When Should Government Regulate Lawyer-Client Relationships? the Campaign to Prevent Insurers from Managing Defense Costs

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WHEN SHOULD GOVERNMENT REGULATE LAWYER-CLIENT RELATIONSHIPS? THE CAMPAIGN TO PREVENT INSURERS FROM MANAGING DEFENSE COSTS

CHARLES SILVER*

INTRODUCTION

I have recently undertaken to defend private interest lawyering.¹ Some may wonder why, the facts not suggesting any particular need. Law is the fourth largest sector of the service economy, the profession has grown dramatically, lawyers who represent private clients are highly paid, and competition for slots in prestigious law schools is fierce. The economic downturn has hurt many lawyers, but other professionals have suffered too. Why worry about lawyers who work for private clients?

One reason is that private interest lawyering is greatly under-appreciated and often maligned. Although it is extremely valuable for clients, the economy, and society as a whole, rarely are its contributions recognized. Comments at the Arizona conference that preceded this symposium confirmed this opinion. Many speakers maligned private interest lawyers, claiming they have lost sight of professional values, are too adversarial, and employ an outmoded paradigm of lawyering. An Arizona supreme court justice called the profession a “disgrace” for failing to meet the legal needs of the poor. Many comments would have led an observer to conclude that the profession is in serious

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trouble.

I disagree with these assessments. As far as I can tell, the legal profession is in excellent shape. Growing numbers and competitive pressures are encouraging lawyers to be more efficient. Even so, private interest lawyers continue to hold themselves to high professional standards. Consider interest conflicts. A forthcoming American Bar Foundation study states that “[w]hile other fiduciaries are strangling on their tangled loyalties, law firms may turn out to be the last fiduciary bastion where confidences are honored and uncompromising loyalty fiercely defended.” The truth, I believe, is that private interest lawyers are helping more clients than ever and serving them better.

These lawyers also serve the public. By building and maintaining a culture in which citizens use law and become accustomed to asserting legal rights, they strengthen the rule of law and help create private centers of power that limit governmental excesses. By contributing to economic growth and being charitable in diverse ways, they help the poor and promote valuable institutions. Pro bono enthusiasts have offered no evidence that lawyers are less charitable than other people. They are disappointed with the profession because they give legal services undue priority and because they expect lawyers to be exceptionally generous.

Another reason for focusing on private interest lawyering is that state bar associations, courts, and other authorities often regulate this activity badly. This is not all

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2 *Tangled Loyalties, Conflict of Interest in Legal Practice*, 13 RESEARCHING LAW 1, (Winter 2002) (internal quotation marks omitted).

3 For years, tort reformers and other lawyer-bashers argued that the United States should model itself on Japan, which had far fewer lawyers per capita. Now, Japan has decided that America is rich where it is poor and is revamping its educational system to produce more American-style lawyers. Alan Brender, *Japan Tries to Reform How It Trains Lawyers*, CHRONICLE OF HIGHER EDUC. 47 (Feb. 15, 2002).

4 The points expressed in this paragraph are developed more fully in SILVER & CROSS, supra note 1.
that surprising. Anyone with a background in political science, the economics of regulation, or administrative law should know that top-down regulations often misfire. Sometimes, they advantage powerful interest groups that capture regulatory bodies. Always, they reflect the views of persons far removed from local activities who possess limited information and limited rationality, and who operate within the limits of language as well.\textsuperscript{5}

Because many professional regulations are self-imposed, lawyers can enact restrictions like minimum fee schedules, advertising restrictions, and unauthorized practice of law prohibitions that benefit lawyers by constraining competition. Judges and legislators, who also regulate lawyers, have their own ideologies, agendas, and constituencies, the latter including insurance companies, product manufacturers, tort reform groups, health care providers, and lawyers. One should no more expect judges and legislators to promote the public good when regulating lawyers than when doing other things.

The risk that good intentions may backfire must also be remembered. For example, bar leaders restrict advertising because they want to improve the public’s opinion of lawyers. Yet, the level of television advertising correlates positively with public opinion,\textsuperscript{6} suggesting that the public would like lawyers better if lawyers were less constrained. Proponents of fee restrictions want to protect clients, but state bar rules prohibiting traffic in causes of action may enable lawyers to acquire additional income,


and limits on contingent fees may make claimants worse off on the whole by driving down settlement amounts.\(^7\)

As a general matter, it is difficult to say whether state bar rules and other professional regulations are beneficial or detrimental because no one has studied their effects. Our ignorance is astonishing, even with respect to the most entrenched and significant regulations. No empirical study supports the use of unauthorized practice of law restrictions, moral fitness committees, fee rules, continuing legal education requirements, bar examinations, or bar membership requirements. For all we know, the country would be better off if all these regulations were scrapped.

In this Article, I will use the current controversy over the professional responsibilities of insurance defense lawyers to emphasize that state bars and other authorities should regulate attorney-client relationships only when reliable information demonstrates the advantage of doing so. Since the mid-1990s, advisory committees and courts have issued a plethora of opinions on insurance defense practices.\(^8\) These opinions

\(^7\) See Rudy Santore and Alan D. Viard, *Legal Fee Restrictions, Moral Hazard, and Attorney Rents*, XLIV (2) J.L. & ECON. 549, 550 (2001) (arguing that prohibitions preventing lawyers from purchasing clients’ causes of action enable lawyers to overcharge, and that efforts to push contingent fees below market equilibrium would reduce clients’ recoveries “by enough to outweigh the client’s larger share of the recovery”). See also Albert Choi, *Allocating Settlement Authority under Contingent Fee Arrangement*, http://papers.ssrn.com/sol3/delivery.cfm/SSRN_ID287925_code011024100.pdf?abstractid=287925 (October 9, 2001) (explaining that “the contingent fee contract also functions as a bargaining tool against the defendant during the settlement negotiations,” and that keeping the fee percentage high can maximize the advantage gained by the plaintiff in settlement).

\(^8\) As they say in the music business, the hits just keep on coming. After this article was substantially complete, the Utah bar issued a lengthy opinion on insurance defense ethics. UTAH OP. 02-03 (February 27, 2002). In Florida, the Special Commission convened to investigate insurance defense practices released its second report, focusing on staff counsel operations. REPORT OF THE SPECIAL COMMISSION ON INSURANCE PRACTICES II (Mar. 1, 2002) (http://www.flabar.org/). A new Florida rule specific to insurance defense lawyers also took effect. Joan C. Rogers, *Regulation of Bar Florida Rule Changes Feature New Form That Insurance Defense Lawyers Must Use*, A.B.A. & THE BUREAU OF NAT'L AFFAIRS, INC., (May 8, 2002) (http://bna-pub2.bna.com/LNNPUBS/mpc.nsf/). In Tennessee, the supreme court issued an opinion holding that insurance companies have no legal right to control defense lawyers but may nonetheless exercise actual control of them and may therefore be vicariously liable for defense lawyers’ torts. Givens v. Mullikin, (Tenn. March 25, 2002). In Minnesota, the supreme court granted a petition to review an appellate decision holding that an insurance carrier is not a client of the lawyer retained to defend a liability
question or prohibit long-standing practices, including the use of staff counsel, litigation management guidelines, flat fees, and fee audits. There is no evidence that these practices are harmful. Regulators sprang into action because defense lawyers asked them to, not because policyholders or insurers complained or because there was any evidence of danger to anyone. This is precisely the situation in which one should expect regulations to be counterproductive.

When considering the desirability of regulating private interest lawyers, several reasons support the choice of insurance defense as an example. First, defending covered lawsuits truly is a private interest activity. The lawsuits concern mainly money sought as compensation for physical or economic injuries, and the point of the tripartite relationship is to handle in an advantageous way the task of responding to payment demands. Second, defense lawyering is a mainstay of litigation. Insurance companies provide lawyers in a sizeable fraction of all civil cases. The decision to adopt significant regulations is therefore a momentous one. Third, insurance companies are sophisticated, high volume purchasers who participate in the market for legal services over the long haul. They should develop excellent working relationships with attorneys without the help of paternalistic regulations. Fourth, there is reasonably good empirical data relating to covered claims. Because one can gauge relevant matters, such as the frequency with which policyholders face excess exposure and defense cost tends, with some precision, one need not take the accuracy of empirical claims on faith. Fifth, insurance defense
lawyering has been a practice area for over century. In that time, defense lawyers have handled millions of cases and developed a track record. Their practices are well known, and it should be possible to document changes in their success rates. Again, when considering claims about the conditions in which these lawyers operate, we can reasonably demand empirical support.

The article will proceed as follows. Part I will provide a brief overview of regent regulatory developments relating to the practice of insurance defense. Part II will argue that these developments occurred because lawyers pressured advisory committees and other authorities to give them greater control of decisions and easier access to fees. Part III will explain the danger of waste that arises when lawyers are free to spend insurance companies’ dollars. Part IV will show that no empirical evidence of harm to policyholders supports the contention that defense lawyers should have greater freedom from carriers’ efforts to manage litigation. Separate sections on staff counsel operations, flat fee arrangements, and litigation guidelines and third-party fee audits will tailor this general point to the specific activities that have recently been the targets of so much regulation. Part V will draw a brief conclusion.

I. RECENT REGULATORY ACTIVITY

For most of the twentieth century, regulators had little interest in the professional responsibilities of insurance defense lawyers. Over many years, a trickle of common law decisions, advisory opinions, and statutes produced a body of authority that was broad but not deep. Many states had no decided cases on fundamental issues, such as the number of clients a defense lawyer represents. The attitude of regulators was one of
Despite this, or perhaps because of it, insurance carriers, policyholders, and defense lawyers went about their business with remarkably few hitches. Working hand-in-glove with insurers, defense lawyers handled millions of claims. Judging from case reports, malpractice statistics, and closed-claim studies, carriers and policyholders were happy with their work. The most controversial subject probably was the unauthorized corporate practice of law, an issue raised by independent defense lawyers who opposed insurers’ staff counsel operations.9

In the 1990s, the trickle became a flood. Courts and advisory committees issued dozens of opinions purporting to find serious problems and ethical deficiencies of diverse kinds. In Florida, the state bar convened a special committee to investigate insurance defense practices10 and adopted a new rule devoted exclusively to the representation of insureds.11 In Texas, after two supreme court justices asked the legislature to intervene,12 bills relating to litigation guidelines and third-party fee audits were passed but the governor vetoed them.13 In Montana, the supreme court invalidated working arrangements that required lawyers to obtain prior approval of litigation activities from insurers.14 In Kentucky, the supreme court prohibited defense lawyers from handling

9 See, e.g., A.B.A. FORMAL OP. 252 (1950) (addressing staff counsel operations).
10 The Committee’s reports are available at http://www.flabar.org/.
11 Rule 4-1.8(j). New Florida rule on representation of insureds; Conflict of Interest; Prohibited and Other Transactions, (j) Representation of Insureds.
13 See 2001 TX S 1653 (introduced Mar. 9, 2001) (regulating fee audits) and 2001 TX S 1654A (introduced Mar. 9, 2001) (regulating litigation guidelines). See also Winning the Battle and the War, TEX. LAWYER (Feb. 22, 2002) (describing passage and vetoes of the bills).
insurance work on a fixed fee basis and reaffirmed the prohibition on staff counsel operations.\(^{15}\) In state after state, advisory committees sprang into action in response to defense lawyers’ requests for guidance.

### INSERT TABLE 1 HERE

Table 1 catalogues advisory opinions and court decisions issued between 1994 and the present. The list includes six opinions on staff counsel operations, six on flat fees, twenty-two on litigation management guidelines, and thirty-nine on fee audits. In the entire field of legal ethics, I know of no other subject area in which so much authority issued in so short a space of time. Nor do I know of any area in which state bar committees and judges criticized existing practices so severely. Overall, the opinions describe flat fees and staff counsel operations as unfortunate but ethically tolerable, litigation guidelines as bad and often intolerable, and third-party fee audits as an evil to be avoided at all costs.

II. THE CAUSE OF REGULATORY INTEREST: LAWYERS’ DESIRE FOR CONTROL

Why did regulators suddenly show a keen interest in insurance defense arrangements? Lawyers sought their help. All the advisory committee opinions and many of the court decisions issued, directly or indirectly, in response to requests from attorneys. In Montana, lawyers filed an unprecedented original petition in that state’s supreme court. In Kentucky, the decision prohibiting flat fee arrangements was an appeal of a state bar advisory opinion that issue in response to a lawyer’s request for guidance. In Texas, lawyers obtained opinions condemning litigation guidelines and fee audits from the state bar, and later lobbied the legislature to codify the results. In Florida, lawyers caused the bar to appoint the Insurance Practices Special Study Committee, which produced a report that led to a new disciplinary rule.

Why did lawyers undertake this campaign? Their primary goal is to transform the tripartite relationship in ways that give lawyers greater control over litigation decisions and easier access to fees. Participants in the campaign have announced these objectives repeatedly. Consider attorney Donald W. Ricketts, who charged his former employer, Early, Maslach & Price, a captive law firm founded in the 1940s, with engaging in the unauthorized practice of law. Ricketts particular gripe was that the firm allowed lay claims adjusters employed by Farmers Insurance Group to second-guess lawyers’ recommendations. He called for “a structural change that says, essentially, that once a case ripens to the point of litigation, lawyers call the shots.”

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16 Another aim has been to attack companies that audit lawyers’ bills. This aim has been achieved. See Jill Schachner Chanen, Adios, Outside Auditors: Insurance Carriers Go In-House To Check Attorney’s Bills, A.B.A. J. 20 (Jan. 2000).

17 Gail Diane Cox, Captive Firms of Insurers Get Stung in Court, NAT’L L.J. (May 9, 2000).
awarded Ricketts more than $2 million in damages.\(^\text{18}\)

In Texas, the law firm of Sheinfeld, Maley & Kay sued in the name of policyholder Wicks ‘n’ Sticks stores to recover about $800,000 in fees. The defendants were American Motorist Insurance Co. and Juris Prudent, Inc., a fee auditing company. After the trial court judge issued a summary judgment ruling against the carrier’s use of litigation management guidelines, the head of the Insurance Law Section of the State Bar of Texas was quoted as saying: “This is just another step in the direction of giving defense lawyers some latitude in representing the insurance company.”\(^\text{19}\)

In Georgia, Malcolm S. Murray Sr. filed a racketeering action against Nationwide Mutual Insurance Company, Nationwide’s attorneys, and two external auditing firms after the carrier disallowed about $40,000 in legal bills. Murray accused the defendants of conspiring to “commit fraud by creating a ‘burdensome scheme of denying payment.’” His lawyer promised that a class action seeking “$40 million” in damages would follow on the heels of a successful individual suit.\(^\text{20}\)

The Supreme Court of Montana and the Insurance Practices Special Study Committee of the Florida Bar also recognized these goals. The former castigated insurers for requiring defense lawyers to obtain approval of litigation activities, contending that “prior approval creates a substantial appearance of impropriety in its suggestion that it is insurers rather than defense counsel who control the day to day details of a defense.”\(^\text{21}\)

\(^{18}\) *Id.* Ricketts v. The Farmers Group, Inc., 2001 WL 1487700 (Cal. 2d. Dist. Ct. App.)


\(^{21}\) In the Matter of Rules of Professional Conduct and Insurer Imposed Billing Rules and Procedures, 2 P.3d at 815.
The latter argued that “[t]he insurer … does not have the right to supervise or control the professional conduct of the attorney,” expressed concern that “insurance companies … may exert too much control over how a case is defended,” and pointed out that “defense counsel are feeling increasingly constrained by insurance company controls.” The goal of the campaign is to give defense lawyers greater power over decisions, including decisions regarding services for which insurers must pay.

III. THE “OTHER PEOPLE’S MONEY” PROBLEM

As a legal matter, both the Montana Supreme Court opinion and the Report of the Insurance Practices Special Study Committee are insupportable. Lawyers are agents, not principals, and there is no sound legal basis for giving lawyers powers that clients do not wish them to have.

22 Id. at 8.
23 Id. at 26. See also id. at 8 (“The insurer … does not have the right to supervise or control the professional conduct of the attorney.”).
24 Id., at 13.
25 In more articles, presentations, and amicus curiae briefs than I care to remember, I have argued (1) that attorney-client relationships are consensual, (2) that liability insurers’ status as clients or third party payers therefore depends on the agreements they reach with defense lawyers, (3) that whether a carrier is a client in a particular situation is therefore a question of fact, and (4) that ordinary working arrangements establish clearly that liability carriers normally are co-clients of the lawyers they hire to defense lawsuits against insureds. No one has ever offered an alternative to this account of carrier-client-hood. Nor, a fortiori, has anyone offered an alternative that would convert the question of insurer-client-hood from one of fact to one of law.

Even so, courts and advisory committees have continued to deny that insurers are clients as a matter of law. The Montana Supreme Court did so in In the Matter of Rules of Professional Conduct and Insurer Imposed Billing Rules and Procedures, 2 P.3d 806, 814 (2000), holding “that under the Rules of Professional Conduct, the insured is the sole client of defense counsel.” This is doubly wrong. First, even in Montana, attorney-client relationships are agency relationships that arise by mutual agreement. Kaeding v. W.R. Grace & Co.--Conn., 961 P.2d 1256, 1261 (Mont. 1998) (“The attorney-client relationship is an agency relationship.”); Smith v. Fladstol, 807 P.2d 1361 (Mont. 1991) (“It is a well-established rule in Montana that the attorney/client relationship is one of agency”); Clinton v. Miller 226 P.2d 487 (Mont. 1951) (same). Consequently, even in Montana, whether a defense lawyer agreed to represent an insurer is a question of fact, not a question of law. Fladstol, 807 P.2d at 1362-1363 (holding that the range of tasks a client hired an attorney to perform is a question of fact). Second, because the Montana rules of professional conduct are based on the ABA’s Model Rules of Professional Conduct, they do not determine
Presently, though, I wish to ask how the Montana Supreme Court and the Florida Bar Committee proposed to deal with the obvious incentive problem that arises when providers (be they lawyers, doctors, or others) are empowered to order services for which third parties (typically but not necessarily insurers) must pay. When remunerated on a fee-for-service basis or at an hourly rate, providers make money by delivering services, not by withholding them. The profit motive is present regardless of the value services have for recipients. Even harmful services may be lucrative. Consequently, payers (and recipients) need security against abuse. They require assurance that providers will order services only when the benefits exceed the costs.

Insurance companies use litigation guidelines, monitoring by claims professionals, staff counsel operations, and fee audits to discourage over-spending. According to the American Insurance Association (AIA), a survey of its members in 1999 [showed] that, from 1996 to 1998, insurers were able to decrease average defense costs by 1%, while the U.S. inflation rate for legal services rose by 14.4% during that same time period. During the

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I spelled out the correct analysis of client-hood in an amicus curiae brief submitted to the Montana Supreme Court. Brief of Amicus Curiae Professor Charles Silver, Pro Se, submitted in In the Matter of Rules of Professional Conduct and Insurer Imposed Billing Rules and Procedures, Supreme Court of Montana, Cause No. 98-612 (filed May 17, 1999) (www.lawlibrary.state.mt.us/ds.cgi/View/Collection-1831). Having done so, when I came to the section of the court’s opinion entitled “Whether insurers and insureds are co-clients under Montana’s Rules of Professional Conduct,” In the Matter of Rules of Professional Conduct and Insurer Imposed Billing Rules and Procedures, 2 P.3d at 812-15, I expected to find that my account would be accepted or rejected on the merits. Instead, I found nothing. The opinion neither sets out my account, nor denies the validity of any of its constituent propositions, nor attacks the soundness of the syllogism. Instead, I found that the
same period, the average amount AIA members paid to plaintiffs on litigated cases decreased 7.6%, providing clear evidence that insurer litigation management tactics have caused no deterioration in the quality of the defense provided to policyholders.26

This is some evidence that modern defense management techniques help insurers reduce costs.

If barred from using these techniques, how will insurers offset the perverse incentives created by fee-for-service arrangements and hourly rates? The Montana Supreme Court dealt with this issue in a single paragraph. After ruling that defense lawyers do not represent insurance carriers as clients,27 the court wrote:

We caution, however, that this holding should not be construed to mean that defense counsel have a “blank check” to escalate litigation costs nor that defense counsel need not ever consult with insurers. Under Rule 1.5, M.R. Prof. Conduct, for example, an attorney must charge reasonable fees.28

Evidently, the only permissible way for insurers to discourage defense lawyers from

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27 For a brief criticism of this holding, see supra note 25.

spending excessive amounts of their money is by urging them to be ethical. With billions of dollars at stake in the aggregate and thousands at issue in any given lawsuit, only a simpleton would regard this as sufficient protection.

The Florida Bar Committee expressly recognized that liability insurers have a “legitimate and understandable desire to keep costs under control.” One might therefore have expected the Committee to identify concrete and effective means by which insurers can police overspending. On this subject, however, the Committee’s report is silent. Not a single sentence explains how the “legitimate and understandable desire to keep costs under control” may properly be advanced. The more extreme rhetoric in the report seems to imply that no cost control measure is acceptable if it prevents a defense lawyer from doing what he wants: “What is clear under Florida law is that insurance provided defense counsel must be free to exercise ‘completely unhampered professional judgment’ for the insured client and not be swayed by any conflicting interests of the insurer that may be paying the bill.”

Judging from this sentence, an insurer’s desire to manage litigation costs, although “legitimate and understandable,” must carry no weight with a defense lawyer at all.

When discussing principal-agent relationships, economists have emphasized the importance of the “other people’s money” problem. By empowering an agent to manage an asset, a principal incurs a risk that the agent will the right of control to enrich himself at the principal’s expense. In the insurance defense context, this risk is patent. Despite this, regulators have made it harder for liability carriers to prevent waste and exploitation.

29 REPORT OF THE INSURANCE PRACTICES SPECIAL STUDY COMMITTEE 13 (June 2, 2000).
30 Id. at 10 (emphasis added).
IV. NO EVIDENCE DEMONSTRATES A NEED TO PROTECT POLICYHOLDERS BY PREVENTING INSURERS FROM MANAGING DEFENSE COSTS

Clearly, the policy of constraining insurers requires a solid justification. Supporters of the campaign to empower defense lawyers have sought to provide one by claiming that policyholders’ interests require nothing less.

They have had a hard time proving this. The AIA survey mentioned above indicates that carriers have managed defense costs without harming insureds. Lawyers campaigning against insurers have no evidence to the contrary. The Florida Insurance Practices Special Study Committee admitted that “[it] uncovered little evidence of actual harm to the insured.”

Yet, it explained away the absence of evidence in a footnote: “The committee is mindful of the fact that there is an inherent inequity in the ability of relatively unsophisticated insureds to present information to the committee versus the ability of the organized and informed insurance companies who were represented by experienced counsel in this process.”

Given the speakers who communicated with the Committee and the materials it reviewed, the Committee’s unwillingness to embrace the evidence is extraordinary. The many speakers who addressed the Committee could have presented evidence of harm to policyholders, including “attorneys who represent policyholders in claims against insurance companies,” “general counsel for the Florida Department of Insurance,” and “a professor of legal ethics,” namely, me. “[T]he committee also solicited and received

31 REPORT OF THE INSURANCE PRACTICES SPECIAL STUDY COMMITTEE 13 (June 2, 2000).
32 Id. at 16, n.10.
33 Id. at 6-7. I received no compensation for appearing before the Committee, although an insurance company did reimburse my travel and lodging expenses.
written comments or submissions from approximately seventy individuals,” including plaintiffs’ attorneys.34 The Committee also claims to have “reviewed voluminous materials, including case law from Florida and other states, unlicensed practice of law and ethics opinions from Florida and other states, scholarly articles, newspaper articles, legal memoranda and other written materials,” and to have “conducted interviews with individuals who indicated a willingness to speak to the committee concerning insurance practice issues.”35 The search for signs of harm was extremely thorough.

The Committee’s treatment of staff counsel operations reflects its unwillingness to deal with evidence fairly. The report notes that, in 1969, the Florida Supreme Court rejected a petition filed by the Florida bar that would have restricted staff counsel operations.36 The report then observes that during the thirty years between the Supreme Court’s decision and the Committee’s creation, “the use of ‘house counsel’ [became] an increasingly common practice in Florida.”37 An unbiased person might have thought that the Florida bar, having lost the first battle and having failed to gather evidence of harm in the ensuing thirty years, should give staff attorneys a break. Instead, the Committee asked the Bar’s Standing Committee on Unlicensed Practice of Law to review all instances in which lay employees of insurance companies stand over defense attorneys.

Another impressive broadside against modern defense cost management practices appears in State Farm Mutual Automobile Insurance Company v. Traver, where Texas Supreme Court Justice Raul Gonzalez filed a separate opinion railing against insurers’

34 Id. at 7.
35 Id.
36 Id. at 11.
37 Id. at 12.
efforts to reduce costs. Justice Gonzalez attacked captive law firms that have the appearances of regular firms but whose attorneys really “are the insurance company’s salaried employees.” After “ventur[ing] to say that in most cases, the policy holder is not aware of this arrangement,” Justice Gonzalez asserted that “it is probably impossible for an [employee] attorney to provide the insured [] unqualified loyalty.” He bemoaned the existence of “[c]ompetition for insurance work[, which] weakens the defense lawyer’s hand while it allows insurance companies to demand ever-stringent cost containment measures.” He criticized insurance companies for allowing case administrators, “who may not even be [] lawyer[s], [to] decide[] legal strategy and tactics in the policy holder’s defense.” He condemned “billing restrictions and … billing audits.” He concluded by asking the legislature to intervene.

Justice Gonzalez’s tirade is remarkable for many reasons, as I pointed out in a letter to the Texas Supreme Court. First, none of the matters he addressed was at issue in Traver. The defense lawyer whose conduct was said to have harmed the insured did not work at a captive law firm and was not a staff attorney. There was no allegation that the policyholder suffered when the insurer improperly used a non-lawyer case administrator, subjected the defense lawyer to onerous litigation guidelines, or audited the defense lawyer’s bills. Justice Gonzalez’s tirade has nothing to do with the case.

Second, Justice Gonzalez offered no empirical support for his opinions. He cited no evidence that attorneys at captive law firms or staff counsel offices protect policyholders less ably than outside defense lawyers. He did not show that claims administrators, many of whom have years of experience with litigation, harm policyholders by supervising attorneys. He did not prove that competition, litigation
management guidelines, billing audits, or any other cost-cutting measures are harming policyholders. He simply asserted these things and expected others to believe him.

Some have believed him. The Montana Supreme Court relied on Gonzalez’s separate opinion in *In the Matter of Rules of Professional Conduct and Insurer Imposed Billing Rules and Procedures.* Certain commentators have also quoted it with approval. Their veneration of shoddy authority brings to mind Bismarck’s aphorism: “If you like laws and sausages, you should never watch either one being made.”

The AIA survey mentioned above is some evidence that, despite the introduction of modern cost management techniques, policyholders continue to be well protected. Other evidence supports this impression. The American Bar Association’s malpractice study found that claims against lawyers who defend personal injury cases constitute about the same percentage of all malpractices cases today as they did a decade ago. An article by Stephen Daniels of the American Bar Foundation reports the impression of Texas trial lawyers that settlements payments in automobile accident cases have fallen considerably

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38 In an amicus curiae brief submitted to the Montana Supreme Court, I explained some of the problems with Justice Gonzalez’s opinion. See Brief of Amicus Curiae Professor Charles Silver, Pro Se, pp. 11-12, submitted in *In the Matter of Rules of Professional Conduct and Insurer Imposed Billing Rules and Procedures*, Supreme Court of Montana, Cause No. 98-612 (filed May 17, 1999) (www.lawlibrary.state.mt.us/dsgei/ds.py/View/Collection-1831).


41 A.B.A., *PROFILE OF LEGAL MALPRACTICE CLAIMS 1996-1999* (2000), Table 1. The absolute number of claims against all lawyers, including personal injury-defense lawyers, increased over time. *Id.*
because of tort reform measures.\textsuperscript{42} This is a small quantum of evidence, but it is fair to ask whether any advisory, court, or academic who condemns modern defense cost management techniques court has countervailing evidence that outweighs it. None does. When reviewing the many reports, cases, advisory opinions, and law review articles that have issued in recent years, I found no documented evidence of harm to policyholders.

\textbf{A. Staff Counsel Operations}

Staff attorneys are insurance companies’ employees.\textsuperscript{43} As I explained in 1998, Most staff attorneys are former outside defense lawyers with years of experience trying and settling liability cases. They receive regular performance reviews, participate in bar associations and other professional groups, take continuing legal education courses, do pro bono work, receive malpractice coverage, enjoy paid vacations, and have health insurance plans and pensions. Most staff counsel offices are indistinguishable in basic respects from outside law firms. They have libraries, computers, paralegals, secretaries, procedure manuals, conflict-checking systems, continuing legal education programs,

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\textsuperscript{43} Companies in other lines of business also use in-house legal counsel to handle legal work and are routing more work to these lawyers to reduce costs. See \textit{U.S. Corporations Aim to Rein in Spending for Outside Lawyers,} \textit{BLOOMBERG NEWS,} Jan. 4, 2002. http://www.nera.com/template.cfm/c=6168&0=4821 (discussing results of survey predicting that overall corporate spending on outside legal services will decline in 2002 because of corporate cost-cutting plans that “include routing more legal work to in-house lawyers”).
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retreats, letterhead, receptionists, and business cards. Some
staff counsel offices even use surveys to gauge
policyholder satisfaction with services they provide. And
unlike many outside lawyers, most staff attorneys are
specialists who handle large numbers of similar cases. As
specialists, they should be able to defend lawsuits better
than many outside defense lawyers who, being generalists,
know less about the particular subject areas in which cases
arise.\footnote{Silver, Flat Fees and Staff Attorneys, supra note 15, at 248-49 (footnotes omitted).}

The New Jersey Supreme Court was right when it stated that staff attorneys “are not
second-class lawyers; [they] are first-class lawyers who are delivering legal services in an
evolving format.”\footnote{In re Weiss, Healey & Rea, 109 N.J. 246 (1988). Many staff attorneys are active participants in debates
about legal ethics and professionalism. See, e.g., John Conlon, Insurer Litigation Guidelines: Attorney
Ethical Considerations, RES gestae (Oct. 1998).}

Staff counsel operations have existed since the late 1800s. Most large carriers
have them, and some assign them more than half their cases.\footnote{James Howland & Michael Pritula, Legal Costs: Can the Flow Be Slowed?, Best’s Rev. Prop. & Cas.
handles well over half of their litigated cases”).}

A study of large claims
that closed in 1990 and 1991 found that in-house lawyers handled 22 percent of all
litigated claims.\footnote{See Legal Defense: A Large and Still Growing Insurance Cost, ISO Insurance Issues Series (Insurance

Given the volume of claims they handle, it is to be expected that many
staff counsel offices are sizeable. Some carriers employ more than 500 staff attorneys.
Whether measured in terms of attorney numbers, claims handled, or operating budgets,
the importance of staff counsel operations is great and growing.

Judging from the length of time staff counsel operations have existed, their size, and the number of lawsuits they have defended, one must conclude that insurance companies are confident in their ability to deliver quality services at reasonable cost.48 Closed-claim studies support this contention.

The Insurance Services Office has conducted three closed-claim surveys in which the relative efficiency of staff counsel operations was assessed. All three surveys “have shown that the ratio of paid-to-date ALAE [allocated loss adjustment expenses] to paid loss is higher for claims in which insurers use only outside counsel to defend their insureds than the ratio is for claims in which insurers use only in-house counsel.” In the most recent study, the ratio for outside counsel was almost twice as large as that for in-house counsel, even when severity of injury alleged by the claimant was controlled.49

I know of no reason to doubt that insurance companies save money by using staff attorneys. If and when staff counsel operations become losing propositions, insurers close them.

Opponents of staff counsel operations deny neither that insurers like them nor that they save insurers money. They contend that by using staff attorneys, insurance carriers

48 The magnitude of the savings is described in SILVER, Flat Fees and Staff Attorneys, supra note 15, at 241-42.
49 Id. at 242.
engage in the unauthorized practice of law and subject insureds to dangerous interest conflicts. The latter allegation gives the former its appeal.\footnote{Most jurisdictions that have addressed the issue have refused to find that staff counsel operations violate unauthorized practice of law restrictions. \textit{See Leo J. Jordan & Hilde E. Kahn, Ethical Issues Relating to}} If everyone admitted that staff attorneys benefit policyholders by defending them ably and reducing insurance costs, law firms’ efforts to invoke unauthorized practice prohibitions would appear as naked acts of self-interest. Their object would be to prevent employed attorneys from siphoning cases and fees away from independents. Only the appearance of protecting policyholders gives outside defense lawyers a claim to the high ground.

Yet, if harm to policyholders is the issue, it is reasonable to ask opponents of staff counsel operations for evidence supporting their charge. Given the length of time staff counsel operations have existed and the number of cases they have handled, evidence should be easy to find. For example, one might compile a record of complaints filed with state bar associations in which staff attorneys were disciplined. One might cite reported opinions holding staff attorneys or their employers liable for disloyalty or malpractice. One might produce complaints that policyholders lodged with state insurance regulators, attorneys general, or consumer protection agencies. Citing closed claim studies, one might show that trial losses or settlement payments are higher in cases handled by staff attorneys than when outside lawyers are engaged. One might use the same studies to show that outside lawyers resolve excess exposure cases within the policy limits more often than staff attorneys do.

Writing in 1998, I explained that no one had offered any evidence showing that carriers endanger policyholders by referring cases to staff attorneys. I also offered evidence that staff attorneys serve policyholders as well as outside lawyers do.

\footnote{Most jurisdictions that have addressed the issue have refused to find that staff counsel operations violate unauthorized practice of law restrictions. \textit{See Leo J. Jordan & Hilde E. Kahn, Ethical Issues Relating to}}
example, I explained that although there were many reported cases involving misdeeds by outside defense lawyers, neither my WESTLAW research nor my review of the literature on staff counsel operations turned up a single instance in which an adjudicated breach of duty by a staff attorney saddled a policyholder with harm.\textsuperscript{51} A review that I personally conducted of a staff counsel operation in Texas found no record of disciplinary action or malpractice complaints and only one grievance. The “staff attorneys compared well to the average member of the Texas bar in terms of credentials, years of experience, salary, and other characteristics.”\textsuperscript{52} I also observed that “[w]hen the Florida bar reviewed staff counsel operations in that state, the insurance commissioner reported that his office had received no complaints about staff attorneys.”\textsuperscript{53}

There are even reasons for thinking that staff attorneys are likely to outperform other defense lawyers. They may be more independent minded because they are better protected against wrongful discharge and because they stand to lose less by violating insurers’ instructions. They may be more careful because they are supervised more closely and because their employers are vicariously liable for their mistakes. Insurance carriers want staff lawyers to be careful and ethical. They know that shoddy conduct would jeopardize the existence of staff counsel operations.

In 1998, I asked for empirical evidence of harm to policyholders, and I criticized the Supreme Court of Kentucky for giving staff attorneys an undeserved “slap in the

\textit{Staff Counsel Representation of Insureds, 30 TORT & INS. L.J. 25 (1994).}

\textsuperscript{51} The only published opinion listed in the 1996 edition of \textit{LEGAL MALPRACTICE} was Bevevino v. Sydjari, 76 F.R.D. 88 (S.D.N.Y. 1977) (cited in RONALD E. MALLEN & JEFFREY M. SMITH, \textit{LEGAL MALPRACTICE} § 28.5 at 498 n.3 (4th ed. 1996)). In Bevevino, the policyholder escaped injury because the staff lawyer’s negligence “fell exclusively upon the insurance carrier.” \textit{Id.} at 94.

\textsuperscript{52} SILVER, \textit{Flat Fees and Staff Attorneys, supra} note 15, at 248.

\textsuperscript{53} \textit{Id.}
face.” Since then, the campaign against staff counsel operations has continued. Advisory committees received several requests from lawyers for opinions and responded with grave warnings that staff attorneys must make complete disclosures. Michael D.

Morrison and James R. Old, Jr. contended in a law review that Texas ethics opinions “compel the conclusion” that liability insurers’ use of house counsel “involves the unauthorized practice of law.”54 Yet the truth continues to be that opponents of staff counsel operations have offered no evidence of harm to insureds.

Consider the law review article. Morrison and Old accuse staff attorneys of “violat[ing] prohibitions against the corporate practice of law, conflicts of interest rules barring even the appearance of impropriety, and prohibitions against partnerships where lawyers share legal fees with non-lawyers.”55 Given the number of charges, their seriousness, the length of time staff counsel offices have existed, and the number of cases staff attorneys have handled, the authors should have no difficulty proving that insureds have suffered. Yet, they offer no evidence. When discussing unauthorized practice restrictions,56 they cite a raft of cases and advisory opinions,57 but they fail to identify even a single policyholder who was harmed. When discussing interest conflicts58 they write, “the use of house counsel takes a situation … fraught with conflicts and economic

55 Id. at 51-2.
56 Id. at 46-55.
58 MORRISON & OLD, supra note 39, at 56-60.
tension, and adds even greater opportunity for mischief.” Yet they again offer no evidence of harm to an insured. When discussing rules regarding law firm names, they accuse insurers of engaging in conduct that “is at best misleading and at times fraudulent” and that “raises serious ethical and consumer protection issues.” Again, though, their commentary is long on law but decidedly short on examples of harm. Judging from the article, one would have to conclude that staff attorneys have violated important ethics rules thousands or millions of times to the demonstrable detriment of no one.

Morrison and Old seem to think they can prove that a particular practice endangers policyholders by finding a legal authority that says so. This belief reflects a deep misunderstanding as to where one must look to find relevant facts. Policyholders experience the effects of insurance defense practices in the physical world, not in the minds of judges and lawyers who write legal opinions applying state bar rules. One must therefore examine the world, not the opinions, to discover how well or badly insurance defense practices work. Dire statements and warnings in reported cases and advisory opinions that have no empirical foundation are worthless when it comes to establishing

59 Id. at 57.
60 Id. at 58.
61 Morrison & Old have a point when they contend that insurance companies should stop beating around the bush when advertising staff counsel operations. Id. at 59. I have previously advised insurers to advertise staff counsel offices forthrightly, and I am pleased that some are now doing so. Insurers should be proud of staff attorneys’ accomplishments, and staff attorneys should be too.
62 It also demonstrates Morrison and Old’s willingness to use authorities selectively. When condemning flat fee arrangements, they rely heavily on Douglas R. Richmond, The Business and Ethics of Liability Insurers’ Efforts to Manage Legal Care, 28 U. MEM. L. REV. 57 (1997). Yet, when discussing staff counsel operations, they ignore many statements by Richmond that wholly undercut their position. See, e.g., id. at 112 (“There is no reason to believe that insurance company staff counsel uniformly offer insureds a less competent defense.”); id. at 113 (“For professional responsibility purposes then there is little difference between many attorneys in private practice and staff counsel.”); id. at 113 (“The problem with staff counsel representation of insureds is largely one of perception.”); id. at 113 (“It is difficult to evaluate the validity or accuracy of this perception [that staff attorneys are more loyal to carriers than private practitioners], for it is unsupported by any sort of evidence.”).
Fortunately, advisory committees have had better sense than to outlaw staff counsel operations on the basis of unsupported allegations and fears. Recent opinions allow staff counsel offices to continue in operation. Yet, these opinions also convey a sense of unease. For example, in 1996 the New Jersey Committee on the Unauthorized Practice of Law supplemented its original opinion affirming the permissibility of staff counsel operations because “the Committee was troubled by a number of ethical issues raised not only by the inquirer, but by many of the commentators as well.”

One such issue was the use of non-lawyer claims managers to supervise defense lawyers. Another concerned a practice of renting out staff attorneys to self-insured companies at a profitable hourly rate. A third related to the disclosures staff attorneys made to policyholders about their employment status.

The Committee handled the third issue well. After observing that no one presented evidence that failure to disclose employment status “resulted in harm to the insureds,” it expressed reluctance to require disclosure.

Yet, the Committee spoke out against the first two policies even though, insofar as one can tell, no evidence of harm was submitted regarding them either. Absent such evidence, neither policy should have raised hackles. Non-lawyers have supervised defense attorneys for decades. The arrangement is entirely proper. Any corporate client can engage a non-lawyer agent for

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64 The Committee on Professional Ethics of the New York State Bar Association was less restrained. Despite having no evidence that existing practices were confusing insureds, it required various disclosures. See N.Y. ETH. OP. 726, 2000 WL 567960. Other states have done the same. Or. Op. 1998-153, 1998 WL 717727 (Or.St.Bar.Assn.) (requiring disclosure in letterhead); W. VA. Op. 99-01 (requiring that captive law firms disclose their affiliations with insurance companies on “their letterhead, business cards, phone book identification, phone answering method, office entrances and pleadings and … explain this to each client”).

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the purpose of monitoring a lawyer. The practice of renting out staff attorneys is new but not obviously dangerous.\textsuperscript{65} The self-insured companies that want to hire staff attorneys are sophisticated clients who know that these lawyers are carriers’ employees. The risk of deception is minimal and the hourly rates are attractive, whether or not insurers profit from them.

The Alaska Bar Association Ethics Committee also treated several issues sensibly.\textsuperscript{66} It declined to find either that staff counsel offices violate unauthorized practice prohibitions or that conflict rules establish per se prohibitions on joint representations by staff attorneys of carriers and insureds. On a third issue, however, the Committee’s opinion can be quarreled with. According to the Committee, an actual and unwaviable conflict of interests exists when a claimant submits a settlement demand “at or within policy limits where there is a substantial likelihood of an excess judgment.”\textsuperscript{67} Again in the Committee’s view, “representation by salaried staff counsel is prohibited” in this situation “since counsel could not reasonably believe” other than that the representation of both clients would be impaired.\textsuperscript{68}

For reasons I have explained at length elsewhere,\textsuperscript{69} the Committee’s conclusion that a policy limits settlement demand creates a fatal conflict is far too quick. First, the Committee assumes that the carrier and the policyholder will hold different opinions. This need not be true. Both may want to accept the demand or to reject it. Second, if a

\textsuperscript{65} Many companies charge the cost of in-house legal operations separately to their subsidiaries. See \textit{TEX. Op.} 531 (1999) (discussing propriety of billing subsidiaries at market rates rather than actual cost for in-house legal services).

\textsuperscript{66} ALASKA ETHICS OP.: 99-3, 1999 WL 1494993.

\textsuperscript{67} \textit{Id.}

\textsuperscript{68} \textit{Id.}

\textsuperscript{69} PRYOR & SILVER, \textit{Excess Exposure Cases, supra} note 15, at 651-63.
disagreement exists, one client may change its mind upon learning how the other feels or upon hearing the reasons supporting the other’s opinion. A lawyer can properly help the clients discuss the expected costs and benefits of trying the case in hope of enabling them to resolve their disagreement. Third, if disagreement persists, the carrier may waive the conflict in hopes of avoiding a bad faith lawsuit by the insured, or the insured may do so in the hope of avoiding a coverage denial. Informed clients can waive nearly all conflicts under prevailing ethics rules. They should be free to waive this one too.

The Alaska Committee can also be faulted for failing to demand evidence that policyholders represented by staff attorneys are at particular risk of harm when claimants offer to settle at or within policy limits. The assertion that they are at risk is just a specific application of the general charge that staff attorneys put carriers’ interests ahead of insureds’ when the two clients’ interests conflict. I know of no evidence supporting this general proposition, as I have said. A fortiori, I know of no evidence suggesting that staff attorneys cannot be trusted to protect policyholders in the specific situation that worried the Alaska Ethics Committee. Nor did the Committee offer any. It merely posited an unwaivable conflict, thereby continuing the tradition of impeding clients’ freedom to structure attorney-client relationships as they wish even when there is no evidence that consensual arrangements are especially dangerous.

B. Flat Fee Arrangements

Seeking to manage defense costs while motivating defense lawyers to use resources wisely, liability insurers have recently turned to flat fees. In my 1998 article, I described how some of these arrangements work and explained the relevant economics. My conclusion was that
Flat fees are … flexible arrangements that, when handled thoughtfully, offer some important advantages to institutional purchasers of legal services who are dissatisfied with hourly rates. They also have advantages for lawyers. They give lawyers access to reliable work flows, predictable profits, regular employment, training opportunities for associates and paralegals, and opportunities to build strong relationships with commercial clients who are potential sources of unbundled matters for which firms will be paid higher fees.70

I also critiqued the arguments supporting the Kentucky Supreme Court’s conclusion that by working for flat fees defense lawyers would violate their professional responsibilities. No rule cited by the court supports this view. Nor does any other rule of which I am aware. The court’s conclusion rests on a series of confusions.

Several commentators have defended the Kentucky Supreme Court against my accusations. For example, although Nancy Moore agreed with me that “the Kentucky court’s opinion is remarkably unpersuasive,” she thought its position on flat fees “not nearly as indefensible” as I contended.71 She based this statement partly on the existence of a small number of advisory opinions expressing views like those espoused by the Kentucky Supreme Court. Even though she candidly admitted that “none” of these opinions “satisfactorily addresse[d] the questions” I raised, she correctly pointed out that

70 SILVER, Flat Fees and Staff Attorneys, supra note 15, at 221.

there was more legal authority for the court’s decision than I acknowledged. Moore also argued that the possibility that “bundled flat fee arrangements do pose additional dangers” should not be foreclosed summarily, while tak[ing] no position on whether these additional dangers do or do not exist.” I agree that one should always be willing to consider new evidence.

Factually, then, Moore’s position is close to my own. She agrees that “[g]iven the lack of empirical evidence, an absolute prohibition on the practice [of using bundled flat fees] seems harsh and unwarranted.” Philosophically, though, we are far apart. Despite the lack of evidence of harm to policyholders, Moore does not oppose a prophylactic prohibition: “[G]iven the extent to which the tripartite relationship already seems to favor the insurer over the insured,” she writes, “it may not be unreasonable to want to avoid any new [fee] arrangements that further undermine an attorney’s loyalty to the insured.” This circumlocution troubles me. Rather than have regulators erect barriers that “may not be unreasonable,” I would have them do nothing unless and until the need for barriers is proved. I am more strongly committed to philosophical liberalism than Moore.

Morrison and Old also wish to rescue the Kentucky Supreme Court, but they proceed in the oddest way. Although they draw upon my 1998 article when discussing staff counsel operations, they neither mention it nor respond to my critique of the Kentucky Supreme Court’s opinion when taking up flat fees. Insofar as I know, mine is the only law review article that both attacks the AIA decision and defends flat fees.

72 Id. at 288-89.
73 Id. at 291.
74 Id. at 292.
75 Id.
Without seeming too self-important, I hope I can say that Morrison and Old should have addressed my arguments or at least dropped a footnote acknowledging my article as expressing an opposing view.  

Morrison and Old also embrace the discredited view that disciplinary rules requiring reasonable fees are supposed to protect lawyers from fees that are unreasonably low. They repeatedly voice the fear that powerful insurers will drive down payments to the point where lawyers working for fixed fees will incur losses. This is a surprising gambit. In *Goldfarb v. Virginia State Bar*, the U.S. Supreme Court condemned the Bar for enforcing minimum fee schedules on the ground that this made the Bar complicit in “what [was] essentially a private anticompetitive activity.” Morrison and Old renew the idea that bar associations should maintain fees at high levels by prohibiting lawyers from

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76 Speaking of opposing views, James R. Old, Jr. has repeatedly asserted that “the ‘client’ of defense counsel is the insured, not the insurance carrier.” James R. Old, Jr., *Walking the Ethical Tightrope: An Insurance Defense Laywer’s Perspective on Third Party Audits and Billing Guidelines*, ETHICS AND PROFESSIONALISM NEWSLETTER, TEX. ASS’N OF DEFENSE COUNSEL (Fall 2000). See also Morrison & Old, supra note 39, at 8-9. As authority, Old cites Employers Cas. Co. v. Tilley, 496 S.W.2d 552 (Tex. 1973). I have repeatedly shown that this reading of *Tilley* is mistaken. Justice Samuel Johnson regarded the insurer as a third party payer, but no other justice joined his *Tilley* concurrence. The rest of the court decided the case under the conflict rules that apply to lawyers with multiple clients. See, e.g., Silver & Quinn, *Wrong Turns on the Three Way Street*, supra note 15, at . This analysis of *Tilley* recently persuaded the Texas Supreme Court to withdraw its original opinion in State Farm Mutual Automobile Insurance Company v. Traver, which treated a defending carrier as a third party payer.

Old has never responded to my reading of *Tilley*. Nor has he come to terms with the Texas Supreme Court’s action in *Traver*. These are important failings, I believe.

77 Morrison and Old also repeatedly invoke the “appearance of impropriety” when arguing against flat fees. See, e.g., Morrison & Old, supra note 39, at 67 (asserting that “flat fee agreements may create an appearance of impropriety”). This objection also has outlived its useful life, I believe. When an appearance of impropriety bears no connection to an actual violation, the appropriate course is to educate the public about the permissibility of the conduct, not to ban it.

78 See Morrison & Old, supra note 39, at 61 (“At a normal price of between $3,500 and $5,000 per file, the margin for the defense firm is so slight that any untoward event, no matter how slight, could put the firm at a loss on the whole program. The economic pressure is enormous.”); id. at 64 (arguing that flat fees will force lawyers to choose “between taking a loss—possibly even missing a draw or payroll—and overlooking the interests of a client,” by which they mean a policyholder.

accepting flat fees from insurers. The omission is troubling. In her comment on my 1998 article, Nancy Moore observed that “[t]he Kentucky Supreme Court did not even mention” the “reasonable fee” rule in AIA, possibly because it “agreed that Goldfarb prohibits the regulation of unreasonably low fees.” Morrison and Old should have addressed Moore’s point.

I will respond to Morrison and Old’s legal arguments against flat fees in another publication. Here, I will point out a common failing associated with their factual claims, namely, their failure to provide any supporting evidence. Morrison and Old contend that lawyers cannot make decent profits from flat fees, that ignorance prevents lawyers from setting flat fees appropriately, that flat fees cause lawyers to ignore their responsibilities and to defend policyholders inadequately, and that flat fees deny policyholders the benefit of their insurance bargains. Again, given the seriousness of the complaints and the certainty with which Morrison and Old express them, one would expect them to offer examples in which dire consequences occurred and empirical studies demonstrating the systemic nature of the effects. They offer neither. Morrison and Old do not cite a single case or empirical study showing that a policyholder was harmed. Nor do they show that an inadequate flat fee arrangement has ever led a defense lawyer to declare bankruptcy or to give a policyholder short shrift.

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80 Advisory committees have written similar statements. See, e.g., OHIO ADVISORY OP. 97-7, 1997 WL 782951 (“The more pertinent concern is that the flat fee agreements between an attorney or law firm and a liability insurer will provide insufficient and inadequate compensation to the attorney or law firm. When a flat fee agreement … provides insufficient compensation in regards to the time and effort spent on the representation, ethical problems emerge.”).

81 MOORE, supra note 71, at 289.

82 See SILVER, Wrong Turns Retaken, supra note 15.

83 Morrison and Old do quote language from Justice Gonzalez’s concurring opinion in State Farm Mut. Auto. Ins. v. Traver, 980 S.W.2d 625 (Tex. 1998), vilifying flat fees, staff counsel operations, and other modern cost reduction techniques. See, e.g., Morrison & Old, supra note , at 63. Yet, as I explained in an
Given the frequency with which lawyers receive flat fees in criminal cases, matrimonial matters, and other representations, the failure to cite cases requires some explanation. There must be hundreds of malpractice cases involving lawyers who worked for fixed fees. Why did Morrison and Old not cite them? An important possibility is that citations would have undermined their position. After all, neither courts, nor advisory committees, nor state bar associations have seen fit to prohibit flat fees in other contexts, despite the frequency of malpractice. Citations to other cases would have caused readers to wonder why a special prohibition should apply to insurance defense lawyers when other lawyers have track records that are demonstrably worse.

Other problems also plague Morrison and Old’s factual claims. For example, it seems obvious that lawyers who find flat fees unprofitable will refuse to accept them. Nothing prevents defense lawyers from moving into more lucrative practice areas. Consequently, insurers will have to offer flat fees that are high enough to convince defense lawyers to handle their work. The market should therefore keep flat fees from falling to unacceptable levels. The market should handle the problem of ignorance the same way. Ignorance implies that lawyers’ estimates of case costs will have high associated variance. Insurers will have to deal with this problem by offering lawyers risk premiums, by using techniques like case bundling to boost lawyers’ confidence in cost estimates, or by tying increases in flat fees to litigation events that drive up costs.

Finally, the charge that flat fees put insurers in breach of their contracts with insureds founders on two grounds. First, in most cases only carriers’ dollars are at stake.

amicus curiae brief submitted in Traver, Justice Gonzalez’s comments have nothing to do with the facts of the case. The defense lawyer whose acts of malpractice gave rise to Traver was a independent practitioner, not a staff attorney, and was not compensated on a flat fee basis. Justice Gonzalez should have withdrawn
By being excessively parsimonious with their attorneys, insurance companies would harm mainly themselves. Second, policyholders’ attorneys are ready, willing, and able to bring bad faith actions when insureds are disserved. The threat of liability should give carriers an additional reason to see that policyholders are defended zealously.

Morrison and Old drew most of their objections to flat fees from a 1997 article by Douglas R. Richmond. Richmond is a prolific insurance lawyer who, despite devoting an enormous amount of time to writing and public speaking, keeps his clients extremely happy. A 1999 survey ranked him first among lawyers most admired by industry insiders “for providing excellent service—and better results—to insurance companies.”

Because Richmond’s 1997 article and my 1998 article were in production at the same time, I did not respond to him in my prior work. However, because Richmond and I participated in a program on insurance defense ethics in late 1997, he knew my views on flat fees and anticipated them in his essay. After noting my view that insurers would harm mainly themselves by offering inadequate fixed fees, Richmond responded,

This pro-insurer argument, while theoretically sound, often fails in practice. Insurers seldom appreciate the potential for increased indemnity obligations when looking for ways to cut defense costs. Defense expenditures are concrete and predictable, while the potential for increased future indemnity payments is speculative and incapable of

his opinion, as the Traver majority did after receiving my amicus brief. Brief of Professor Charles Silver Amicus Curiae on Motions for Rehearing, Cause No. 96-1201 (letter dated October 14, 1998).


85 Lori Tripoli, Among the Best … No Bad Rap for These Insurance Defense Lawyers, 18 Of Counsel 1 (1999).
measure. Insurance company claims managers focus on trimming defense costs because they can and because their ability to control defense costs is one of the factors by which their job performance is evaluated. The indemnity side of insurance claims management is too often discounted or discarded, even though both insurers and insureds may suffer as a result.  

Although the attack on modern cost reducing techniques consists mainly of lawyers accusing liability carriers of stinginess, Richmond believes that liability insurers are not really good at saving money.

In keeping with the spirit of this essay, I begin my critique of Richmond’s point by noting that he offers insufficient evidence for it. Clearly, some evidence is required. Insurance companies understand that defense outlays affect indemnity losses. This is why they defend many lawsuits instead of settling them or allowing default judgments to be entered. Insurance companies also monitor claim-related losses and maximize profits by keeping these losses down. When total losses grow, insurers have incentives to figure out why. One should not expect significant false economies to persist over time.

Even if Richmond has identified a problem, then, its magnitude may be small. Should claims managers be one percent more generous than they are? Ten percent? Fifty percent? Richmond provides no evidence that answers this question, but without an answer the desirability of regulation can at best be unclear.

Some flat fee arrangements are designed to avoid the problem that bothers

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86 Richmond, Business and Ethics, supra note , at [text appears in conclusion of article, following fn. 274].
Richmond. As I explained in 1998, a carrier can use a variety of methods to monitor the impact of flat fees on indemnity losses and to encourage lawyers minimize payouts.

[An insurer] can [] compare judgment and settlement costs incurred in the block of cases handled by the firm with costs incurred in similar matters handled by other lawyers, including staff attorneys, and with its own historical payouts on closed claims. To make even better comparisons, a large insurer could divide cases into two or three blocks, sending the blocks to different firms and letting each firm know that its performance will be measured against the others’. Short of this, the carrier could establish targets for a firm based on the firm’s or the carrier’s historical loss experience. It could then give the firm a preference on future work assignments if the targets are met, taking advantage of the firm’s desire to keep the insurer’s business. To further encourage optimal effort, the insurer could offer the firm a bonus inversely proportionate to the insurer’s loss experience across the bundle. The smaller the carrier’s payout on judgments and settlements, the larger the bonus to the firm.87

Neither Richmond nor Morrison and Old show that these monitoring devices and incentive arrangements are inadequate.

87 Silver, Flat Fees and Staff Attorneys, supra note , at 218-219.
Still, no one is perfect, and managers of companies never have ideal motives, incentives, information, or judgment. Some claims managers probably are as short sighted as Richmond contends. Even admitting this, however, one must still ask why it is right to use state bar disciplinary rules to police mistaken judgments made by claims managers. State bar rules govern neither insurance carriers nor their lay employees. Even conceding that Richmond spotted a problem, it is not a problem that state bar rules exist to correct.

A prohibition on fixed fees would not correct the problem anyway. If claims managers are willing to slash defense outlays even when doing so generates larger indemnity losses, then they will abuse any fee arrangement. They will slash hourly rates, refuse to pay for legal research, and disallow expenses. They will set reverse contingencies too low. They will substitute less experienced and less able attorneys for better ones who demand higher fees.\(^{88}\) To prevent claims managers from being too stingy requires a prohibition against parsimony that applies to all defense-related decisions carriers make. By itself, the ban on flat fees will only divert cost-obsessed managers to other opportunities to save defense dollars.

The ban on flat fees may also have counterproductive effects. First, it may prevent well-managed insurers from demonstrating their superiority by using fixed fee arrangements just when these are economically superior to other forms of compensation. Second, it may insulate inefficient lawyers from competition. Lawyers who are able to

\(^{88}\) The Report of the Insurance Practices Special Study Committee suggests that insurers are unduly parsimonious in an extraordinary variety of ways. See, e.g., Report, at 14 (noting that insurer refused to pay lawyer for more than one draft of appellate brief); Id. (noting “[I]nstances where only paralegal rates would be paid for certain services even where the attorneys felt the work should be done by lawyers”); Id., at 15 (reporing “insurance company limitations on the number of depositions that could be taken, … the number of hours … for trial preparation [and] … trial time”).
deliver quality legal services while shouldering the risks that fixed fees entail will be
denied the opportunity to attract business away from those who cannot. \(^{89}\)

This last point bears emphasis. Richmond complains that fixed fees are creating an “underclass” of defense firms that deliver services of rock-bottom quality at rock-bottom prices. This is a pejorative description of a development that may be desirable from the joint perspective of policyholders and insurers. On the plaintiffs’ side, market forces long ago produced law firms, colloquially referred to as “mills,” that churn out cases in volume, settling most and investing significant resources in few. Mills have large staff to lawyer ratios, enormous cases portfolios, and the bare minimum of overhead. For these reasons, they are not prestigious places for lawyers to work, but their existence is good for small claimants. By keeping costs down, mills provide plaintiffs with small injuries a realistic shot at recovering.

To date, staff counsel operations have been insurance carriers’ best responses to plaintiffs’ mills. However, there is no reason to prevent independent practitioners from showing that they too can be low-cost operators. Many carriers experience too few claims to support staff counsel offices in all areas where they do business. Low-cost independent providers may offer them an opportunity to compete with plaintiffs’ mills on an equal footing. Because positive defense costs increase the settlement value of many marginal claims, the option of using low-cost defense lawyers may be an important way of reducing liability costs.

Because the factual objections to flat fee arrangements are unproven and doubtful, it is reassuring that few advisory committees have seen fit to follow the Supreme Court of

\(^{89}\) I have no empirical data to support these assertions. I wish I did. Fortunately, I am arguing against regulation, not for it. In a liberal society, those who support regulations carry the burden of proof.
Kentucky’s lead. The consensus thus far is that flat fees are permissible as long as the terms of the fee arrangement are disclosed to the insured. However, as Nancy Moore observed, even the disclosure requirement is a departure from tradition. “[V]irtually all fee arrangements pose conflicts between lawyers and clients, yet there is no support for any routinely required disclosure to clients of these types of risks.” Disclosure may be a minor nuisance or a major one, but in the absence of evidence that policyholders are exposed to unique risks, why impose special requirements on insurance defense lawyers who work for flat fees? Lawyers who represent criminal defendants in death cases receive grossly inadequate flat fees from public coffers and have much worse incentives, yet there is no ethical requirement that they make fee-related disclosures and no nationwide campaign to create one.

Some advisory committees have also endorsed the argument that flat fees are permissible as long as they are high enough to provide compensation that is reasonable in light of the time and effort cases require. This argument also smacks of hypocrisy. If applied across the board, it would prevent lawyers for capital defendants from accepting the meager wages states dole out. And what of pro bono representations? Apparently, a fixed fee of $0 is always proper but a flat payment of $5,000 may be ethically suspect. There also is Goldfarb to consider. By insisting that insurers set fees high enough to compensate lawyers handsomely, advisory committees are taking us back to the days before minimum fee schedules were barred.

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90 See, e.g., Fla. Eth. Op. 98-2, 1998 WL 796691 (reviewing prior opinions and stating that attorneys’ obligations include “disclosure to the insured of the fee arrangement between the insurer and the attorney”).
91 Moore, Ethical Duties, supra note , at 289.
93 See supra notes ___ - ___ and accompanying text (discussing Goldfarb).
No one has ever suggested that state bar rules place lower bounds on the hourly rates insurance companies may offer defense lawyers or the number of hours they must allow defense lawyers to bill. No one has ever suggested that defense lawyers must disclose hourly rate compensation arrangements to insureds, even though these too are rife with conflicts. Yet, these ideas and a slew of others are taken seriously when insurers offer flat fees. The explanation, I believe, is simply that flat fees are more effective than hourly rates at reducing defense costs.

C. Litigation Management Guidelines and External Fee Audits

My 1998 article mentioned litigation guidelines and fee audits but did not focus on them. The Kentucky Supreme Court had not addressed these cost control methods in AIA, the opinion I was critiquing, and I did not foresee how controversial they would become.

I now wish I had discussed guidelines and audits at length. As Table 1 shows, they have received the bulk of the attention of state bar committees. Already, the advisory opinions are too numerous to examine individually. The opinions also are decidedly hostile. Because of them, many insurance companies no longer employ fee auditors, and an industry-wide effort has been made to craft guidelines that advisory committees will approve.94 Both developments were needless.95 Defense lawyers can adhere to litigation guidelines and submit invoices for review by fee auditors without

95 The latter also appears to have been unsuccessful. The General Counsel of the Alabama State Bar has stated that the guidelines prepared by the Defense Research Institute present many of the same concerns and problems” that led the Alabama Disciplinary Commission to prohibit compliance with guidelines in RO-98-02 (www.thefederation.org/Public/DCI-Relations/alabama.htm).
violating any disciplinary rules. Other academics share this view.  

The positive account of insurance carriers’ right to insist on guidelines and audits is straightforward. Ordinarily, liability carriers are co-clients of the lawyers they retain to defend liability suits against policyholders. As clients, they may manage legal fees and control lawyers’ actions by any means to which they and their attorneys agree. They may carve up tasks among attorneys, paralegals, and secretaries, and they may assign different billing rates (including rates of $0) to these providers. They may agree that the lawyer will obtain prior approval from the client before taking particular actions, such as hiring an expert witness or incurring travel costs. They may use lay claims managers to instruct lawyers and to monitor lawyers’ conduct. They may even agree that certain legal services will be omitted. And, obviously, they may review lawyers’ bills themselves or hire specialized legal auditors for this task. Clients have been doing all these things for years without causing lawyers to run afoul of state bar rules.

Sometimes, insurance carriers are third-party payers, not clients. Whether they

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96 Several opinion letters by law professors were appended to the opinion Geoffrey Hazard submitted in  
Rules of Professional Conduct and Insurer Imposed Billing Rules and Procedures. See Appendix to  
Opinion of Geoffrey C. Hazard, Jr. (http://www.lawlibrary.state.mt.us/ds/cgi/ds.py/Get/File-2908/98-612(4- 
Lawyers at franchise law firms that provide low cost services to individual clients also follow  
guidelines, though guidelines that are self-imposed. By offering standardized services and devolving tasks  
to secretaries and paralegals, they reach people whose legal needs would otherwise go unmet. Jerry Van  

97 For descriptions of the content of litigation management guidelines used by insurers and other  
corporations, see Randall, supra note  , at 7-8; Brief of the American Insurance Association Amicus  
Curiae in Support of Respondents, submitted in In the Matter of Rules of Professional Conduct and Insurer  
Imposed Billing Rules and Procedures, Supreme Court of Montana, Cause No. 98-612 (filed May 9, 1999)  

98 For a debate over the ethics of unbundling legal services, see Fred C. Zacharias, Limited Performance  
agreements: Should Clients Get What They Pay For?, 11 Geo. J. Legal Ethics 915 (1998); David A. Hyman  
and Charles Silver, “And Such Small Portions: Limited Performance Agreements and the Cost-  
Quality/Access Trade-Off,” 11 G’town J. Legal Ethics 959 (1998); Fred C. Zacharias, Reply to Hyman and  
hold one status or the other is governed by agreement. As a third-party payer, an insurer may neither tell a defense lawyer what to do nor reasonably expect a defense lawyer to protect its interests, except as they happen to coincide with an insured’s. Because the duties of obedience and loyalty run only to clients, only policyholders may give lawyers instructions and demand their fidelity when liability carriers are third-party payers.

Yet, even as a third-party payer, a carrier may have rights against a defense attorney. Usually, these too are determined contractually. By agreement with a defense lawyer, a carrier may set the lawyer’s billing rate, the format in which bills are to be submitted, the information the carrier is to receive, and the services for which the carrier will pay. An agreement may also indicate the insurer’s unwillingness to

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99 Some people who agree that carriers usually are clients continue to get this point wrong. For example, Susan Randall writes that “the typical insurance defense is a joint defense in which both the policyholder and the company are clients,” Randall, supra note , at 3, but she attributes the carrier’s status to the harmony of interest it shares with its policyholder rather than to the agreement between the carrier and the defense lawyer. Id., at 3 & 13. This is incorrect. You and I may have common interests after being injured in a traffic accident, but to become co-clients we must hire the same attorney pursuant to an appropriate agreement. Moreover, we may become co-clients by hiring the same attorney even if our interests conflict. Our status depends solely on our agreement with our lawyer. The compatibility of our interests bears not on client-hood but on whether the conflict rules are triggered.

Randall also makes another errant assertion. Writing in 2001, she contends that the “crucial distinction between insurer as client or nonclient has been largely overlooked in the debate over managed litigation.” Id., at 3. Having defended the two-client view against one-client thinkers hundreds of times, I can say with authority that the carrier’s status has been hotly debated, not “overlooked.” It was the focus of my first article on insurance defense ethics, Does Insurance Defense Counsel Represent the Company or the Insured?, published in 1994. It also was an important issue in my debate with Thomas Morgan and Charles Wolfram over the treatment of insurers in the Restatement (Third) of the Law Governing Lawyers. I repeatedly tried to convince them that there is a “world of difference between being a client and not being one.” Silver, Lost World, supra note , at 781. Stephen Gillers’ memorandum also expressly divides the analysis on the alternative assumptions that the carrier is or is not a defense lawyer’s client. See Stephen Gillers, Ethical Issues in Monitoring Insurance Defense Fees: Confidentiality, Privilege and Billing Guidelines (1998) (tarlton.law.utexas.edu/silver/gil.htm).


101 California’s statute recognizes the importance of various aspects of relationships between carriers and defense lawyers in third-party payer situations. It requires the lawyer (and the policyholder) to give the carrier “all information concerning the action except privileged materials relevant to coverage disputes, and timely to inform and consult with the insurer on all matters relating to the action.” It explains how claims of attorney-client privilege are to be handled. It requires independent counsel to cooperate with the carrier’s own attorney and obligates the parties to allow both lawyers to participate in all aspects of the
compensate the lawyer for the insured’s coverage work, for time spent on the insured’s affirmative claims, for attempting to settle the claim on behalf of the insured, for work that is not properly documented, or for work that is not reasonably needed to defend the liability suit. Insurers need rights like these to ensure that they pay only for services their policies obligate them to cover and to enable them to evaluate settlement opportunities intelligently. No state bar rule prohibits a carrier that is a third-party payer from coming to terms with a defense attorney that protect these important interests. Such terms may include, for example, portions of litigation guidelines relating to billing and the use of fee auditors.

Why, then, do so many advisory committees and commentators reach the opposite conclusion? Starting with guidelines, “[t]he primary ethical concern is whether compliance with [them] interferes with the independent professional judgment of insurance defense counsel and consequently with the quality of legal services provided.”\textsuperscript{102} Many states have prohibited defense lawyers from working under carrier-imposed guidelines after finding that interference is bound to occur.\textsuperscript{103} According to these opinions, carriers interfere by micro-managing defense lawyers, for example, by refusing to pay for conversations between lawyers, by requiring that certain personnel perform certain tasks, or by paying for identified work at rates appropriate for associates underlying litigation. These are practical matters that must be handled when, because of an ethical difficulty, a defense lawyer cannot represent a carrier and an insured jointly.

\textsuperscript{102} OH Adv. Op. 2000-3, 2000 WL 10051223. Even ABA Formal Op. 01-421, which stated that “[i]n the vast majority of cases, litigation management guidelines do not raise ethical concerns,” also observed that “[s]ome litigation management guidelines … give the insurance company the right to control the defense to the degree that the lawyer’s professional judgment in rendering legal services may be materially impaired.” ABA Formal Op. 01-421.

even when partners are involved.\textsuperscript{104} Advisory committees have been particularly put off by pre-approval requirements that obligate defense lawyers to request permission before conducting legal research, asserting claims on behalf of the insured, visiting accident scenes, scheduling depositions, hiring experts, scheduling medical examinations, or instituting surveillance. As the Ohio advisory committee wrote, “[t]o the extent that the insurer reserves unto itself the right to withhold approval for reasonable and necessary legal services to be provided to an insured, these provisions of the guidelines impermissibly interfere with the independent professional judgment of the inquiring attorney.”\textsuperscript{105} Several authorities have taken the further step of finding that because claims professionals are not lawyers, a defense lawyer who seeks a carrier’s approval for a requested service thereby encourages the unauthorized practice of law.\textsuperscript{106}

To my mind, the contention that litigation guidelines interfere with lawyers’ judgment is a non-starter. As I explained in 1998, “budgetary restrictions and other ordinary payment terms do not and cannot interfere with a lawyer’s independence of professional judgment … because 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 run afoul [this requirement].”\textsuperscript{107} The contrary position conflates “freedom of judgment” with “freedom of action.” “Lawyers must always have the former, but they rarely, if ever, have the latter and no rule requires clients to give it to them.”\textsuperscript{108} To the contrary, when it comes to actions, the duty of obedience requires

\textsuperscript{105} Id. (citing Rhode Island Sup. Ct., Ethics Advisory Panel, Op. 99-18 (1999)).
\textsuperscript{106} Id. (citing Cincinnati Bar Ass’n, Op. 98-99-02).
\textsuperscript{107} Silver, Flat Fees and Staff Attorneys, supra note , at 230.
\textsuperscript{108} Id., at 230-231.
lawyers to respect clients’ wishes.

It is easy to forget, but essential to remember, that lawyers are first and foremost agents and advisors, not decision makers. Their job is to generate and recommend strategies for protecting clients’ interests and, after doing so, to follow their client’s lawful marching orders as given. Following orders may require a lawyer to employ a strategy a lawyer neither recommends nor endorses. This does not mean that a client violates a duty to the lawyer or that a client impairs a lawyer’s independence of professional judgment. As a principal, a client can properly decline to follow a lawyer’s suggestions, including suggestions that are simply too expensive. No rule requires a client to pay a lawyer for actions a lawyer wants to take. That clients frequently reject expensive suggestions and require lawyers to stick to budgets is a matter to which any experienced lawyer will attest.

Anyone familiar with the Restatement (Second) of Agency or the Restatement (Third) of the Law Governing Lawyers should know better than to quarrel with this point. Both volumes recognize the duty of obedience to which all lawyers are subject.109

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109 See, e.g., Restatement (Second) of Agency § 385 (1958) (“an agent is subject to a duty to obey all reasonable directions in regard to the manner of performing a service that he has contracted to perform”); Restatement (Third) of the Law Governing Lawyers § 16, Comment c (2000) (“The lawyer … must follow a client’s instructions; id. § 21(2)) (“A client may instruct a lawyer during the representation”); id., Comment d (“a lawyer may not continue a representation while refusing to follow a client's continuing instruction”); id. § 23, Comment c (2000) (“[A] lawyer has no right to remain in a representation and insist,
In fact, neither advisory committee member nor judges have quarreled with my analysis. They have ignored it. Not a single published opinion addresses the distinction between judgment and action or mentions the duty to obey instructions to which all lawyers are subject. The latter point is especially important for opinions that object to carriers’ use of lay claims adjusters to supervise defense attorneys. Millions of non-lawyers, better known as clients, control lawyers daily.

It is hard enough to forgive advisory committees that did their work before 1998 for missing the distinction between freedom of judgment and freedom of action. The duty of obedience has existed for centuries, and any dictionary will explain that the word “judgment” encompasses opinions, evaluations, and estimates, not actions taken pursuant to them. The sentence, “In my judgment you ought to do X” makes a recommendation that one may or may not have the power to implement. A lawyer who can recommend any course of action he wishes has complete independence of professional judgment, even when a client refuses to go along.

That committees, courts, and commentators writing after 1998 condemned litigation guidelines without coming to grips with the distinction is inexcusable. The Insurance Practices Special Study Committee of the Florida Bar stated “that enforcement of [ ] guidelines as written may affect the independent professional judgment of lawyers representing insureds.” Its report says nothing about the duty of obedience or the difference between judgments and actions. Having personally brought these matters to

contrary to a client’s instruction, that the client comply with the lawyer’s view of the client’s intended and lawful course of action.”).

110 See Merriam-Webster Collegiate Dictionary (www.m-w.com/cgi-bin/dictionary?va=judgment) (listing definitions of “judgment” or “judgement”). See also American Heritage Dictionary of the English Language (4th ed. 2000) (defining “judgment” as “the formation of an opinion after consideration or deliberation”).

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the Committee’s attention, I am dismayed. The Montana Supreme Court concluded that “the requirement of prior approval fundamentally interferes with defense counsels’ exercise of independent judgment.” As amicus curiae, I explained that lawyers are “agents and advisors, not decision makers,” and that “clients who choose not to [follow lawyers’ recommendations] do not thereby interfere with lawyers’ freedom in any wrongful way [but] simply exercise their authority to make decisions.” I also quoted the portion of my 1998 article that distinguished freedom of judgment from freedom of action. The court ignored these crucial points.

Our common law process relies greatly on those who apply rules to meet squarely arguments grounded in law that oppose their philosophical, political, or personal leanings. The point of issuing a reasoned opinion is partly to show that a decision maker embraced this duty. Yet, when prohibiting lawyers from complying with litigation guidelines, advisory committees and judges ignored serious arguments that undercut their conclusions, even though these arguments were put to them directly. The only conclusion one can reach is that their commitment to reaching legally defensible conclusions is weak.

Insofar as I know, Professor Susan Randall is the only person to question my analysis of the duty to exercise independent professional judgment. That Randall should be my critic is surprising. She accepts my view that a defending insurer is typically a defense lawyer’s co-client, and she also believes that “[w]here the insurance company is

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111 2 P.3d at 815.
113 Id., p. 16.
a client … it makes sense to permit it to exercise a significant measure of control over the litigation.”114 Applying the latter point, she concludes that a defense lawyer may abide by co-client carrier’s litigation guidelines without necessarily violating any rules.

Yet, Randall rejects my argument litigation guidelines and other budgetary constraints cannot cause lawyers to run afoul of Rule 1.8(f)(2) or 5.4(c), the rules applying the independence of judgment requirement to third party payer situations.”

“Surely, this conclusion gets it backwards,” she writes.

The goal of [Model Rules 1.8(f) and 5.4(c)] is to provide a client with competent, independent representation, free of nonclient, third-party interference, and not to afford a lawyer and client the freedom to imagine but not to implement such a representation. Rule 5.4(c) in particular is directed at interferences with the lawyer’s “professional judgment in rendering legal services.” Legal services in some contexts may consist of advice, but an adequate representation in the context of litigation must also include the possibility of action based on advice.115

There are many defects in this response. First, if Randall’s construction of the independence of judgment rule is correct, her conclusion that carriers can use litigation management guidelines when they are co-clients must be wrong. The duty to exercise independent professional judgment applies equally to first-party and third-party payer

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114 Randall, supra note , at 51.
115 Randall, supra note , at 23-24 (emphasis deleted).
Consequently, if professional judgment is wrongly constrained when a third party payer declines to pay for recommended legal services, a violation must also occur when a client refuses to pay. It follows that if insurance carriers’ litigation management guidelines cause lawyers to violate Rules 1.8(f) and 5.4(c), guidelines must also cause violations of Rule 2.1 when clients pay the bills.

This is a major difficulty. Many corporate clients use the same cost management techniques that insurance carriers apply. They subject lawyers to guidelines requiring prior approval legal services and expenses. They maintain corporate counsel offices, some of which are enormous and handle large numbers of claims. They employ outside auditors for the purpose of assessing the reasonableness of lawyers’ invoices. They use task-based billing arrangements that resemble flat fees. The ethical argument that prohibits insurers from using these techniques also prohibits corporate clients from using them. Now that this argument has the imprimatur of state supreme courts and state bar advisory committees, it is a question of politics, not of law, whether lawyers will target efforts to manage legal costs more generally.

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117 Susan Randall misses this point. She believes that cost management techniques that are impermissible in third party payer situations because they impair a defense lawyer’s ability to exercise independent professional judgment may be used when a carrier is a co-client because they then are “consistent with the lawyer’s professional obligations when a carrier is a co-client. Randall, supra note , at 3-4. Unfortunately, although Randall rightly contends that Model Rule 1.8(f) does not apply to co-client representations, she fails to address Model Rule 2.1, which does. The only way to avoid this dilemma is to show, as I have, that budgetary limitations and constraints on lawyers’ freedom of action never interfere with their freedom of judgment, action and judgment being different things.


119 Examples of litigation guidelines used by clients can be found at www.devilsadvocate.com.

120 A survey conducted by National Economic Research Associates found that corporate spending on outside legal services is likely to decline in 2002, owing partly to “the adoption of cost-cutting plans that
Randall ignores Model Rule 2.1 even though I explained its importance when discussing flat fees in 1998. The omission is fatal to her project, which attempts to force a distinction between first-party payer and third-party payer representations. Insofar as the requirement of independent professional judgment is concerned, no distinction exists. Litigation guidelines must therefore be permissible or impermissible in both contexts.

Second, Randall ignores the duty of obedience, another centerpiece of my analysis. This duty requires a lawyer to honor a client’s lawful instructions, even when a client disagrees with a lawyer over the best course to pursue. Nor does Randall explain how, when a client rejects a lawyer’s recommendation, a lawyer can satisfy this duty without violating Rule 2.1. In fact, the matter is simple. A lawyer never violates Rule 2.1 by respecting a client’s decision to forego a recommended legal service because the rule requires only that the client receive the lawyer’s independent recommendation. By rendering an honest and well-considered opinion, a lawyer satisfies Rule 2.1 regardless of a client’s reaction.

This account of the relationship between the duty of obedience and Rule 2.1 respects the plain language of the rule. As just explained, the rule talks of judgment, not of acting upon judgment. Given the importance of this language to Randall’s project, it is curious that, when critiquing my position, she says nothing about the plain language of the rule.

Third, Randall errs by contending that the point of the independent judgment requirement is to ensure adequate representation. The standard of care serves this function by subjecting lawyers to liability for negligence. Yet, a lawyer never violates

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the standard of care by honoring a client’s decision to omit a recommended service. As Comment h to § 54 of the *Restatement (Third) of the Law Governing Lawyers* plainly states, “[a] client may not recover from a lawyer for any action or inaction that the client, after proper advice, instructed the lawyer to take.” The reference to “proper advice” supports my reading of the independent judgment requirement.

Neither agency law nor the law governing lawyers establishes a free-floating requirement of adequate representation. Under both bodies of law, the sufficiency of a lawyer’s conduct depends on what a client wants and is willing to pay for. If a client is unwilling to purchase a service, a lawyer may properly omit it. Even the duty of competence leaves a lawyer free to omit recommended services at a client’s request, as I have argued elsewhere at length.

In sum, the point of the various rules that require lawyers to exercise independent professional judgment is to ensure that a client receives “straightforward advice expressing the lawyer’s honest assessment.” Professional independence is the focus of these rules, not service levels. Lawyers must be candid with clients, even when clients, third-party payers, or persons referring clients want lawyers to be patsies.

Even if I were wrong about all this, it would still be appropriate to ask whether litigation management guidelines harm policyholders. Do they cause defense lawyers to represent policyholders inadequately? No judge, advisory committee, or scholar has made a serious effort to answer this crucial empirical question. All assume that the goodness or badness of litigation guidelines turns solely on whether state bar rules allow

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lawyers to work under them. This is shallow thinking. State bar rules are fallible guides. A policy analysis might show that litigation guidelines have desirable consequences, leading one to conclude that rules restricting their use should be revised or more narrowly construed.

It was especially wrong of the Insurance Practices Special Study Committee to obsess on rules. Its mission statement required it to determine whether “the business practices of certain insurance companies … compromise the quality of the defense provided to Florida insureds.”124 This is a question of fact, not of law. One cannot answer it by citing rules. Yet, the Committee relied on rules to the exclusion of facts when discussing guidelines and other cost containment techniques. After emphasizing their dangers, the Committee wrote,

[F]or the most part, insureds have no idea that any of this is occurring. [M]ost insureds do not appreciate the potential harm. Insureds typically want the claim resolved within policy limits and they want to be involved in the process as little as possible. The Bar, however, has important interests that must be protected in all of this. Our Rules of Professional Conduct must be enforced and the Bar must be ever vigilant in enforcing our UPL rules. This is our solemn obligation.125

A person interested in facts would want to know why, if the dangers are as

123 M.R. 2.1, Comment [1].
124 Report, supra note 6, at 3.
formidable as the Committee contends, policyholders are unconcerned. Such a person also would want to know whether litigation guidelines have caused the frequency or severity of excess judgments or settlements to rise. After all, the Committee’s contention is that “[i]nsureds typically want the claim resolved within policy limits. The Committee’s Mission Statement required it to address factual questions like these. Instead of doing so, the Committee justified its efforts to regulate insurers by citing its “solemn obligation” to enforce the rules.

Rule-bound policymaking would bother me less if courts, advisory opinions, and commentators routinely got the law right. Unfortunately, when the subject is legal ethics, they err with great frequency. One must therefore urge authorities to honor the maxim “first do no harm.” Because harm is a matter fact, however, adherence to the maxim requires looking beyond rules. The “solemn obligation” to enforce rules impedes this. We thus have a dismal situation in which bad policies based on bad law are impervious to factual assault.

Discussions of fee audits confirm this impression. Although insurers have been auditing defense lawyers’ bills for decades, the campaign against audits makes no use of facts. It rests wholly on strained readings of the law. This time, the law at issue is the duty of confidentiality that defense lawyers owe insureds. The endlessly repeated allegation is that “disclosure by defense counsel of detailed descriptions of professional services to third-party auditors without first obtaining the contemporaneous fully informed consent of insureds violates client confidentiality under the Rules of Professional Conduct.” This was, in fact, the holding of the Montana Supreme Court.

126 2 P.3d at 822.
When evaluating this position, it seems fitting to begin by noting that no court
presiding over a dispute between a policyholder and a defense lawyer or an insurer has
ever held that a defense lawyer violated the duty of confidentiality by submitting bills to
a third-party auditor for review. Nor has any court presiding over a discovery dispute
held that the attorney/client privilege was waived because an external auditor reviewed a
defense lawyer’s bills. On the latter point, even the Montana Supreme Court
equivocated. After finding that auditors fall outside the “magic circle” of persons to
whom the privilege extends, the court immediately added, “however, we do not hold that
the disclosure of detailed descriptions of professional services to a third-party auditor
necessarily violates any privilege that may attach to them. Resolution of that issue would
clearly entail findings of fact that we have not made.”127

Given the dearth of cases, the legal basis for a rule barring defense lawyers from
sending bills to auditors must be slim. And so it is. The claim that the attorney/client
privilege is endangered rests on a strained reading of U.S. v. Mass. Inst. Of Technology,128
a case in which the party asserting the privilege had previously turned over its records to
an auditor associated with its adversary, the Department of Defense. When hired by
insurers, external fee auditors are agents, not enemies. It is therefore quite a reach to
apply the MIT case to insurers.

The argument that the duty of confidentiality prohibits defense lawyers from
sending bills to third-party auditors without policyholders’ consent is no stronger.
Because defense lawyers have been submitting detailed invoices to insurers for decades,

127 2 P.3d at 821.
128 129 F.3d 681 (1st Cr. 1997).
no one denies that this is proper.\textsuperscript{129} Only distribution to third parties is contested. Insurers are therefore free to audit bills internally, something they have also done for years. Plainly, the distinction between internal audits and external audits elevates form over substance. A carrier that is willing to acquire an auditing firm can scrutinize defense lawyers’ bills as intensively as it wants.

Still, those who endorse the distinction have forged ahead. They contend that revelation to third-party auditors violates confidentiality because it is neither expressly nor impliedly authorized by insureds. Express consent is lacking because carriers do not ask policyholders to give it. Implied consent is absent because, unlike secretaries and paralegals, auditors do not help lawyers represent insureds. Their only function is to reduce defense lawyers’ bills.

This argument too is a stretch. Insurance companies and other purchasers of legal services derive many benefits from audits. One is protection against over-billing. Another is information about a lawyer’s honesty, obedience, organization, and performance. Clearly, this information helps insurance companies provide for the legal representation of insureds. It may influence a carrier’s decision to hire a particular lawyer, to assign the lawyer responsibilities, to have a claims manager monitor a lawyer with unusual care, or to obtain a second opinion when a lawyer submits a case evaluation or recommends a strategy for defending a case. Many industries use audits to ensure compliance with guidelines. They do so because compliance generates the consistent performance that is needed to assure the delivery of high quality goods and services to consumers. The Total Quality Management movement relies heavily on compliance with

\textsuperscript{129} See, e.g., 2 P.3d at 821 (“Petitioners do not dispute that disclosures of billing information to \textit{insurers} are impliedly authorized to carry out representation”) (original emphasis).
procedures to minimize the frequency of mistakes.\textsuperscript{130}

Those who reject this argument have a difficult burden to bear.\textsuperscript{131} Internal fee audits and external audits serve the same functions. Consequently, if external audits contribute nothing to the representation of insureds, internal audits must suffer the same defect. It must therefore follow that the duty of confidentiality prohibits defense lawyers from allowing carriers to audit legal bills internally. Policyholders’ implied consent allows defense lawyers to reveal information only as needed to carry out representations.\textsuperscript{132} A defense lawyer may not reveal confidences to a law firm’s janitor. Unless an audit helps a representation progress in an appropriate way, a lawyer may not share confidences with an auditor either.

In view of this, one must proceed in one of two directions. Either one must require that policyholders expressly consent to in-house audits, or one must rethink the belief that audits are not reasonably related to the legal defense of insureds. I see no need for the former approach. Insurance companies have been reviewing lawyers’ statements internally since the first carrier paid the first defense bill. In all this time, no one has suggested that internal audits are improper or that defense lawyers violate the duty of confidentiality to insureds by participating in them. Given the tradition that has been established and the lack of demonstrable harm to policyholders, there is no reason to change. Second, audits are reasonably related to the delivery of legal services to insureds, for the reasons just stated. They help carriers gauge and control the quality of


\textsuperscript{131} See, e.g., Douglas A. Richmond, Of Legal Audits and Legal Ethics at 522 (contending that “[a]uditors cannot improve the quality of defense lawyers’ work”).

service that defense lawyers provide when pursuing the jointly held goal of loss minimization. Because insurers rely heavily on defense lawyers’ recommendations when litigating and settling claims, information about lawyers’ honesty, reliability, and efficiency is of great importance to them and their insureds.

V. CONCLUSION

The quality of the debate over defense lawyers’ professional responsibilities is depressing. Despite the enormity of the stakes, regulators have made little effort to study or think about the consequences of modern litigation cost management techniques in a serious way. Instead of examining the history of carrier control of defensive representations, advisory committees, judges, and commentators have ignored the facts and even shown disdain for them. Many have also done an exceedingly poor a job of reading and applying the law. In 1998, I wrote that the law governing insurance defense lawyers was basically sound but needed some “weeding and pruning.”¹³³ Now, the weeds have taken over the garden. The doctrinal foundation of the practice of insurance defense is endangered as never before.

All this happened because liability insurers sought to manage litigation costs. In other words, it happened because they tried to do their job. Policyholders contract with insurance companies so that insurers will handle litigation management for them. Part of managing lawsuits is managing costs. Policyholders would manage costs themselves if they were bearing expenses. Insurers must manage costs when they are in charge. The problem that rankles defense lawyers is that insurers do the job too well. They place

¹³³ Silver, Lost World, supra note , at 785.
significant pressure on defense lawyers to become more efficient. This is purely a matter of economics; it raises no problems of ethics.

Nor does carriers’ success in moderating defense costs provide a basis for regulation. In a liberal society, the primary justification for regulation is to prevent people from harming others without their consent. Tripartite relationships are contractual. Insurance contracts govern relationships between carriers and policyholders, and retainer agreements govern the principals’ relationships with defense lawyers. These agreements attenuate the need for governmental intervention by providing a consensual foundation for the manner of allocating benefits and costs within tripartite relationships. Moreover, if the point of regulation is to prevent harm, proof of harm in the absence of regulation is indispensable. Because participants in the campaign to empower defense lawyers have offered no evidence of harm to policyholders, regulators should decline to come to their aid.
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<td>Ala. OGC Formal Op. 98-02, <a href="http://www.alabar.org/page.cfm?page=im_include/im_fopDisplay.cfm&amp;oneId=2">http://www.alabar.org/page.cfm?page=im_include/im_fopDisplay.cfm&amp;oneId=2</a></td>
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<td>April 28, 2000</td>
<td>299 Mont. 321, 2 P.3d 806, No. 98-612</td>
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<td>Utah</td>
<td>February 27, 2002</td>
<td>UT Eth. Op. 02-03, 2002 WL 340262</td>
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<td>American Bar Association</td>
<td>February 16, 2001</td>
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**FLAT FEES**
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<td>American Insurance Association v. Kentucky Bar Association, 917 S.W.2d 586 (Ky. 1996)</td>
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<td>Oklahoma</td>
<td>March 27, 1998</td>
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