies of law, the attorney-client privilege in the law of evidence . . . and the rule of confidentiality established in professional ethics. The attorney-client privilege applies in judicial and other proceedings in which a lawyer may be called as a witness or otherwise required to produce evidence concerning a client. The rule of client-lawyer confidentiality applies in situations other than those where evidence is sought from the lawyer through the compulsion of law. The confidentiality rule applies not merely to matters communicated in confidence by the client but also to all information relating to the representation, whatever the source.

77. Richmond, *supra* note 15, at 515 (citing *In re Anonymous*, 654 N.E.2d 1128 (Ind. 1995) (reprimanding attorney for revealing client information that was available from public sources); *Lawyer Disciplinary Bd. v. McGraw*, 461 S.E.2d 850 (W. Va. 1995) (reprimanding state's attorney general for disclosing client information that was available under Freedom of Information Act)).

rules of attorney ethics—submit their bills directly to the auditors. Procedures for submitting legal bills to outside auditors differ among companies. Some insurance companies require their attorneys to submit their bills directly to the outside auditor,<sup>78</sup> while at least a few companies may be forwarding their legal bills to the auditor without notifying their attorneys.<sup>79</sup> Although the latter procedure superficially appears to constitute a means to cut the ethical Gordian knot—since attorney ethics rules are not binding on insurance companies—such a procedure could cause problems for both insurance companies and their outside auditors. The circumvention of the attorneys could expose the companies to bad faith claims, and willful ignorance by an attorney that his or her bills are being sent to an auditor might not relieve the attorney of his ethical obligations to the client.<sup>80</sup>

The Maryland ethics opinion warned that the attorney should request the carrier to refrain from releasing confidential information if the lawyer becomes aware that the carrier is sending legal bills to an auditor.<sup>81</sup> Similarly, the District of Columbia opinion stated:

Prior to disclosure of protected information to the insurer . . . the lawyer should instruct the insurer not to release the protected information and should designate all such information clearly. If there is reason to believe that the insurer will not follow this instruction, the lawyer should so advise the client, prior to disclosure, explaining any additional risks that would result from disclosure by the insurer to a third party.<sup>82</sup>

Of course, such an admonition is likely to strain relations between the insurer and the insured and to jeopardize the attorney's retention of the account. It is no wonder that one insurance defense attorney has described this option as a bitter pill.<sup>83</sup>

Although all of the ethics opinions warn attorneys to refrain from disclosing confidential client information to auditors, they

---

78. See Va., *supra* note 1. The Virginia opinion hypothesized a situation in which insurance carriers required "the attorney to submit billing statements directly to outside auditing firms for review and approval," even though the insureds had "no knowledge of this submission." *Id.*

79. See Cooley, *supra* note 28.

80. See *id.*

81. See Md., *supra* note 1.

82. D.C., *supra* note 1, (visited Feb. 20, 2000) <[http://www.dcbarr.org/attorney\\_resources/opin290.pdf](http://www.dcbarr.org/attorney_resources/opin290.pdf)>.

83. See Cooley, *supra* note 28, at 53 ("None of us is happy sending strident letters to an insurance company demanding it stop sending your billing statements to a third party. But it must be done, no matter how bitter the pill.").

vary in the extent to which they warn that the bills are likely to contain confidential information. The state ethics opinions are generally based on the assumption that the legal bills disclosed to the auditor would contain confidential information. For example, the Maryland and Virginia opinions explicitly presuppose that bills sent to auditors will contain confidential information.<sup>84</sup> The hypothetical billing statements in the Virginia opinion provided detailed descriptions of the attorney's work for the insured, including information regarding what was discussed in the office and by whom, specific issues researched, specific non-deposition discovery prepared, specific trial work performed, and the identity of all materials and documents reviewed.<sup>85</sup> Hypothetical auditors also requested that the attorney attach all his work product to the billing statements, and information regarding the amount of the last settlement offer made prior to suit and the attorney's estimate of the insured's percentage or degree of exposure.<sup>86</sup>

Some of the state ethics opinions have suggested that the mere fact that an insured has obtained legal assistance might constitute a client confidence.<sup>87</sup> In defending the reasonableness of this contention, one insurance defense attorney has contended:

Even in routine automobile accident suits, most people are reluctant to let others know they have been sued. In some areas—like professional malpractice—there may be serious complications to advertising a lawsuit. It doesn't matter that the lawsuit is a matter of "public record." The bottom line is that the mere identity of your client is probably a client secret.<sup>88</sup>

Even those opinions that do not seem to contend that bills are rife with confidences have warned that the trend toward more detailed bills inevitably increases the likelihood that bills will contain client confidences. The Kentucky Bar Association's

---

84. The Maryland opinion declared that "[i]t appears obvious, and this Committee will presume, that the detailed billing and supplemental information which the auditor requests will require" disclosure of confidential information about the insured. Md., *supra* note 1. Similarly, the Virginia opinion stated that an attorney's transmission of billing information to auditors "would involve disclosure of confidential information regarding both the facts of the insured's case and the attorney's representation of that insured." Va., *supra* note 1.

85. See Va., *supra* note 1.

86. See *id.*

87. See Md., *supra* note 1; Wash., *supra* note 1; Vt., *supra* note 1.

88. Cooley, *supra* note 28, at 20.

opinion on the use of auditors pointed out that many legal bills, at least in insurance cases, "are now quite detailed, and contain information about the nature of the legal services performed, information about legal research conducted, and information which could contain strategic decisions made regarding the handling of the case."<sup>89</sup> Similarly, the Indiana opinion found that an increasing number of insurance carriers require the billing attorney to identify the parties with whom the attorney communicates by telephone or letter, describe the subjects of legal research, and include in bills the names of witnesses interviewed or experts consulted.<sup>90</sup>

In fixating on the need to protect client confidences, these ethics opinions ignore other ethical obligations of attorneys toward their clients and other ideals which the Model Rules of Professional Conduct are designed to facilitate. For example, Rule 1.5(a), which provides that a "lawyer's fee shall be reasonable," is advanced by both audits and guidelines; indeed, the comment to Rule 1.5 explains that a lawyer "should defer to the client regarding such questions as the expense to be incurred."<sup>91</sup> Similarly, audits help to assure that "a lawyer shall not make a false or misleading communication" concerning her services, as prohibited by Rule 7.1.<sup>92</sup> Audits also help to prevent the type of "dishonesty, fraud, deceit or misrepresentation" which Rule 8.4(c) prohibits.<sup>93</sup> Likewise, billing guidelines generally contain provisions which help to assure that a "lawyer shall keep a client reasonably informed about the status of a matter and promptly comply with reasonable requests for information," as required by Rule 1.4(a).<sup>94</sup>

The opinions have generally agreed that an attorney could submit bills to legal auditors if the bills did not contain client confidences. For example, the Oregon opinion stated that if "a detailed bill contains no confidences or secrets" of a client, the attorney could properly submit the client's "detailed bills to the third-party audit service," but that such submission would be improper "if a detailed bill contains confidences or secrets."<sup>95</sup> The New York opinion stated:

---

89. Ky., *supra* note 1, (visited Feb. 20, 2000) <<http://www.uky.edu/Law/kyethics/kba404.htm>>.

90. See Ind., *supra* note 1.

91. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.5 & cmt. (1998).

92. *Id.* Rule 7.1.

93. *Id.* Rule 8.4(c).

94. *Id.* Rule 1.4(a).

95. Or., *supra* note 1, 1999 WL 521543, at \*1.

Although not every individual bill, and not every particular item of information contained in supporting documentation, will itself comprise a "secret" or "confidence" of the insured who is the client, much of the information contained in a defense lawyer's bills and related records will constitute a "secret of a client," if not a confidence. . . .<sup>96</sup>

As is explained in detail below in Part III(D), there are many ways in which attorneys can ensure that bills submitted to outside auditors do not contain client confidences. Even if the bills contained confidences, however, the submission of the bills to the auditors would not necessarily violate any ethical rule since the auditors could be regarded as agents of the insurance companies or the attorneys.

The ethics opinions generally overlook the fact that insurance defense attorneys routinely share client confidences with a wide array of third parties. The need for attorneys to protect client confidences in communications with agents is tacitly recognized in Model Rule 5.3, which requires attorneys to "make reasonable efforts to ensure that" the agent's "conduct is compatible with the professional obligations" of the attorney.<sup>97</sup> An ABA ethics opinion has indicated that a lawyer could properly provide a computer maintenance company with access to information in client files, provided that the lawyer made reasonable efforts to ensure the confidentiality of client information.<sup>98</sup> In its opinion, the ABA committee acknowledged that it was "aware that lawyers now use outside agencies for numerous functions such as accounting, data processing and storage, printing, photocopying, computer servicing, and paper disposal."<sup>99</sup> The opinion explained that "[s]uch use of outside service providers . . . inevitably entails giving them access to client files[, . . . thus] trigger[ing] the application of Rule 5.3."<sup>100</sup>

---

96. N.Y., *supra* note 1, 1999 WL 221884, at \*2; *see also id.*:

Billing records typically contain "secrets" within the meaning of DR 4-101(A) [the New York version of Rule 1.6]. That is because they almost invariably include information "gained in the professional relationship" with the client; often, this will be information that the client would want to be held inviolate or that, if disclosed, would be embarrassing or detrimental to the client. . . .

97. MODEL RULES OF PROFESSIONAL CONDUCT Rule 5.3 (1998).

98. *See* ABA Comm. on Ethics and Professional Responsibility, Formal Op. 95-398 (1995).

99. *Id.*

100. *Id.*

Similarly, submission of bills to an auditor by an insurance company should not create any ethical problem for insurance defense attorneys. Professor Stephen Gillers has pointed out:

[A]n insurer's decision to give the independent contractor access to the insured's confidential information to assist it in exercising its contractual right to control the defense should stand on no different footing from a law firm's decision to give an independent contractor access to a much greater volume of confidential information to aid it in representing clients.<sup>101</sup>

Professor Gillers has aptly concluded:

[Even though] the duties of insurers and lawyers emanate from different sources . . . , [an attorney's] duties with regard to client information are at least as stringent if not more so than insurers' duties, yet the ABA has recognized the legitimacy of law firms giving independent contractors access to extensive confidential information with appropriate safeguards. There is no doctrinal difference here.<sup>102</sup>

As agents of insurance companies, legal auditing companies can be expected to protect any confidences of policy holders that might be included in the bills that they review. An auditor would certainly have no reason to betray such a confidence. On the contrary, the auditor's own interest would encourage it to avoid the disclosure of confidential information to third parties. Similarly, there is no empirical reason to fear that legal auditors may be forced to involuntarily disclose confidences. One leading legal auditor reports that his firm, which reviews an average of forty thousand legal bills each month from six thousand law firms, has never in its ten years of operation received even one discovery request or subpoena for production of billing records.<sup>103</sup>

### C. Waiver of Attorney-Client Privilege

Even though Rule 1.6 goes beyond the attorney-client privilege, the danger that legal audits might waive the attorney-client privilege nevertheless may be presumed to be a major consideration in the state ethics opinions, although these decisions do not

---

101. Stephen Gillers, *Ethical Issues in Monitoring Insurance Defense Fees: Confidentiality, Privilege and Billing Guidelines* (visited Feb. 20, 2000) <http://tarlton.law.utexas.edu/silver/gil.htm>.

102. *Id.*

103. See interview with Jed Ringel, President, Law Audit Services (Feb. 11, 2000). Mr. Ringel says that he has never heard of any other legal audit firm that has received such discovery requests.

purport to directly answer the question of whether submission of the legal bills to the auditors would waive the attorney-client privilege.<sup>104</sup> Some, however, appear to assume that the privilege would not extend to outside auditors.<sup>105</sup> Accordingly, it may be useful to consider the extent to which audits may compromise the privilege.

The attorney-client privilege protects communications between an attorney, made in confidence, for the purpose of obtaining legal advice or services from the attorney.<sup>106</sup> The privi-

---

104. As the Louisiana committee explained, "[w]hether or not the providing of the bills to the auditing company constitutes a waiver of the attorney-client privilege is a legal question which the committee may not answer." La., *supra* note 1. Similarly, the Oregon opinion states that "[i]n the absence of definitive Oregon authority, whether the submission to a third-party audit service of bills containing Client's confidences and secrets waives the attorney-client privilege or work-product doctrine is a matter of substantive law beyond the scope of this opinion." Or., *supra* note 1, 1999 WL 521543, at \*2. See also Mass., *supra* note 1; ("whether the *subject* of the communication with your client is protected by the attorney-client privilege is a question of substantive law which the Committee's rules do not permit it to address"); N.Y., *supra* note 1, 1999 WL 221884, at \*3 ("The question of whether disclosing a document would explicitly or implicitly reveal attorney-client privileged communications is a question of evidence law that ordinarily calls for fact-specific determination.").

105. Although the Indiana opinion indicated that waiver of the attorney attorney-client and work-product privileges were "fact-sensitive, legal" issues about which it could offer no opinion, it also expressed the opinion that the attorney-client "privilege would not appear to extend to an independent auditing company, which, of course, has no contractual relationship with or duty to defend the insured client." Ind., *supra* note 1. Similarly, the District of Columbia opinion stated that "where applicable law affords privileged status to communications among the insurer, insured and the insured's attorney, disclosure by the insurer to a third party could effectively waive the privilege." D.C., *supra* note 1, (visited Feb. 20, 2000) <[http://www.dcbar.org/attorney\\_resources/opin290.pdf](http://www.dcbar.org/attorney_resources/opin290.pdf)>. In its opinion on billing guidelines, the Iowa ethics board stated:

[I]t would be improper for an Iowa lawyer to agree to, accept or follow . . . proposed service-log requirements in any form that causes the attorney-client privilege to be placed in jeopardy, if the service-log is sent to a third party. An Insurer may require a lawyer to identify the services rendered and time spent, so long as it does not control the lawyer's professional judgment or undermine the attorney-client privilege.

Iowa, *supra* note 2, (visited Feb. 20, 2000) <<http://www.iowabar.org/ethics.nsf/e61beed77a215f6686256497004ce492/b662fde548eef686862567e80053fa52!OpenDocument>>.

106. The elements of the privilege have generally been described as follows:

(1) Where legal advice of any kind is sought (2) from a professional legal adviser in his capacity as such, (3) the communications relating to that purpose, (4) made in confidence (5) by the client, (6) are at his instance permanently protected (7) from disclosure by himself or by the legal adviser, (8) except the protection be waived.



lege does not protect communications which are made primarily for a business purpose rather than primarily for a legal purpose.<sup>107</sup>

Although the distinction between business advice and legal advice is not always easy to draw since business advice and legal advice are often intertwined, courts have indicated that the primary or predominate purpose of a communication must relate to legal advice in order for the privilege to attach.<sup>108</sup> As one court has explained, "if the lawyer is serving as a business representative of his client, those functions that he performs purely in that capacity—such as negotiation of the provisions of a business contract or relationship—are not the source of a privilege."<sup>109</sup>

A client's voluntary disclosure to third persons of confidential information that is protected by the attorney-client privilege "has long been considered inconsistent with maintaining [the] privilege."<sup>110</sup> Accordingly, disclosure of legal bills to an outside auditor could waive the privilege to the extent that auditors were regarded as third parties and to the extent that such bills contained confidential information.

Attorney billing records are protected by the attorney-client privilege only to the extent that they would tend to reveal confidential information.<sup>111</sup> As the First Circuit stated in a recent opinion, "[w]e certainly agree that . . . documents are not per se non-privileged merely because they were intended primarily for billing purposes."<sup>112</sup> Accordingly, the privilege protects billing records that would disclose the nature of the services of the attor-

---

See *United States v. Evans*, 113 F.3d 1457, 1461 (7th Cir. 1997) (citing 8 JOHN HENRY WIGMORE, *EVIDENCE IN TRIALS AT COMMON LAW* § 2292 (1961)).

107. See, e.g., *In re Allen*, 106 F.3d 582, 603 (4th Cir. 1997); *Marten v. Yellow Freight Sys., Inc.*, No. Civ. A. 96-2013-GTV, 1998 WL 13244, at \*7 (D. Kan. Jan. 6, 1998); *Georgia Pac. Corp. v. GAF Roofing Mfg. Corp.*, No. 93 Civ. 5125 (RPP), 1996 WL 29392, at \*3-5 (S.D.N.Y. Jan. 25, 1996).

108. See, e.g., *Itoba Ltd. v. LEP Group PLC*, 930 F. Supp. 36, 43 (D. Conn. 1996); *United States v. Chevron Corp.*, No. C-94-1885 SBA, 1996 WL 264769, at \*2 (N.D. Cal. Mar. 13, 1996); *McCaugherty v. Sifferman*, 132 F.R.D. 234, 238 (N.D. Cal. 1990).

109. *Note Funding Corp. v. Bobian Inv. Co.*, No. 93 Civ. 7427 (DAB), 1995 WL 662402, at \*2 (S.D.N.Y. Nov. 9, 1995).

110. *United States v. South Chicago Bank*, No. 97 CR 849-1, 97 CR 849-2, 1998 WL 774001, at \*3 (N.D. Ill. Oct. 30, 1998).

111. See *United States v. Keystone Sanitation Co.*, 885 F. Supp. 672, 675 (M.D. Pa. 1994); *Old Holdings, Ltd. v. Taplin, Howard, Shaw & Miller*, 584 So. 2d 1128, 1128-29 (Fla. Dist. Ct. App. 1991).

112. *In re Grand Jury Subpoenas*, 123 F.3d 695, 699 (1st Cir. 1997) (remanding for determination of whether billing records were privileged).

ney or the type of work performed by the attorney.<sup>113</sup> Similarly, the privilege prevents disclosure of billing records which would reveal the content of discussions between an attorney and client.<sup>114</sup>

In contrast, billing records which merely reveal the amount of time spent or billed and the character of the fee arrangement are generally discoverable.<sup>115</sup> As the Ninth Circuit has explained:

The identity of the client, the amount of the fee, the identification of payment by case file name, and the general purpose of the work performed are usually not protected from disclosure by the attorney-client privilege. . . . However, correspondence, bills, ledgers, statements, and time records which also reveal the motive of the client in seeking representation, litigation strategy, or the specific nature of the services provided, such as researching particular areas of law, fall within the privilege.<sup>116</sup>

Accordingly, the Ninth Circuit held that legal bills that showed the identity of the client, the case name for which payment was rendered, the amount of the fee, and the general nature of the services performed did not constitute privileged information.<sup>117</sup> Similarly, another federal court has stated that "[i]t is generally accepted . . . that attorney billing statements and time records are protected by the attorney-client privilege only to the extent that they reveal litigation strategy and/or the nature of services performed."<sup>118</sup>

Likewise, a New Jersey court has held that the attorney-client privilege did not prevent a police union from using a right-to-know law to obtain bills which attorneys submitted to a municipality.<sup>119</sup> The court explained:

---

113. See *C.J. Calamia Constr. Co. v. Ardco/Traverse Lift Co.*, No. Civ. A. 97-2770, 1998 WL 395130, at \*2 (E.D. La. July 14, 1998).

114. See *DiPalma v. Medical Mavin, Ltd.*, No. Civ. A. 95-8094, 1998 WL 123009, at \*3 (E.D. Pa. Feb. 10, 1998).

115. See *In re Grand Jury Proceedings*, 33 F.3d 342, 354 (4th Cir. 1994); *C.J. Calamia*, 1998 WL at \*2; *Beavers v. Hobbs*, 176 F.R.D. 562, 564-65 (S.D. Iowa 1997); *Tipton v. Barton*, 747 S.W.2d 325, 332 (Mo. App. 1988).

116. *Clarke v. American Comm. Nat'l Bank*, 974 F.2d 127, 129 (9th Cir. 1992).

117. See *id.* at 130.

118. *Leach v. Quality Health Servs.*, 162 F.R.D. 499, 501 (E.D. Pa. 1995) (citing *United States v. Keystone Sanitation Co.*, 885 F. Supp. 672, 675 (M.D. Pa. 1994)).

119. See *Hunterdon County Policemen's Benevolent Ass'n. Local 188 v. Township of Franklin*, 669 A.2d 299, 302 (N.J. 1996).

The billings of an attorney are not likely to contain information which is confidential. In the experience of this court, it will contain a few word description of the general category of work performed, the number of hours required to perform the work, the date of the performance, and the total cost to the client.<sup>120</sup>

In concluding that legal bills do not necessarily contain privileged information, the Nebraska ethics opinion relied in part upon the Ninth Circuit's decision in *Clarke* in concluding that legal "bills are not privileged information" and that their submission by an insurer to an outside auditor does not necessarily constitute a violation of an attorney's duty to maintain client confidences.<sup>121</sup>

This opinion may have gone too far, however. As the District of Columbia opinion pointed out, the question of whether a bill reveals client confidences depends upon the precise wording of the bill. As this opinion explained, "[w]hile some billing statements may not reflect protected information, at least some of the information described by the inquirer clearly falls within the protection of Rule 1.6."<sup>122</sup> The material described by the inquirer had involved "the content of all communications (telephone calls, correspondence, meetings), specific issues researched, the specified trial preparation performed, and the identity of material or documents reviewed and written work product generated in the representation of the client."<sup>123</sup>

Similarly, the New York opinion correctly observed that "the extent to which billing records are protected by the attorney-client privilege would require carefully analyzing the records line by line."<sup>124</sup> The opinion explained:

In general, decisions have recognized that legal bills ordinarily are not privileged insofar as they contain only the identity of the client, the fee amount, and the general nature of the services rendered, but that the attorney-client privilege would protect correspondence, bills, ledgers, statements and time records insofar as they reveal the motive of the client in seeking representation, litigation

---

120. *Id.*

121. Neb., *supra* note 1.

122. D.C., *supra* note 1.

123. *Id.*

124. N.Y., *supra* note 1, 1999 WL 221884, at \*3.

strategy, or the specific nature of the services provided, such as researching particular areas of law.<sup>125</sup>

Similarly, the Washington ethics opinion warned:

Payment for professional services is based on "adequate descriptions" contained in the billing statement. "Adequate descriptions" often require the identity of all participants in, and the purpose of, a conference, letter, call or meeting; the specific issues involved; and specific information about the nature of what has been discussed, reviewed or decided which may require disclosure of specific or tactical and strategic information about the defense of litigation irrespective of whether the information is otherwise privileged, embarrassing to the client, or may involve matters of dispute between the client and the insurer. . . .<sup>126</sup>

Although it therefore appears that the attorney-client privilege protects at least some legal bills that insurance defense counsel might submit to outside auditors, the transmission of such information would not waive the privilege because the auditors are the agents of the insured and the insurer. It is well-established law that the attorney-client privilege protects the confidentiality of communications between an attorney and the agents of the attorney.<sup>127</sup> The privilege clearly applies to subordinate agents such as student clerks, paralegals, secretaries, and investigators.<sup>128</sup> Similarly, the privilege also extends to communications by an attorney with retained experts.<sup>129</sup>

As the Second Circuit explained in the leading case of *United States v. Kovel*,<sup>130</sup> "the complexities of modern existence prevent attorneys from effectively handling clients' affairs without the help of others; few lawyers could now practice without the assistance of secretaries, file clerks, telephone operators, messengers, clerks not yet admitted to the bar, and aides of other sorts."<sup>131</sup> The court in *Kovel* therefore endorsed Professor Wigmore's contention that "[t]he assistance of these agents being indispensable

---

125. *Id.* (citing *Clarke v. American Comm. Nat'l Bank*, 974 F.2d 127, 129 (9th Cir. 1992); *Licensing Corp. of Am. v. Nat'l Hockey League Players Ass'n.*, 153 Misc.2d 126, 127-28 (N.Y. Sup. Ct. 1992)).

126. Wash., *supra* note 1, (visited Feb. 20, 2000) <<http://www.wsba.org/bog/pres/fo/fo195.html>>.

127. See, e.g., PAUL R. RICE, ATTORNEY-CLIENT PRIVILEGE IN THE UNITED STATES 334 (1993).

128. See, e.g., EDNA SELAN EPSTEIN, THE ATTORNEY-CLIENT PRIVILEGE AND THE WORK-PRODUCT DOCTRINE 106-09 (3d ed. 1997).

129. See *id.* at 109-15.

130. 296 F.2d 918 (2d Cir. 1961).

131. *Id.* at 921.

to [the attorney's] work and the communications of the client being often necessarily committed to them by the attorney or by the client himself, the privilege must include all persons who act as the attorney's agent."<sup>132</sup> Accordingly, the court in *Kovel* held that the privilege extended to communications made by a client to an accountant in an attorney's employ.<sup>133</sup> The court likened the work of the accountant to that of a translator of a foreign language.<sup>134</sup>

The court in *Kovel* emphasized:

What is vital to the privilege is that the communication be made in confidence for the purpose of obtaining legal advice from the lawyer. If what is sought is not legal advice but only accounting service . . . or if the advice sought is the accountant's rather than the lawyer's, no privilege exists.<sup>135</sup>

Accordingly, courts have applied the privilege to communications with agents who were consulted in connection with litigation.<sup>136</sup> In other cases, courts have refused to recognize the privilege when outside consultants have performed business functions that were not closely related to litigation.<sup>137</sup>

---

132. *Id.* (citing WIGMORE, *supra* note 104, at § 2301; Annotation, *Persons Other Than Client or Attorney Rendered Incompetent by the Privilege Attaching to Communications Between Client and Attorney*, 53 A.L.R. 369 (1928)).

133. *See id.*

134. *See id.*

135. *Id.* at 922.

136. *See Carter v. Cornell Univ.*, No. 97-9180, 1998 WL 537842, at \*2 (2d Cir. July 9, 1998) (dean employed by defendant university was acting as agent of defendant's attorney when she conducted interviews of university employees in connection with the litigation); *Compulit v. Banctec, Inc.*, 177 F.R.D. 410, 413 (W.D. Mich. 1997) (law firm did not necessarily waive its client's privilege by contracting with an independent contractor that provided litigation support services); *H.W. Carter & Sons v. William Carter Co.*, No. 95 Civ. 1274 (DC), 1995 WL 301351, at \*3 (S.D.N.Y. May 16, 1995) (privilege was not lost when public relations consultant participated in discussions between attorney and defendant to formulate response to plaintiff's lawsuit).

137. In one recent case, for example, a federal court held that an engineering consultant hired by a chemical corporation to work on an environmental cleanup project was not an agent or representative of the corporation's attorney for purposes of the privilege with respect to documents prepared by the consultant. *See Occidental Chem. Corp. v. OHM Remediation Servs. Corp.*, 175 F.R.D. 431, 436-38 (W.D.N.Y. 1997). The court explained that documents prepared by the consultant were not privileged even if they were prepared during negotiations to settle legal matters because the consultant was hired to formulate a remediation plan rather than to put information into a usable form for attorneys to render legal advice, and because assistance provided by the consultants was obtained through studies and observations of the cleanup site rather than through client confidences. *See id.* at 437.

No court appears to have directly addressed the question of whether a client would waive the attorney-client privilege by submitting its legal bills to an independent agency that reviews legal bills.<sup>138</sup> In the most closely analogous decision, a federal court in 1979 held that an Indian tribe did not waive work-product protection by disclosing legal bills to the Bureau of Indian Affairs (BIA) in connection with BIA's review procedure for approval of the bills.<sup>139</sup> Although this decision has been heavily relied upon by the respondents in the Montana case,<sup>140</sup> it may be distinguishable to the extent that the BIA acted "as confidential agent for

---

In another case, a court refused to extend the privilege to police officers' conversations with a union representative for the purpose of helping the representative provide advice about the officers' rights and options, including their right to consult an attorney. See *In re Grand Jury Subpoenas*, 995 F. Supp. 332, 338-40 (S.D.N.Y. 1998). The court stated that it was "simply not prepared to extend the attorney-client privilege to those conversations a person may have with a third party whether a union representative, a parent, a trusted teacher, or a close friend—in seeking that party's guidance about a potential legal problem or assistance in procuring a lawyer." *Id.* at 338-39; accord *In re E.I. Du Pont de Nemours & Co.*, 918 F. Supp. 1524, 1547-48 (M.D. Ga. 1995); *rev'd on other grounds*, 99 F.3d 363 (11th Cir. 1996) (data from tests performed by an independent laboratory hired by a defendant in a products liability action was not protected from disclosure); *Massachusetts Sch. of Law v. American Bar Ass'n*, 895 F. Supp. 88, 90-91 (E.D. Pa. 1995) (privilege did not apply to consultant who was hired to help law school obtain accreditation because he was not acting as a lawyer and his communications were not exchanged for a legal purpose); *United States Postal Serv. v. Phelps Dodge Ref. Corp.*, 852 F. Supp. 156, 161 (E.D.N.Y. 1994) (outside scientific consultants hired by corporate vendor of property to conduct environmental studies of soil, oversee remedial work on property, and develop supplemental remedial program were not attorney's agents for purposes of the privilege); *E.I. DuPont de Nemours & Co. v. Formapack*, 718 A.2d 1129, 1141-42 (Md. 1998) (attorney-client privilege did not apply to communications between the legal department of a corporation and a collection agency which was not comprised of attorneys, for purposes of conducting collection efforts through a business approach which did not involve litigation).

138. In a recent concurring and dissenting opinion concerning the circumstances under which an insurance company's influence over an attorney can call into question the attorney's professional responsibilities toward a client, a justice of the Supreme Court of Texas remarked that "[s]ome insurance companies impose billing restrictions and subject the lawyers to billing audits. These audits threaten the attorney-client privilege. Some companies even dictate whether an attorney or a paralegal does some of the work." *State Farm Mut. Auto. Ins. Co. v. Traver*, 980 S.W.2d 625, 634 (Tex. 1998) (Gonzalez, J., concurring and dissenting) (discussing circumstances under which an insurance company's influence over an attorney can call into question the attorney's professional responsibilities to a client).

139. See *Indian Law Resource Ctr. v. Department of Interior*, 477 F. Supp. 144, 148 (D. D.C. 1979).

140. See Joint Brief of Respondents at 18, *In re Prof'l Conduct & Insurer-Imposed Billing Rules & Procedures*, No. 98-612 (Mont. filed Nov. 4, 1998).

the tribe.”<sup>141</sup> Numerous decisions in which courts have held that disclosure of privileged information to an auditor has waived the attorney-client privilege<sup>142</sup> do appear to be distinguishable, however, from the situation in which an insurance company asks an outside auditor to review legal bills.

In support of their application for a judgment declaring that outside auditing of insurance defense attorneys’ bills constitutes an ethical violation, petitioners in the Montana case have relied heavily upon the First Circuit’s recent decision in *United States v. Massachusetts Institute of Technology*.<sup>143</sup> That case is distinguishable because a potentially adversarial relationship existed between MIT and its auditor, a governmental agency.

In the *Massachusetts Institute of Technology* case, MIT submitted legal bills related to government defense contracts to the Defense Contract Audit Agency, the auditing arm of the Department of Defense, in compliance with those contracts in order for the government to determine whether MIT had overcharged the government.<sup>144</sup> When the Internal Revenue Service later attempted to obtain the legal bills from the auditor in connection with an investigation of MIT’s tax-exempt status, MIT refused to consent to the disclosure, arguing that the attorney-client privilege protected their confidentiality.<sup>145</sup> MIT contended that its disclosure of the legal bills to the audit agency was “akin to the disclosure by a client’s lawyer to another lawyer representing another client in a common defense,” a recognized exception to waiver of the attorney-client privilege.<sup>146</sup> In rejecting this argument, the court pointed out that there was no common interest because “MIT’s disclosure to the audit agency was a disclosure to a potential adversary.”<sup>147</sup>

---

141. *Indian Law Resource Ctr.*, 477 F. Supp. at 148.

142. See *United States v. Massachusetts Inst. of Tech.*, 129 F.3d 681, 683-87 (1st Cir. 1997); *United States v. Adlman*, 68 F.3d 1495, 1500 (2d Cir. 1995); *In re John Doe Corp.*, 675 F.2d 482, 488-89 (2d Cir. 1982); *United States v. South Chicago Bank*, No. 97 CR 849-1, 97 CR 849-2, 1998 WL 774001, at \*3 (N.D. Ill. Oct. 30, 1998); *In re Subpoena Duces Tecum Served on Willkie Farr & Gallagher*, No. M8-85 (JSM), 1997 WL 118369, at \*2-3 (S.D.N.Y. Mar. 14, 1997).

143. See Petitioner’s Memorandum at 29-33, *In re Rules of Prof’l Conduct & Insurer-Imposed Billing Rules and Procedures*, No. 98-612 (Mont. filed Nov. 4, 1998) (discussing *United States v. Massachusetts Institute of Technology*, 129 F.3d 681 (1st Cir. 1997)).

144. See *Massachusetts Inst. of Tech.*, 129 F.3d at 683.

145. See *id.*

146. *Id.* at 685.

147. *Id.* at 687. Although the court acknowledged that MIT and the audit agency may have shared a common interest to the extent that they were both interested in the “proper performance of MIT’s defense contracts and the proper auditing and payment of MIT’s bills,” the court explained that “this is

In discussing the scope of the attorney-client privilege, the court reaffirmed that attorneys may share confidential information with agents without sacrificing the privilege.<sup>148</sup> Moreover, the court pointed out that communications between insured and insurer are one example of a situation in which "disclosure has been allowed, without forfeiting the privilege, among separate parties similarly aligned in a case or consultation."<sup>149</sup> As Dean Syverud has argued, *Massachusetts Institute of Technology* therefore "actually supports insurers' use of outside auditors, because disclosure of billing information is necessary to facilitate the insured's representation and because the insurer and the insured have a common interest in efficient, cost-effective and appropriate representations."<sup>150</sup>

The recent decision of the U.S. District Court for the Northern District of Illinois in *South Chicago Bank* is distinguishable because information for which the privilege was waived had been submitted to the auditors in connection with a routine year-end audit rather than in connection with the company's efforts to

---

not the kind of common interest to which the cases refer in recognizing that allied lawyers and clients—who are working together in prosecuting or defending a lawsuit or in certain other legal transactions—can exchange information among themselves without loss of the privilege." *Id.* at 685. The court stated that "[t]o extend the notion to MIT's relationship with the audit agency, which on another level is easily characterized as adversarial, would be to dissolve the boundary almost entirely." *Id.*

148. See *id.* at 684. Although the First Circuit observed that the case law involving waiver occurring as the result of "a deliberate and voluntary disclosure of a privileged communication to someone other than the attorney or client" is "far from settled," the court explained that "decisions do tend to mark out, although not with perfect consistency, a small circle of 'others' with whom information may be shared without loss of the privilege (e.g., secretaries, interpreters, counsel for a cooperating co-defendant, a parent present when a child consults a lawyer)." *Id.*

The court further explained:

Although the decisions often describe such situations as ones in which the client "intended" the disclosure to remain confidential . . . the underlying concern is functional: that the lawyer be able to consult with others needed in the representation and that the client be allowed to bring closely related persons who are appropriate, even if not vital, to consultation . . . . An intent to maintain confidentiality is ordinarily necessary to continued protection, but it is not sufficient.

*Id.* According to the court, "where the client chooses to share communications outside this magic circle, the courts have usually refused to extend the privilege." *Id.*

149. *Id.* at 685.

150. Kent D. Syverud, *The Ethics of Insurer Litigation Management Guidelines and Legal Audits*, INS. DEF. RPTR., May 1, 1999, at 180; see also Anderson, *supra* note 38.



obtain legal advice.<sup>151</sup> The court indicated, however, that information provided to the auditor in connection with a legal matter—an investigation of employee fraud—remained privileged to the extent that it was not shared with the auditors who were conducting the year-end audit.<sup>152</sup> The Second Circuit's decisions in two other recent decisions are distinguishable because the court in those cases found that the communications involved business advice rather than legal advice.<sup>153</sup> Moreover, the decision of the United States District Court for the Southern District of New York in another recent decision appears to be distinguishable because the court stated that the company in that case had made a "strategic decision to waive the privilege" in order to obtain a qualified audit opinion.<sup>154</sup>

Taken together, these decisions suggest that the privilege would not be waived if a client communicates with a non-adversarial outside auditor in connection with efforts to obtain legal advice rather than business advice. The submission of bills to an auditor, however, appears to fall in a murky zone between legal advice and business advice. The legal bills themselves were generated, of course, in connection with the client's quest for legal advice. But the legal advice has already been rendered by the time that the bill is sent to the auditor, and one could argue that the principal purpose of the audit is to enable the company to make a business decision about how much of the attorney's bill it

---

151. See *United States v. South Chicago Bank*, No. 97 CR 849-1, 97 CR 849-2, 1998 WL 774001, at \*8 (N.D. Ill. Oct. 30, 1998) (explaining that "the bank's year-end audit team . . . was outside the circle of persons with whom confidential information could be shared because they were performing work in the ordinary course of business, not for the sake of legal advice").

152. See *id.*

153. See *United States v. Adlman*, 68 F.3d 1495 (2d Cir. 1995); *In re John Doe Corp.*, 675 F.2d 482 (2d Cir. 1982). In *Adlman*, the Second Circuit held that the privilege did not extend to communications between a corporation and the accounting firm of Arthur Andersen, which had advised in-house counsel of the tax consequences of a proposed merger, insofar as the taxpayer rather than inside counsel had contacted the firm and the taxpayer regularly employed Arthur Andersen to provide routine accounting, auditing, and advisory services. The court explained that these facts suggested that the company contacted Arthur Andersen for business-related advice rather than for legal advice. See *Adlman*, 68 F.3d at 1500. The court pointed out that Arthur Andersen's "billing statements lump the work done in this consultation together with its other accounting and advisory services." *Id.* In *John Doe*, the court explained that "this particular conversation was sparked by Accountant's responsibilities in conducting the audit, not by [the] seeking of legal advice requiring the aid of an accountant." *John Doe*, 675 F.2d at 488.

154. *In re Subpoena Duces Tecum Served on Willkie Farr & Gallagher*, No. M8-85 (JSM), 1997 WL 118369, at \*7-8 (S.D.N.Y. Mar. 14, 1997).

should have to pay. It is therefore not entirely clear that the attorney-client privilege would protect such communications.

Even if the privilege did not protect such communications, however, the transmission of such communications to the outside auditor in most instances would not prejudice the client because most of the information that attorneys typically include in billing entries would not be so confidential that it would benefit an adversary. Although some billing entries include information that could help an adversary, an attorney who believes that the attorney-client privilege would not protect the bill could refrain from writing prejudicial entries, or could redact such entries from the bills sent to the auditor.<sup>155</sup> Moreover, as is explained in greater detail below, the attorney could also avoid ethical violations by obtaining the informed consent of the client to the disclosure.

Finally, the work product rule presumably would protect billing information even if the attorney-client privilege were not available, since virtually any insurance defense bill concerns information about actual or anticipated litigation.<sup>156</sup> Since work product protection is waived only by disclosure to an adversary of the party for whom the work product was created, disclosure to a legal auditor would not waive work product protection because the auditor is not an adversary. The Colorado opinion acknowledged that "[a]rguably, the third party auditor, as the insurer's agent, could fall within . . . the protection" of the work product rule.<sup>157</sup> The work-product issue was also addressed briefly in the Indiana opinion, which expressed concern that disclosure of "such detailed descriptions of legal services likely would describe 'mental impressions, conclusions, opinions or legal theories' of defense counsel, subjects which ordinarily are protected from disclosure by the work-product privilege."<sup>158</sup> The opinion, however, stated that "[w]aiver is a fact-sensitive, legal issue" about which it could not opine.<sup>159</sup>

#### D. *Means of Avoiding Disclosure of Confidential Information*

Even if the disclosure of certain types of billing information to auditors would result in the waiver of the attorney-client privi-

---

155. See *infra* Pt. III(D)(3).

156. See Statement of Geoffrey C. Hazard, *In re* Rules of Prof'l Conduct & Insurer-Imposed Billing Rules and Procedures, No. 98-612 (Mont. filed Nov. 4, 1998) [hereinafter Hazard] (on file with author).

157. Colo., *supra* note 1, (visited Feb. 20, 2000) <[http://www.cobar.org/comms/ethics/fo/fo\\_107.htm](http://www.cobar.org/comms/ethics/fo/fo_107.htm)> (citation omitted).

158. Ind., *supra* note 1 (citation omitted).

159. *Id.*

lege or otherwise would compromise the confidentiality of client confidences, there are a number of means by which insurance defense attorneys can avoid the violation of any rules of professional responsibility or any other obligation to insureds.

### 1. Consent of the Insured

The state ethics opinions generally agree that attorneys would not breach any confidence if the attorney submits bills to an auditor with the consent of the insured rather than solely at the direction of the insurance company.<sup>160</sup> Such consent presumably would be required pursuant to Model Rule 1.4(b), which states that "[a] lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation."<sup>161</sup> Informed consent also is mandated by Rule 1.2(a), which provides that "[a] lawyer shall abide by a client's decisions concerning the objectives of representation . . . and shall consult with the client as to the means by which they are to be pursued."<sup>162</sup> The comment to Rule 1.2(a) states that "the lawyer shall defer to the client regarding such questions as the expense to be incurred."<sup>163</sup> Such consent, of course, must be voluntary and informed.

The state ethics opinions differ widely in their assessment of the extent to which attorneys are likely to be able to obtain informed consents to audits, and the procedures by which such consent could be obtained. Although insurance policies typically provide that carriers shall direct the defense of insureds, the state ethics opinions generally assume that such general consent would be insufficient for the attorney to satisfy his ethical obligation to the insured. The Indiana opinion explained, for example, that "since the provision of such detailed information is not necessary to carry out the representation, there does not exist an

---

160. See, e.g., Fla., *supra* note 1; N.Y., *supra* note 1; S.C., *supra* note 1. The Alabama, Mississippi, North Carolina, and Washington opinions, however, indicate that an attorney could not properly obtain consent. See *infra* notes 189-97 and accompanying text.

161. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.4(b) (1998). Moreover, the Restatement (Second) of Agency provides:

An agent is subject to a duty to use reasonable efforts to give his principal information which is relevant to affairs entrusted to him and which, as the agent has notice, the principal would desire to have and which can be communicated without violating a superior duty to a third person.

RESTATEMENT (SECOND) OF AGENCY § 381 (1958).

162. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.2(a) (1998).

163. *Id.* cmt.

implied authorization to reveal such information to others.”<sup>164</sup> The Florida opinion states that an “attorney must inform his clients, the insureds, of their insurance companies’ demands and restrictions on the attorney in his preparation of the insured’s case. The [attorney] may not follow the insurer’s guidelines without full knowledge and consent of the insured.”<sup>165</sup>

Accordingly, the ethics opinions have tended to take the position that informed consent requires explicit rather than implicit authorization to release billing records to auditors. As the New York ethics opinion stated, an attorney has a duty to obtain specific consent from the client even if the insurance contract “might be interpreted implicitly, or even explicitly, to require the client to disclose certain information to an outside auditor as a condition of the insurance company’s duty to defend the insured.”<sup>166</sup> The New York ethics opinion explained that “[s]uch a provision in the insurance policy ordinarily would not constitute ‘consent . . . after a full disclosure’” within the meaning of the New York ethics code “because it would not have been preceded by the type of disinterested explanation . . . that would be necessary to make the client’s decision fully informed.”<sup>167</sup> Similarly, the District of Columbia’s opinion concluded that “[c]onsent to disclose confidences and secrets to the insurer may not provide a basis to infer consent to disclose the same information to another entity who performs work for the insurer” and that such “consent should not be assumed to include consent to disclosure to a third party.”<sup>168</sup>

The ethics opinions have emphasized that the elements of informed consent must be analyzed on a case by case basis.<sup>169</sup> The opinions have nevertheless attempted to provide some general guidelines. The Maryland opinion indicated that “[t]he lawyer should inform the client of the types of information that may be disclosed in any billing records, as well as the potential legal

---

164. Ind., *supra* note 1.

165. Fla., *supra* note 1, available at 17 TRIAL ADVOC. Q. 7, 9 (1998).

166. N.Y., *supra* note 1, 1999 WL 221884, at \*3.

167. *Id.*

168. D.C., *supra* note 1.

169. For example, the Maryland opinion stated that “[t]he level of information required to obtain consent must be analyzed on a case by case basis.” Md., *supra* note 1. Similarly, the New York opinion stated that while “[t]he nature of the necessary disclosure will vary somewhat from case to case and client to client” and that “it is, therefore, not possible to identify a comprehensive list of specific considerations that the lawyer should bring to the client’s attention and discuss with the client to enable the client to decide whether to authorize the lawyer to provide documents to the auditor.” N.Y., *supra* note 1, 1999 WL 221884, at \*5.

effects of releasing such information to third parties.”<sup>170</sup> Similarly, the New York opinion advised:

[T]he lawyer should at least discuss the nature of the information to be found in the billing records sought by the auditor as well as the relevant legal and nonlegal consequences of the client's decision. This would include giving advice concerning the extent of the client's obligation under the insurance contract to authorize such disclosures and the risk that the insurance company would refuse to indemnify the client and to pay the client's attorneys fees if the client does not consent.<sup>171</sup>

Likewise, the South Carolina opinion warned:

Client consent to the release of confidential information must be informed consent, based upon more than the mere fact that a certain type of information, such as billing records, will be released to third parties. Due to the potential effects of the misuse or abuse of such information, disclosure must be full. The lawyer should elaborate on the type of information which may be found in billing records, as well as the potential legal effects of releasing such information to third parties.<sup>172</sup>

Such potential legal effects presumably would include the use of such information by the insured's adversary in litigation or in business competition.

Several of the opinions have also required attorneys to renew client consent in accordance with changed conditions.<sup>173</sup> Moreover, as the New York opinion contends, the client should be permitted “to revoke the advance consent” even if its “advance consent to share information with the insurer's auditor was sufficiently informed.”<sup>174</sup> Similarly, the Utah opinion states that “the lawyer must consult with the client to make sure that the client

---

170. Md., *supra* note 1.

171. N.Y., *supra* note 1, 1999 WL 221884, at \*5. The New York opinion also stated:

[The lawyer might give] advice concerning the risk that the information disclosed to the auditor would be obtained by others directly or indirectly as a result of the disclosure, the risk that a disclosure will involve waiver of the lawyer-client privilege, and ultimately, the risk that a disclosure could be used to the client's disadvantage.

*Id.*

172. S.C., *supra* note 1, 1997 WL 861963, at \*2.

173. See Wash., *supra* note 1, (visited Feb. 20, 2000) <<http://www.wsba.org/bog/pres/fo/fo195.html>> (an attorney should “consult with the client periodically thereafter as circumstances may require”).

174. N.Y., *supra* note 1, 1999 WL 221884, at \*3.

understands and renews the consent" even if the contract provides for such consent.<sup>175</sup>

Prudence would seem to require that such consent be in writing. The Wisconsin opinion has stated that "it is generally advisable that such consent be in writing," even though this is "not required."<sup>176</sup> The North Carolina opinion, however, stated that written consent is not required.<sup>177</sup>

Some of the opinions have emphasized that the attorney's communications with the client are complicated by the potential conflicts of interest which are inherent in the tripartite relationship among insurers, insureds, and defense counsel. The District of Columbia's opinion pointed out that "a lawyer may have an interest in cooperating with the insurance company to preserve the lawyer's business relationship with the insurance company."<sup>178</sup> The District of Columbia opinion also warned, however, that "[t]he lawyer may have a financial interest in avoiding an audit of his billing practices, and should avoid exaggerating the risks of disclosure to a client whose consent to disclosure is sought."<sup>179</sup>

Similarly, the North Carolina opinion states that "[w]ith respect to the payment of legal fees, the interest of the insurance company and the insured are usually not the same."<sup>180</sup> According to the North Carolina opinion, "[t]he insurance company usually has an interest in controlling or reducing its defense costs, while the interest of the insured is generally to receive the best possible defense particularly if the claim may exceed the policy limits available for insured's protection."<sup>181</sup> The New York opinion likewise declared that "the lawyer must avoid being influenced either by the interests of the insurance company, which may have selected the lawyer, or by those of the lawyer, who may have an ongoing relationship with the insurance company."<sup>182</sup>

One obvious problem with "informed consent," is that even ostensibly "disinterested" advice can be slanted to encourage the

---

175. Utah, *supra* note 1, 1998 WL 199533, at \*1.

176. Wisc., *supra* note 1, (visited Feb. 20, 2000) <<http://www.wisbar.org/ethop/formal/ethics99-1.html>>.

177. See N.C., *supra* note 1.

178. D.C., *supra* note 1.

179. *Id.*

180. N.C., *supra* note 1, 1998 WL 609887, at \*2.

181. *Id.*

182. N.Y., *supra* note 1, 1999 WL 221884, at \*5; see also *id.* (explaining that "[a]lthough an insurance contract may give the insurer an unfettered right to control the defense of a claim, the lawyer must exercise independent judgment on behalf of the client, especially when rendering advice about decisions that are entrusted to the client").

client to give consent. One insurance defense attorney has argued that "a letter explaining the audit procedure, enclosing a copy of the insurer's guidelines to illustrate what disclosure it requires, and asking whether the insured has any objection to the proposed disclosure" might fail to satisfy the lawyer's ethical obligations because "a benign sounding letter is probably not going to 'fully inform' the client."<sup>183</sup> According to this commentator:

[A] conservative approach would require that the letter be alarmist, not benign. The client would have to be informed that the forwarding of the billing statement to an outside party could lead to a waiver of the attorney-client privilege. Since no one knows how the information will be used by the auditing company, dire predictions would have to be made.<sup>184</sup>

He nevertheless acknowledges, however, that "if the lawyer obtains truly informed consent from the client, there appears to be no ethical prohibition against sending the billing statements to a third party."<sup>185</sup>

The state ethics opinions have likewise tended to assume that informed consent will not be easy to obtain because the insured will not benefit from legal audits. As the North Carolina opinion explains, an insured who consents to a legal audit "agrees to release confidential information that could possibly (even if remotely) be prejudicial to her or invade her privacy without any return benefit."<sup>186</sup> Similarly, the South Carolina ethics opinion stated that "[a]s a practical matter, achieving . . . informed consent . . . is highly problematic."<sup>187</sup>

Indeed, the Alabama, Mississippi, North Carolina, Oregon, and Washington state opinions seem to imply that an attorney could virtually never obtain the client's informed consent because the client presumably would not knowingly consent to a disclosure of information that would contravene its interests. Accordingly, these opinions have discouraged attorneys from even trying to obtain the consent of insureds except in the presumably unlikely event that the attorney has some reason to sup-

---

183. Cooley, *supra* note 28, at 21.

184. *Id.* As examples, Mr. Cooley argues that "a client should be warned of the possibility that the information sent to the auditor may be used to justify a premium rate increase; or it could be shared with other insurance companies to the detriment of the client if the client wanted to change carriers at some point." *Id.*

185. *Id.*

186. N.C., *supra* note 1, 1998 WL 609887, at \*2.

187. S.C., *supra* note 1, 1997 WL 861963, at \*2.

pose that disclosure of the bills would be in the insured's best interests.

For example, the Washington opinion declared that a requirement by the insurer that defense counsel "seek or obtain the informed consent of the insured to disclose client confidences or secrets in billings to be submitted to the insurer or its outside auditing service, would . . . place defense counsel in an impossible situation, requiring withdrawal from representation" because "it is almost inconceivable that it would ever be in the client's best interests to disclose confidences or secrets to a third party."<sup>188</sup> The Washington opinion therefore concluded that defense counsel could ethically obey a carrier's direction to seek or obtain an insured's consent only "[w]here confidences or secrets of the client are not revealed in billings."<sup>189</sup> Moreover, the opinion concluded that the attorney must counsel the insured to withhold consent "[i]f there is the slightest risk of embarrassment to the client."<sup>190</sup>

Moreover, the Alabama opinion questioned "whether an attorney may ethically seek the client's consent if disclosure may result in a waiver of the client's right to confidentiality, the attorney-client privilege or the work product privilege."<sup>191</sup> Likewise, the Oregon opinion contended that the prohibition against conflicts of interest by attorneys would prohibit an attorney from seeking client permission to send bills to an auditor under "ordinary circumstances" in which such submission would "create an actual conflict of interest between insured and insurer."<sup>192</sup>

The North Carolina opinion also seemed to express skepticism that an attorney could ever obtain informed consent. After concluding that the insured ordinarily would have nothing to gain and would have something to lose from disclosure, the opinion stated that "[w]hen the insured could be prejudiced by agreeing and gains nothing, a disinterested lawyer would not conclude that the insured should agree in the absence of some special circumstance."<sup>193</sup> Accordingly, the North Carolina opinion stated that "the lawyer must reasonably conclude that there is some benefit to the insured to outweigh any reasonable expectation of prejudice, or that the insured cannot be prejudiced by a release of the confidential information, before a lawyer may seek

---

188. Wash., *supra* note 1, (visited Feb. 20, 2000) <<http://www.wsba.org/bog/pres/fo/fo195.html>>.

189. *Id.*

190. *Id.*

191. Ala., *supra* note 1, (visited Feb. 20, 2000) <<http://www.alabar.org/>>.

192. Or., *supra* note 1, 1999 WL 521543, at \*2.

193. N.C., *supra* note 1, 1998 WL 609887, at \*2.



the informed consent of the insured after adequate consultation."<sup>194</sup>

Likewise, the Mississippi opinion warned that "before the lawyer may seek the informed consent of the insured after adequate consultation, the lawyer must reasonably conclude there is some benefit to the insured to outweigh any reasonable expectation of prejudice or that the insured cannot be prejudiced by a release of the confidential information."<sup>195</sup> This opinion concluded that an attorney for an insured may not seek the informed consent of an insured to the submission of a legal bill to an outside auditor "if a *disinterested* lawyer would conclude that the client should not agree to such disclosure."<sup>196</sup>

These opinions, however, are unduly restrictive in their concept of informed consent in the context of submission of legal bills to outside auditors. There is no apparent reason why the level of disclosure needed for informed consent in this context should exceed what is required with respect to other aspects of the attorney's defense of the insured. In its opinion on the ethical duties owed to insureds by insurance defense attorneys, the ABA opined that "[w]e presume that in the vast majority of cases the insured will have no objection to proceeding in accordance with the terms of his insurance contract."<sup>197</sup>

Indeed, the requirements of most of the recent state ethics opinions greatly exceeded what the ABA ethics committee recommended in its opinion requiring insurance defense counsel to explain the nature of their representation to insureds in cases in which insureds are deemed to be their client.<sup>198</sup> The ABA opinion concluded that "[a] short letter clearly stating that the lawyer intends to proceed at the direction of the insurer in accordance with the terms of the insurance contract and what this means to the insured is sufficient to satisfy the requirement of Rule 1.2 in this context."<sup>199</sup> The opinion explained:

---

194. *Id.*

195. Miss., *supra* note 1, (visited Feb. 20, 2000) <<http://www.msbar.org/opinions/246.html>>. The opinion explained that "[t]he primary concern to the lawyer must be the protection of client confidentiality and the consequences to the client, given the client's informed consent, to the release of information which may potentially constitute a waiver of the attorney-client or the work product privileges." *Id.*

196. *Id.*

197. ABA Comm. On Ethics and Professional Responsibility, Formal Op. 96-403 (1996).

198. *See id.*

199. *Id.*

We do not believe that extended discussion is required or, indeed, that any oral communication is necessary. As long as the insured is clearly apprised of the limitations on the representation being offered by the insurer and that the lawyer intends to proceed in accordance with the directions of the insurer, the insured has sufficient information to decide whether to accept the defense offered by the insurer or to assume responsibility for his own defense at his own expense. No formal acceptance or written consent is necessary. The insured manifests consent to the limited representation by accepting the defense being offered by the insurer after being advised of the terms of the representation being offered.<sup>200</sup>

The ABA reached this conclusion even though it acknowledged that "[w]e cannot assume that the insured understands or remembers, if he ever read, the insurance policy, or that the insured understands that his lawyer will be acting on his behalf, but at the direction of the insurer without further consultation with the insured."<sup>201</sup>

Similarly, the comment to Rule 1.4 explains that while every attorney must communicate with clients in a manner that serves their best interests, "each client will have different levels of willingness, ability, and desire to participate intelligently in the representation."<sup>202</sup> The comment explains:

These levels are often dependent upon the kind of representation. Thus, the guiding principle is contingent upon the client's reasonable expectation but is limited or expanded by the client's willingness, ability and desire to participate in the particular representation, and by the practicability of the lawyer's meeting the client's expectations.<sup>203</sup>

Although the New York opinion acknowledges that "a client's desire to take advantage of the insurance company's duty to defend will heavily influence the client to consent," the opinion

---

200. *Id.*

201. *Id.*

202. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.4 cmt. (1998); *see also id.*:

Adequacy of communication depends in part on the kind of advice or assistance involved . . . [but that] . . . [t]he guiding principle under this Rule is that the lawyer should fulfill the reasonable expectation of the client for information. In determining what is reasonable, the lawyer must consider that the lawyer has a duty to act in the client's best interests.

203. *Id.*

properly concludes that "it cannot be concluded that policy-holders' informed consent to disclose information to insurance companies' auditors will invariably, or even generally, be involuntary."<sup>204</sup>

Only two of the ethics opinions—those of Nebraska and Massachusetts—have indicated that an attorney would not need to obtain the independent consent of an insured before sending legal bills to an outside auditor. The Massachusetts opinion advised:

To the extent that disclosure to the insurer would be permissible (e.g., because the client consents to such disclosure) . . . [an attorney] may make such disclosures to the auditor so long as . . . [he] satisf[ies] [him]self that the auditor has taken reasonable steps to protect the confidentiality of the disclosed information.<sup>205</sup>

The Nebraska opinion did not appear even to require that the insured consent to disclosure of confidential information to the insured. As the Nebraska ethics opinion stated, "disclosure of legal bills by a third party payor of those bills for the client without any consent is a rather routine matter. This would be the situation of any audit of the payor by its certified public accountant."<sup>206</sup> Moreover, as the Nebraska opinion on legal auditing pointed out, an attorney does not violate a client confidence by revealing otherwise confidential information about fees in a lawsuit against a client to collect a fee.<sup>207</sup> The Nebraska Advisory Committee stated that "[w]e see no distinction from the context of the attorney suing the client to the context of the insurance company submitting the bill to an audit by an outside auditor."<sup>208</sup>

At least two of the opinions have explicitly expressed disagreement with the Massachusetts opinion.<sup>209</sup> The District of Columbia opinion, for example, stated that the District of Columbia rules contain nothing which would support "the conclusion that consent to disclosure to the insurer may be used to infer consent to disclosure to other third parties whose purpose it is to assist the insurer in its business, not the attorney in representing the client's interests."<sup>210</sup>

---

204. N.Y., *supra* note 1, 1999 WL 221884, at \*4.

205. Mass., *supra* note 1.

206. Neb., *supra* note 1.

207. *See id.*

208. *Id.*

209. *See* D.C., *supra* note 1; Va., *supra* note 1.

210. D.C., *supra* note 1.

Ronald E. Mallen has pointed out that the forms of consent envisioned by the ethics opinions would entail substantial costs.<sup>211</sup> As Mr. Mallen has observed:

[These requirements] would apply to every routine liability case, often where the insured has minimal or no involvement in the defense. Because the risk and consequences of disclosure of confidential information will vary from case to case, the time required for defense counsel to perform this task will be a noticeable entry on the bill.<sup>212</sup>

As Mr. Mallen has warned, the duty to evaluate the need for informed consent with respect to each bill—a responsibility that some of the ethics opinions seem to impose—could impose significant burdens on the lawyer, the insurer, and the insured.<sup>213</sup>

Although the redrafting of insurance contracts might seem to provide a means of obviating the need for an endless cycle of consent, the costs of redrafting and refileing contracts throughout the United States would itself impose a significant burden on insurance companies.<sup>214</sup> Moreover, since some of the opinions suggest that insureds must provide informed consent on a case-by-case basis, the reformulation of insurance policies would not necessarily liberate attorneys from the strictures of the ethics opinions.

## 2. Confidentiality Agreement

In its recent opinion concerning the ethics of an attorney for an insured submitting legal bills to an agency that reviews legal bills, the Louisiana State Bar Association's Ethics Advisory Service Committee recommended "that a confidentiality agreement be signed by the auditing company."<sup>215</sup> Some legal audit companies already sign such agreements.<sup>216</sup> Such an agreement should make clear that the reviewing agency will maintain the confidentiality of the bills by not sharing them with anyone who is not authorized by the agreement to see them or with any other person or entity who does not need to see the bills in connection with the services provided by the reviewing agency. A confidentiality agreement should also provide that the agency will take reasonable measures to ensure the confidentiality of the

---

211. See Ronald E. Mallen, *Guidelines or Landmines? Preserving the Tripartite Relationship*, FOR DEF., June 1998, at 9.

212. *Id.*

213. See *id.*

214. See *id.*

215. La., *supra* note 1.

216. See Baker, *supra* note 1, at 23.

information. Such measures should include maintenance of the bills in a secure location and warnings to all persons who see the bills that they are confidential.

The level of protection that the auditing company accords to the legal bills may affect the degree to which an attorney may obtain an insured's informed consent to the release of information. In order to successfully obtain informed consent, the North Carolina opinion advises:

Some of the things that may be necessary for the lawyer to obtain, consider, and review . . . are:

(a) a copy of the agreement between the audit company and the insurance company;

(b) whether the audit company or the auditor may use or share the information with any other third party, including another insurance company;

(c) how the audit company controls access to the information;

(d) the level of security provided by the audit company;

(e) how the confidentiality of the information is maintained;

(f) the assurances given that the confidentiality of the information will be maintained; and

(g) the consequences for the client, if the release of confidential information waives the attorney-client or the work product privileges.<sup>217</sup>

Similarly, the Pennsylvania opinion stated that an attorney who seeks to obtain an insured's informed consent must consider the "level of security and confidentiality of the files" as "[a]ny and all measures taken by Auditor to maintain/insure confidentiality of files."<sup>218</sup>

Although the Virginia opinion contended that "the attorney is in no position to direct the auditing firm to exercise proper precautions to maintain client confidentiality,"<sup>219</sup> insurance defense lawyers may indeed be able to persuade carriers to enter into confidentiality agreements with auditors if they can demonstrate that they may be obliged to withdraw from representation in the absence of such agreements.

---

217. N.C., *supra* note 1, 1998 WL 609887, at \*2.

218. Pa., *supra* note 1, 1997 WL 816708, at \*3.

219. Va., *supra* note 1. The Virginia opinion also stated that "the billing agency is not selected with due care as it is not selected by the attorney but by the carrier." *Id.*

### 3. Maintenance of Confidentiality in Time Entries Themselves

Insurance defense attorneys can help to prevent the disclosure of confidential information by refraining from including such information in their billing entries. Douglas R. Richmond has argued that "it may not be necessary to reveal confidences or secrets in legal bills. Time entries might be drafted so that confidential information is kept confidential."<sup>220</sup> As the Nebraska opinion aptly observed, "[i]t would seem fairly easy to minimize or eliminate confidential information from legal bills."<sup>221</sup>

The burden should, of course, be upon the attorney to ensure that bills submitted to outside auditors do not contain confidential information. Accordingly, the Utah opinion has properly stated that the lawyer has a duty to ensure that no confidential information is in a billing statement that is supposed to be disclosed to an auditor.<sup>222</sup> The New York opinion likewise has counseled attorneys to avoid placing confidential information in bills.<sup>223</sup> The Wisconsin opinion has suggested that "[c]ounsel who . . . are concerned that the transmission of their bills to others may breach client confidences should consider using drafting protocols that assure their billing narratives do not reveal client confidences."<sup>224</sup>

Insurance companies should consider including provisions in their billing guidelines requiring attorneys to avoid including information in bills that would violate duties of confidentiality to the clients if such information were disclosed to third parties.<sup>225</sup> Similarly, the Maryland ethics opinion has stated that the insurance defense counsel "may wish to review the agreement between the auditor and the insurer" in order to "determine who has access to the files and the procedures in place to ensure the confidentiality of the information provided."<sup>226</sup>

As we have seen, various authorities differ in their opinions about the degree to which legal bills are likely to contain confi-

---

220. Richmond, *supra* note 15, at 524.

221. Neb., *supra* note 1.

222. See Utah, *supra* note 1.

223. See N.Y., *supra* note 1.

224. Wisc., *supra* note 1, (visited Feb. 20, 2000) <<http://www.wisbar.org/ethop/formal/ethics99-1.html>>.

225. One insurance company, for example, has admonished attorneys in its guidelines that "[w]hen preparing billing invoices or statements, please remember that your charges may be reviewed by a third-party billing company. We ask that you not include information in your work description which would violate your obligations to our insureds or any other party to protect their privilege and confidential information." Hazard, *supra* note 156, at 30 n.52.

226. Md., *supra* note 1.

dential information.<sup>227</sup> As one commentator has observed, the deletion of such information could be difficult because "the names of potential witnesses interviewed and similar information would normally appear in a detailed bill but could be subject to privilege."<sup>228</sup>

Omission of confidential information also might be difficult because an attorney would need to define what is confidential. As one insurance defense attorney has observed, such attorneys "will be confronted such fundamental questions as whether the mere facts of the client's name and representation are confidential matters."<sup>229</sup>

Moreover, the growing client demand for more detail and specificity in billing<sup>230</sup> is potentially at odds with efforts to purge bills of confidential information. The state ethics opinions that warn against submission of insurance defense bills to outside auditors, therefore, create yet another irony, for they place insurance defense attorneys in a Catch-22 situation: if the attorney's bill is not sufficiently detailed, the auditor will complain about vagueness, but if the bill is sufficiently detailed, it may violate the attorney's duty of confidentiality. Mr. Richmond has suggested that one way to avoid this dilemma is for insurers to "instruct their auditors that if a time entry is vague or lacks sufficient detail and the defense attorney explains that the time was so recorded to safeguard confidential information, the auditors cannot question the time entry."<sup>231</sup>

#### 4. Redaction of Confidential Information

Insurance companies or attorneys who transmit bills to the auditors also might be able to preserve the privilege by redacting confidential information from the bills provided to the auditor. Such redaction would diminish the effectiveness of the review to the extent that this would prevent the reviewer from evaluating the propriety of an attorney's expenditure of time on specific

---

227. Compare *Clarke v. American Comm. Nat'l Bank*, 974 F.2d 127, 129 (9th Cir. 1992), and *Hunterdon County Policemen's Benevolent Ass'n. Local 188 v. Township of Franklin*, 669 A.2d 299, 302 (N.J. 1996), with *Ky.*, *supra* note 1, (visited Feb. 20, 2000) <<http://www.uky.edu/Law/kyethics/kba404.htm>>.

228. Thomas M. Keating, *Detailed Billing and Attorney-Client Privilege—The Balancing Act*, 84 ILL. B. J. 587, 588 (1996).

229. Cooley, *supra* note 25, at 21.

230. See Ross, *supra* note 5, at 63-68.

231. Richmond, *supra* note 15, at 524. Mr. Richmond acknowledges that "this requires that the insurer trust defense counsel not to cloak false or inflated time entries in bogus claims of confidentiality. Insurers simply should not hire untrustworthy defense counsel." *Id.*

issues relating to case strategy or other confidential subjects. The redaction probably would not significantly diminish the effectiveness of the audit, however, since such reviews generally are more concerned with such issues as clarity of entries, excessive staffing, billing for clerical work, extravagant disbursements, and other issues which do not require the review of billing records that reveal litigation strategy.

The recent opinion of the Louisiana State Bar Association's Ethics Advisory Service Committee recommended "that the statements be 'depersonalized' so that confidential information would not be disclosed or recognized."<sup>232</sup> Insurance defense attorney Andrew G. Cooley contends that this "editorial approach may well be impossible to follow effectively" because it "can be effective only if the editing eliminates all information 'relating to the representation' or what an independent conservative lawyer thinks would be embarrassing."<sup>233</sup> Mr. Cooley has also pointed out that "[t]he practical result is that little information can be forwarded to the auditors" since "[t]he detail demanded in the typical billing guidelines issued by the insurance company would require defense counsel to violate ethical obligations as interpreted by the various state bar associations."<sup>234</sup>

## 5. Privilege Log

It would also be useful for the auditor to create a privilege log which lists the names of any attorney and any agency involved in the communication as participants or recipients of information, along with the nature, subject matter, and date of any such communication.<sup>235</sup> In one recent case, the Second Circuit found that the failure to maintain a privilege log resulted in the waiver of privilege for communications between a defendant and its public relations firm.<sup>236</sup>

## 6. Use of Separate Agency

Preservation of the attorney-client privilege also would appear to be more likely if the insurance company hired an auditor that does not provide the company with non-litigation func-

---

232. La., *supra* note 1.

233. Cooley, *supra* note 28, at 21.

234. *Id.*

235. See *Diamond State Ins. Co. v. Rebel Oil Co.*, 157 F.R.D. 691, 697 (D. Nev. 1994).

236. See *Dorf & Stanton Communications v. Molson Breweries*, 100 F.3d 919, 927 (Fed. Cir. 1996).



tions. As we have seen, the Second Circuit's denial of the privilege in *Adlman* was based in large part upon its finding that the attorney had used the same auditor that the company used for routine business.

#### 7. Separate Retainer and Billing

Even if an insurance company submits its bills to an agency that performs other non-privileged functions for the insurance company, the insurance company should enter into a separate agreement with the agency for these services, in order to make clear that the function of the agent is different (and privileged) when it reviews legal bills. Similarly, the company should ask such an agent to submit bills which are separate from those which it submits for routine business functions. The Second Circuit in *Adlman*, denied the applicability of the attorney-client privilege and work product protection in part because of the lack of a separate retainer and billing for the functions for which protection had been sought.

#### 8. Statement of Privilege on Documents and Correspondence

All legal bills and correspondence that are sent to a reviewing agency should make clear on their face that they are privileged and confidential. Accordingly, it is useful to write or stamp "Privileged and Confidential" or similar statements on all such documents.<sup>237</sup>

### IV. BILLING GUIDELINES DO NOT INTERFERE WITH PROFESSIONAL JUDGMENT

Like legal audits, billing guidelines are an increasingly common method for the containment of legal costs. More than half of the nearly one hundred outside counsel who responded to a survey during 1994-95 reported that their companies provided billing guidelines to clients.<sup>238</sup> As one commentator has explained, "[m]any insurers utilize litigation management guidelines in order to effectively manage litigation, to control costs, and to clearly communicate objectives and expectations to defense counsel regarding the cost-efficient handling of the case."<sup>239</sup>

---

237. See James T. Haight, *Keeping the Privilege Inside the Corporation*, 18 BUS. LAW. 551, 559 (1963); John J. Tigue, Jr. & Linda A. Lacewell, *Protecting Corporate Privileges: Attorney/Client & Work Product*, BUS. CRIMES BULL.: COMPLIANCE & LITIG. Mar. 1996, at 4, 5.

238. See Ross, *supra* note 5, at 6-7, 272.

239. John S. Pierce et al., *supra* note 29, at 2.

Billing guidelines address numerous billing issues. For example, typical billing guidelines require attorneys to keep clients informed about their work; establish procedures for regular transmission of work product to the client; prohibit billing for activities performed for more than one client at the same time ("double billing"); provide for requisite detail in billing statements; require attorneys to bill in tenth of an hour units; require notice of staff changes; mandate effective use of technology; and impose limitations upon the number of attorneys who may be deployed for various tasks.<sup>240</sup> Some guidelines require an attorney to obtain the client's advance approval before undertaking certain types of work. Others merely require defense counsel to inform the company before undertaking various projects. These guidelines are based in large measure upon standards that courts have developed in statutory fee decisions.<sup>241</sup>

Although insurance defense attorneys sometimes complain that it is difficult to follow guidelines since different companies provide different guidelines, the chief claims officer of a major insurance company has pointed out that "keeping up with various guidelines should not be too difficult because there is a common thread that runs throughout them—communication with the client."<sup>242</sup>

Pending the outcome of the Montana declaratory judgment action,<sup>243</sup> no court has addressed the ethical propriety of billing guidelines. In dictum, the California Court of Appeals has questioned "the wisdom and propriety of so-called 'outside counsel guidelines by which insurers seek to limit or restrict certain types of discovery, legal research, or computerized legal research by outside attorneys.'"<sup>244</sup> The court in that decision complained that "[s]ome guidelines go so far as to call for the use of paralegals, rather than attorneys, to respond to 'routine' discovery requests or prohibit the retention of experts or the filing of certain pretrial motions until shortly before trial."<sup>245</sup> The court warned that "[u]nder no circumstances can such guidelines be

---

240. See Ross, *supra* note 5, at 59-60, 52-53, 85, 68, 169, 110-11, 77, 106.

241. See Hazard, *supra* note 156, at 24.

242. Wissman, *supra* note 31, at 8 (quoting Michael A. Fortune, executive vice president and chief claims officer of Zurich-American Insurance Group).

243. See *In re Rules of Prof'l Conduct & Insurer-Imposed Billing Rules and Procedures*, No. 98-612 (Mont. filed Nov. 4, 1998).

244. *Dynamics Concepts Inc. v. Truck Ins. Exch.*, 71 Cal.Rptr.2d 882, 889 n.9 (Cal. Dist. Ct. App. 1998).

245. *Id.* at 889.

permitted to impede the attorney's own professional judgment about how best to competently represent the insureds."<sup>246</sup>

In another recent decision, a federal judge in Montana stated in dictum that an insurance company's guidelines for outside counsel were in conflict with Rule 1 of the Federal Rules of Civil Procedure because they were so "bottom line oriented" that they might "hamstring" an attorney's efforts to achieve the "just, speedy, and inexpensive determination" envisioned by the rule.<sup>247</sup> The judge warned that "[i]f a litigant's internal billing 'case management' practice are at odds with the efficient resolution of a case, particularly when 'in house' paralegals and lawyers are controlling discovery, it will not interfere with the fair and orderly processing of the case in Federal District Court."<sup>248</sup>

Recent opinions of state bar associations in eleven states have expressed similar misgivings about billing guidelines and have prohibited or restricted their use by attorneys. For example, the Colorado opinion warned that "billing guidelines that arbitrarily and unreasonably restrict compensation for time spent by counsel performing services deemed necessary by counsel or that impose arbitrary rates for specific services may discourage the performance of such services."<sup>249</sup>

These opinions are based upon various ethics provisions, particularly state versions of the prohibitions against conflicts of interest and interferences with professional independence found in Model Rules 1.7(b) and 1.8(f)(2), and 5.4(c).<sup>250</sup> Some states

---

246. *Id.* The court stated that "[i]f the attorney's representation is to be limited in any way that unreasonably interferes with the defense, it is the insured, not the insurer, who should make that decision." *Id.*

247. *Frederick v. Ulum Life Ins. Co. of Am.*, 180 F.R.D. 384, 385 (D. Mont. 1998). The judge also contended that the guidelines conflicted with local rules of practice by unduly restricting local counsel. *See id.* The guidelines provided, *inter alia*, that no legal services could be rendered unless approved in advance; that outside attorneys must inform the company before making any commitments on the company's behalf; that a company attorney must review all briefs, motions, substantive pleadings, discovery responses, and settlement motions; that the company would not pay for any legal work that did not advance the ball; and that the company would not pay without advance approval for any work that could more effectively have been performed in-house. *See id.* The judge expressed particular objection to the company's refusal to pay for anything that did not "advance the ball," declaring that "[l]itigation is not a game in which counsel are paid only when they 'advance the ball.'" *Id.*

248. *Id.* at 386.

249. Colo., *supra* note 1, (visited Feb. 20, 2000) <[http://www.cobar.org/comms/ethics/fo/fo\\_107.htm](http://www.cobar.org/comms/ethics/fo/fo_107.htm)>.

250. *See, e.g., id.*; Fla., *supra* note 1; Mont., *supra* note 2; Wash., *supra* note 1; Wisc., *supra* note 1; Vt., *supra* note 1.

have also found that guidelines would implicate an attorney's duty to provide competent representation under state analogues to Model Rule 1.1<sup>251</sup> and the duty of diligence under Rule 1.3. Despite their wariness about billing guidelines,<sup>252</sup> the ethics opinions have not found them to be unethical *per se*.

The Montana ethics opinion, for example, acknowledges that "independent counsel may comply with those of the insurer's requests for information which merely serve to keep the insurer apprised of the general status of the litigation and with those billing procedures which merely serve to keep the insurer informed as to what services it pays for."<sup>253</sup> The Washington state opinion warns:

[A billing guideline] that *arbitrarily and unreasonably* limits or restricts compensation for the time spent by counsel performing services which counsel considers necessary to adequate representation, such as periodic review of pleadings, conducting depositions, or in preparing or defending a summary judgment motion, endeavors to direct or regulate the lawyer's professional judgment in violation of RPC 5.4(c).<sup>254</sup>

The same opinion states that "a billing guideline that imposes 'de facto' or arbitrary rates for certain services performed by a lawyer, such as compensating a lawyer at prevailing paralegal rates when the firm does not employ paralegals, operates as a disincentive in violation of RPC 5.4(c)."<sup>255</sup>

Likewise, Tennessee's ethics opinion disapproves billing guidelines, stating that "any directive by the insurance company which compels an attorney to *alter* his/her representation of the insured would be improper."<sup>256</sup> And the Iowa opinion declared:

---

251. See Mont., *supra* note 2; Wisc., *supra* note 1. Rule 1.1 of the ABA Model Rules of Professional Conduct provides that "[a] lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation." MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.1 (1998).

252. See Wisc., *supra* note 1. Model Rule 1.3 states that "[a] lawyer shall act with reasonable diligence and promptness in representing a client." MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.1 (1998). As one commentator has stated, "[a] defense attorney who unreasonably delays or postpones activities because of outside counsel guidelines may violate Rule 1.1." Richmond, *supra* note 42, at 534.

253. Mont., *supra* note 2, (visited Feb. 20, 2000) <<http://www.montana-bar.org/attorneyinfo/ethicsopinions/900517.htm>>.

254. Wash., *supra* note 1, (visited Feb. 20, 2000) <<http://www.wsba.org/bog/pres/fo/fo195.html>> (emphasis added).

255. *Id.*

256. Tenn., *supra* note 1, 1999 WL 406886, at \*4 (emphasis added).

[I]t would be improper for an Iowa lawyer to agree to, accept or follow Guidelines which seek to direct, control or regulate the lawyer's professional judgment or details of the lawyer's performance; dictate the strategy or tactics to be employed; or limit the professional discretion and control of the lawyer.<sup>257</sup>

The opinions are based in part upon various state ethics opinions which have expressed fear that efforts to limit attorney fees in insurance litigation would be prejudicial to insureds. Several state bar associations have stated that a fixed fee for an insured's attorney hired by an insurer could be set so low as to create an impermissible risk that the insurer would encourage the lawyer to provide inferior legal services,<sup>258</sup> and the Kentucky Supreme Court has prohibited all fixed fee arrangements for attorneys hired by insurance carriers.<sup>259</sup>

These recent ethics opinions that discourage the use of billing guidelines are misguided insofar as they are based on the theory that guidelines diminish professional independence or interfere with an attorney's obligation to an insured. Although substantive alteration of the representation might indeed interfere with the attorney's obligations to the insured, the issues addressed by typical billing guidelines do not interfere with the attorney's professional judgment or materially "alter" his or her representation of the insured. There does not need to be any conflict between an attorney's compliance with billing guidelines and Model Rule 5.4(c).

Some of the ethics opinions appear to have failed to distinguish between guidelines that diminish the quality of work and those that actually interfere with an attorney's exercise of independent judgment. The Vermont opinion, for example, complained that the guidelines that were the subject of its opinion seemed "designed to cut costs without regard for the ability of a lawyer to conduct a vigorous defense, and effectively

---

257. Iowa, *supra*, note 2.

258. See Ohio State Bar Ass'n, Op. 97-7 (1997); Or. State Bar Ass'n, Op. 1991-98; N.H. Bar Ass'n, Formal Op. (1991); Wisc. State Bar Comm. On Prof'l Ethics, Op. E-83-15 (1983).

259. American Ins. Ass'n v. Kentucky Bar Ass'n, 917 S.W.2d 568, 569-74 (Ky. 1996). The court explained that "the pressures exerted by the insurer through the set fee interferes with the exercise of the attorney's independent professional judgment." *Id.* at 572. The court also contended that a set fee arrangement "creates a situation in which the attorney has an interest in the outcome of action which conflicts with the duties owed to the client: quite simply, in easy cases, counsel will take a financial windfall; in difficult cases, counsel will take a financial loss." *Id.*

depriv[e] the lawyer of the opportunity to exercise professional judgement in determining how to best conduct such a defense.”<sup>260</sup> An examination of the guidelines discussed in the Vermont opinion, however, reveals nothing that would appear to interfere with professional judgment. Guidelines that require billing entries to include the name of the parties to communications and the subject matter of communications seem to constitute a healthy attempt to require the lawyers to provide both the insured and the insurer with sufficient information to enable them to assess the reasonableness of the bills; courts and commentators have strongly encouraged such details in billing entries for conferences and phone calls.<sup>261</sup> Similarly, guidelines that prohibit deposition digests and deferral of any form of trial preparation until trial is imminent appear very likely to foster sensible economies. Guidelines that discourage the use of paralegals in favor of outside clerical vendors and discourage the use of experienced attorneys for initial research could encourage economies, depending upon the facts of a case. And guidelines that refuse payment for computerized research and proofreading and revision of first drafts seem likely to diminish the quality of legal services. But compliance with none of these guidelines should affect a lawyer’s professional judgment.

As Professor Silver has observed, the contention that billing guidelines violate Model Rule 5.4 “fails to draw an elementary distinction between freedom of judgment and freedom of action.”<sup>262</sup> Even to the extent that billing guidelines may restrict an attorney’s conduct, they “do not limit the content or nature of the advice lawyers can render. Only restrictions that fetter lawyers’ freedom to give clients the benefit of their *judgment* can run afoul of” Rule 5.4.<sup>263</sup> Similarly, Mr. Richmond has observed that “[i]nsurers do not intend outside counsel guidelines to hamstring defense counsel. Certainly insurers never anticipated that their guidelines might have ethical or malpractice ramifications for defense counsel.”<sup>264</sup>

Moreover, the rules themselves do not give an attorney unfettered discretion over the conduct of litigation. As Dean Syverud has pointed out, Model Rule 1.2(a) contemplates that the attorney will abide by an insurance company’s instructions

---

260. Vt., *supra* note 1, (visited Feb. 20, 2000) <<http://www.vtbar.org/>>.

261. See Ross, *supra* note 5, at 64.

262. Brief for Amicus Curiae Charles Silver at 2, *In re Prof’l Conduct & Insurer-Imposed Billing Rules & Procedures*, No. 98-612 (Mont. filed Nov. 4, 1998) [hereinafter Silver].

263. *Id.*

264. Richmond, *supra* note 43, at 531.

"to limit the expenses incurred to those deemed reasonable and to restrict certain expenditures that, in many cases, are unlikely to be cost-effective or necessary to the defense."<sup>265</sup> The insurance company, rather than the insured, is generally in a much better position to determine how to conduct the litigation in the best interests of both the insurance company and the insured.<sup>266</sup> Indeed, it is the insurance company that will principally bear the burden of mistaken decisions, since the insurance company typically pays all of a claim. Similarly, the insurance company may be liable to the insured if it errs in conducting its defense.<sup>267</sup>

Billing guidelines therefore do not necessarily interfere with an attorney's independent judgment. Such guidelines merely impose procedural restrictions on the logistics of the representation rather than substantive restraints on strategy. For example, it is impossible to imagine how a billing guideline which requires an attorney to bill in units of one-tenth of an hour rather in quarter-hour units interferes with the professional judgment of an attorney. Similarly, restrictions on such matters as how many attorneys can attend a deposition or the extent to which attorneys can perform clerical tasks such as photo-copying of documents do not appear to any manner restrict the professional judgment of an attorney. Even the strict Washington opinion acknowledges:

An attorney may ethically comply with the billing guidelines of a person other than the client who pays the lawyer's bill, where the billing guidelines do not endeavor to direct or regulate the lawyer's independent professional judgment and permit defense counsel to provide a degree

---

265. Syverud, *supra* note 150, at 180. MODEL Rule 1.2(a) provides that "[a] lawyer shall abide by a client's decisions concerning the objectives of representation . . . and shall consult with the client as to the means by which they shall be pursued." MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.2(a) (1998).

266. *See id.*:

For more than a century, lawyers jointly representing the interests of the insurance company and the insured have deferred to the insurance company on these sorts of questions for the obvious reason that the insurance company is the client with the delegated authority, pursuant to the insurance contract, to manage the litigation. It is also the client which is in the best position, given its extensive risk-management and litigation experience, to effectively undertake that responsibility for the benefit of both the insureds and itself.

267. *See* Joint Brief for Respondents at 29-31, *In re Prof'l Conduct* (98-612).

of detail and narrative description in billings that meets the test for nondisclosure of confidential information.<sup>268</sup>

Proponents of the lawfulness of billing guidelines have pointed out in the Montana litigation that there is no evidence in Montana or in any other state that billing guidelines have ever prejudiced the defense of an insured.<sup>269</sup> Most billing guidelines are flexible enough to permit attorneys to permit attorneys to seek permission from the client when the attorney believes that the client's best interests require her to exceed limitations prescribed by the guidelines. Indeed, the most outstanding characteristic of billing guidelines is their encouragement of attorneys to communicate more regularly and effectively with their clients. Clients tend to interpret the letter of their guidelines liberally if they believe that the attorney is abiding by the spirit of the guidelines by trying to contain costs.<sup>270</sup> Guidelines, as the word "guideline" suggests, are usually intended merely as guideposts rather than as rigid rules.<sup>271</sup>

Moreover, the danger that reductions in litigation expenses will prejudice the insured is generally minimal because the large majority of insurance claims are resolved within policy limits.<sup>272</sup> Professor Silver has estimated that "covered claims are resolved within the policy limits more than 95 percent of the time."<sup>273</sup>

It is therefore ironic that billing guidelines, which facilitate a guiding principle of the Model Rules of Professional Conduct insofar as they encourage communication between a client and an attorney, are alleged to breach ethical duties. As Professor Hazard has stated in connection with the Montana case:

A requirement of consultation permits the lawyer and the insurer to deal with the conflict of interest inherent in hourly billing. It is always in the lawyer's interest to do more work, as that will generate higher fees. . . . Both abuse and subconscious excess can be restrained by requir-

---

268. Wash., *supra* note 1, (visited Feb. 20, 2000) <<http://www.wsba.org/bog/pres/fo/fo195.html>>.

269. See Hazard, *supra* note 156, at 18.

270. See Ross, *supra* note 5, at 254.

271. As Dean Syverud has explained:

Generally, the Guidelines do nothing more than develop a clear, up-front understanding between the insurer and the lawyer as to what the insurer expects of counsel. The Guidelines also enable the lawyer to make an informed decision regarding the necessity and benefits of performing certain services before incurring expenses attendant to those services.

Syverud, *supra* note 150, at 182.

272. See Hazard, *supra* note 156, at 4.

273. See Silver, *supra* note 262, at 12.



ing the lawyer to think through and explain why a particular action is recommended. The lawyer's evaluation is sharpened by responding to the adjuster's comments and questions.<sup>274</sup>

Even if one assumes for the sake of argument that such interference could occur in the context of particular guidelines, this would not render all guidelines violative of an attorney's professional judgment. Any contrary argument would suggest that an insurer who pays legal bills can have no control over those bills and must pay whatever bill the attorney submits, regardless of the bill's reasonableness.

There also appear to be adequate safeguards to prevent billing guidelines from interfering with an attorney's professional judgment. If a potential attorney for an insured concluded that an insured's billing guidelines would interfere with the attorney's professional judgment, the attorney could decline to undertake the representation. If the attorney concluded that the guidelines were not unduly restrictive and accepted the representation but found later that the directives from the insurer interfered with his judgment, he could attempt to convince the insurer that the guideline should be amended or waived.<sup>275</sup>

Indeed, once the representation has begun, the attorney would be required pursuant to Model Rule 1.4 to communicate with the insured in a manner that enabled the insured to participate intelligently in his representation. Professors Hazard and Hodes have suggested that Model Rule 1.4 seems to require a lawyer to provide a client with information that will help the client to decide whether the services received by the client will be worth the price and whether the continuatio.. of a legal matter

---

274. Hazard, *supra* note 156, at 14-15. Accordingly, Professor Hazard has concluded:

[T]he advance planning and consultation contemplated by the Guidelines are legitimate means of protecting the insurer's interests in the efficient and prudent conduct of the defense. They need not entail any sacrifice of the insured's interests, especially if (as is usually true) the insured faces no financial risk that is not covered by the insurance. To the extent that such consultation avoids unnecessary discovery or motion practice, it also benefits the judicial system.

*Id.* at 3-4. Similarly, Professor Hazard has aptly observed that "[a]n insurance policy is not a blank check, entitling the defense counsel to be paid for whatever services counsel chooses to render. Rather, the services must be appropriate to the case and the charges reasonable." *Id.* at 21-22.

275. See Colo., *supra* note 1, (visited Feb. 20, 2000) <[http://www.cobar.org/comms/ethics/fo/fo\\_107.htm](http://www.cobar.org/comms/ethics/fo/fo_107.htm)> (stating that obtaining permission of the insurer not to follow the guidelines is one alternative if the attorney concludes that billing guidelines interfere with his professional judgment).

will be worth the cost.<sup>276</sup> This communication can include information concerning legal services that the insurer refused, but that the attorney deemed to be necessary for the insured's adequate defense, thereby enabling the insured to remonstrate with the insurer.

If the guidelines truly interfered with the attorney's professional judgment and the attorney had a good working relationship with the insurer, the arrangement of a mutually satisfactory compromise would normally not be difficult. As one commentator has observed, "[w]orking together to resolve problems in the best interests of the insured has been what insurers and defense attorneys have always done. Compliance with insurer litigation guidelines should not change this."<sup>277</sup> If the attorney could not persuade the insurer to alter or waive a guideline that interfered with the attorney's professional integrity, the attorney could resign from the representation.<sup>278</sup>

Ultimately, the attorney must decide for herself whether billing guidelines interfere with her professional judgment.<sup>279</sup> Accordingly, the Colorado Bar Association opinion understandably could not "find any bright line rule that can be used to distinguish the point where the attorney's professional judgment is compromised."<sup>280</sup> The Colorado opinion properly cautioned attorneys "against agreeing to guidelines prior to evaluating how they would apply to foreseeable situations in the cases to which the guidelines would apply."<sup>281</sup> The Colorado opinion also aptly urged attorneys to regularly monitor guidelines to avoid interference with professional judgment.<sup>282</sup>

---

276. See Geoffrey C. Hazard, Jr. & W. William Hodes, *A Look at the Ethical Rules; Fee Shifting in the Federal Courts*, in *BEYOND THE BILLABLE HOUR: AN ANTHOLOGY OF ALTERNATIVE BILLING METHODS* 124 (Richard C. Reed ed., 1989).

277. John A. Conlon, *Insurer Litigation Guidelines: Attorney Ethical Considerations*, *RES GESTAE*, Oct. 1998, at 11.

278. See Colo., *supra* note 1, (visited Feb. 20, 2000) <[http://www.cobar.org/comms/ethics/fo/fo\\_107.htm](http://www.cobar.org/comms/ethics/fo/fo_107.htm)> (stating that refusal to abide by the guidelines and withdrawal as counsel is another alternative if the attorney concludes that billing guidelines interfere with his professional judgment).

279. As the Montana opinion concluded, "[i]n the final analysis, independent counsel must determine on a situational basis what information he can supply to the insurer without violating the ethical duties to the client." Mont., *supra* note 2, (visited Feb. 20, 2000) <<http://www.montanabar.org/attorneyinfo/ethicsopinions/900517.htm>>.

280. Colo., *supra* note 1, (visited Feb. 20, 2000) <[http://www.cobar.org/comms/ethics/fo/fo\\_107.htm](http://www.cobar.org/comms/ethics/fo/fo_107.htm)>.

281. *Id.*

282. *Id.*

As with submission of legal bills to outside auditors, the use of billing guidelines should ultimately benefit insureds by helping to contain or reduce premiums and preventing insurance companies from discontinuing types of coverage which may become prohibitively expensive for the companies.

Even if insurers are not deemed to be clients of insurance defense attorneys, such attorneys would still not violate their ethical obligations to the insured by following such guidelines, for insurance contracts generally provide that policy holders shall consent "to the insurance company's direction of the defense and any settlement of the action."<sup>283</sup> Billing guidelines help insurance companies to fulfill their statutory and contractual obligations to provide cost-efficient defense to their insureds.<sup>284</sup> Accordingly, it is probably not necessary for insurance defense lawyers to obtain the consent of policy holders in order to ethically abide by billing guidelines, notwithstanding the contrary contention of several of the state ethics opinions.<sup>285</sup>

Just as insurers have incentives to avoid compromising client confidences in the submission of bills to auditors, insurers likewise have reason to avoid disregarding sound advice from their attorneys because such disregard could make the carrier liable to the insured in tort or contract if the judgment exceeded the amount of the policy.<sup>286</sup> Dean Syverud has observed that "it

---

283. Syverud, *supra* note 150, at 181. As Dean Syverud has pointed out, "obtaining the benefit of the insurer's claim handling experience is often one factor an insured considers in purchasing insurance." *Id.*

284. As the Respondents' brief in the Montana case points out in arguing that the guidelines are ethical even if the Montana court reversed its own precedent and found that the insured was the sole client:

The insurance contract delegates to the insurer the right and duty to control the defense of the litigation, including the right to monitor the costs and legal services attendant to that defense. Were insurers unable to impose the consultation and other requirements contemplated by the Guidelines, they could not possibly satisfy their statutory and contractual obligations to investigate and settle claims in good faith, and to provide an adequate defense.

Joint Brief of Respondents at 18, *In re Prof'l Conduct & Insurer-Imposed Billing Rules & Procedures*, No. 98-612 (Mont. filed Nov. 4, 1998).

285. For example, the Virginia opinion stated:

[I]t is ethically impermissible for an attorney to agree to an insurance carrier's restrictions on the attorney's representation of the insured absent full disclosure and consent of the client at the outset of the representation and absent a determination that the client's rights will not be materially impaired by the restrictions.

Va., *supra* note 2. See also Wash., *supra* note 1.

286. As one commentator has pointed out:

Most jurisdictions subject insurers to substantial extracontractual damages and even punitive damages for bad faith handling of claims.

would take a remarkably bold insurance company" to reject an attorney's advice that it believed that conformity with the billing guidelines would harm the interests of the insured.<sup>287</sup> Similarly, Professor Hazard has pointed out that "[i]t is extremely unlikely that an insurer would have any incentive to overrule a recommendation the lawyer described as essential to the protection of the insured" since the "ample remedies (including bad faith claims)" that are available to an insured who is harmed by an insurer's refusal to approve recommended legal work "make it extremely perilous for an insured to refuse a recommendation."<sup>288</sup>

Some of the respondent insurance companies in the Montana case have submitted affidavits stating that they rarely withhold approval of activities recommended by defense counsel if those attorneys, after further consultation, continue to recommend the activity.<sup>289</sup> Indeed, some of the respondents in the Montana case say that they always have approved any activity that defense counsel has argued to be essential for the protection of the insured.<sup>290</sup> For example, if a insurer imposed what the attorney regarded as unreasonable limitations on the amount of time that the attorney could spend researching an issue that the attorney regarded as critical to the outcome of the case, the attorney could explain to the insurer why the time was needed.

Since the ultimate question of whether an insurance company is required to pay for legal services depends upon the contractual obligations of the insurance company toward the insured, the attorney can continue the representation if the insured and the insurer can work out their differences within the context of their contract.

---

Even if purely contractual remedies might have left some harm to insureds uncompensated, bad faith tort remedies are unlikely to do so. Existence of causes of action for bad faith give insurers powerful incentives to protect the interests of their insureds and gives insureds who have not been protected powerful remedies for any injuries done them.

William T. Barker, *The Tripartite Relationship and Protection of the Insured: Is There a Problem?*, INS. LIT. RPTR., Oct. 1, 1999, at 6.

287. Syverud, *supra* note 150, at 184. Although Dean Syverud reached this conclusion in the context of the bad faith law of Montana, the prevalence of statutes and common law that protect insureds presumably make his observation relevant to most jurisdictions.

288. Hazard, *supra* note 156, at 4.

289. See Joint Brief for Respondents at 49, *In re Prof'l Conduct* (No. 98-612).

290. See *id.*

## CONCLUSION

The many recent state ethics opinions that have questioned the ethical propriety of billing guidelines and the submission of insurance defense bills to outside auditors have created an unnecessary and ironic controversy. The controversy is unnecessary because the use of guidelines and legal auditors is not likely to prejudice policy holders. The controversy is ironic because restrictions on the use of guidelines and legal auditors could actually harm policy holders.

Contrary to the contention of the various state ethics opinions, legal audits and billing guidelines are not likely to interfere with the professional judgment of attorneys since legal auditors ordinarily only examine the format of bills and identify technical problems rather than question substantive decisions concerning the conduct of litigation. To the extent that attorneys believe that such guidelines or audits interfere with their professional judgment, they may communicate their concerns to the insurer. Since most insurers have good working relationships with their attorneys, the insurers are likely to heed the advice of their counsel. Moreover, insurers have an incentive to heed their attorneys' advice in order to assure a favorable outcome in the case and to avoid liability to policy holders under various causes of action in tort and contract. In the unlikely event that an insurer and an attorney could not agree about litigation strategy, the attorney could withdraw from the representation.

The state ethics opinions also erroneously assume that submission of legal bills to outside auditors will compromise the attorney's duty to maintain client confidences. Some of the opinions have also suggested that the submission of legal bills to auditors might breach the attorney-client privilege. Most legal bills, however, are not likely to contain any confidential information that would materially prejudice the interests of policy holders.

To the extent that such bills might contain confidential information, there are many ways in which an attorney can avoid breaching her duty to maintain client confidences. Virtually all of the ethics opinions agree that an attorney could properly obtain the informed consent of the insured. Many of the opinions are unduly pessimistic, however, about the likelihood that insureds would offer consent because the opinions fail to appreciate that auditing benefits the insured as well as the insurer.

In addition to obtaining the informed consent of insureds, attorneys may also comply with their duty to maintain confidences through various other means, including confidentiality

agreements signed by auditors; maintenance of confidentiality in time entries themselves; redaction of confidential information from bills sent to auditors; creation of privilege logs; the use of auditors who do not perform other functions for insurance companies; the use of separate retainer and billing agreements with auditors who perform multiple functions; and the liberal denomination of documents as "confidential" or "privileged."

The use of billing guidelines and audits serves the best interests of attorneys, insurance companies, and insurance policy holders. Far from prejudicing policy holders, the use of billing guidelines and outside auditors helps to protect their interests by ensuring that their attorneys manage their case in an efficient and ethical manner. Curtailment of excessive legal costs ultimately helps all insureds by helping to reduce insurance premiums. The use of guidelines and auditors also benefit insurance companies by helping them to manage costs, and they serve the legal profession by helping to curb abuses that have created friction between clients and lawyers and have diminished public confidence in the legal profession.

A partial solution to the controversy over the use of billing guidelines and legal auditing may arise out of the use of alternatives to time-based billing,<sup>291</sup> although these carry their own ethical dangers.<sup>292</sup> Despite growing experimentation with alternative forms of billing, however, time-based billing remains standard practice in most types of practice, including insurance litigation.<sup>293</sup> The need for billing guidelines and outside auditors is therefore likely to remain a feature of insurance defense work.

Time-honored ethical rules governing the ethically complex tripartite relationship among lawyers, insurers, and insureds are

---

291. See, e.g., Barbara J. Buba, *Profitable Client Relations: Keeping the Client Happy Without Losing Your Shirt in the Auditing Process*, DEF. RESEARCH INST.: L. OFFICE ECON. SEMINAR, 1999, at 27. One insurance industry official has urged insurance defense attorneys to "come up with a better way" of billing:

[Insurance defense attorneys should use a method of billing that] fits what the client needs . . . . If the client asks for procedures in order for the client to feel comfortable . . . in an hourly billing system that irritate[s] the attorney, then . . . the time has come for those attorneys to . . . develop an alternative billing system.

Wissman, *supra* note 31, at 2 (quoting Janet E. Bachman, vice president of claims administration of the American Insurance Ass'n).

292. See, e.g., Ross, *supra* note 5, at 237-48; Ronald D. Rotunda, *Moving from Billable Hours to Fixed Fees: Task-Based Fees and Legal Ethics*, 47 U. KAN. L. REV. 819 (1999).

293. See Patrick J. Schiltz, *On Being a Happy, Healthy, and Ethical Member of an Unhappy, Unhealthy, and Unethical Profession*, 52 VAND. L. REV. 871, 951 n.189 (1999).

quite sufficient to accommodate the new issues that have arisen out the use of billing guidelines and outside auditors. Although the recent state ethics opinions offer apt reminders of the ethical duties that insurance defense attorneys owe to insureds, any imposition of novel restrictions on the use of guidelines and auditors are unnecessary and are likely to harm attorneys, insurers, and policy holders.