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What Insurers Can Do to Secure Reasonable Rates from Conflict Counsel

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Containing defense costs begins by establishing a reasonable rate for the legal services to be provided by defense counsel. Even in situations where a liability insurer does not have an unrestricted right to select defense counsel or control how the case is defended, the insurer is not powerless to secure reasonable rates from the defense attorneys. This article describes what liability insurers can do to obtain reasonable rates when the selection of conflict counsel does not depend entirely upon the choice of the insurer. As discussed, *infra*, some states have enacted statutes that provide a framework for challenging the reasonableness of fees submitted by independent or conflict counsel. See Cal. Civ. Code §2860 (2001).

How the Right to Select Defense Counsel Affects the Rate Question

One of the basic obligations under general liability policies is the duty to defend the insured for potentially covered suits. The insurer's obligation to defend potentially covered claims is generally accompanied by the contractual right to select defense counsel. However, when a suit against an insured does not fall clearly and certainly within the insuring agreements of the policy, a liability insurer may reserve its right to deny coverage. A conflict of interest between the insurer and its insured can arise when a reservation of rights is asserted. When a conflict does exist, it eliminates or at least limits the insurer's right to select defense counsel.

Depending upon the laws of the particular jurisdiction, a liability insurer finding itself in such a conflict situation may have little or no control over the selection of defense counsel. When a conflict of interest exists, the insurer typically is not allowed to control the defense of the insured, but must discharge its duty to defend by reimbursing the insured for the reasonable costs of the defense. This includes the "reasonable fees" incurred by defense attorneys selected by the insured.

The practical problem is that in circumstances where a conflict of interest deprives an insurer of the right to select defense counsel, the insurer's ability to negotiate fair rates with the lawyers is greatly diminished. Yet, even when the insurer has no say in the selection of counsel, the "reasonable fee" standard represents a significant limitation on the defense costs that conflict counsel can demand of the insurer.

Conflicts of Interest and the Right to Choose Defense Counsel

In circumstances where a conflict of interest exists, state law determines the extent to which the insurer may participate in the selection of defense counsel. This is pivotal with respect to an insurer's efforts to secure a fair and reasonable rate from defense counsel, because the more control the insurer retains over the selection of defense counsel, the better able the insurer will be to negotiate rates with the

attorneys who seek the assignment. Thus, the conflict rules of the governing jurisdiction largely define how much leverage an insurer will have to determine the rates that can be charged by conflict counsel.

Some jurisdictions grant the *insured* sole discretion in the selection of conflict counsel, without any consideration for the insurer's preferences. Insureds in several states enjoy relatively unfettered discretion in assigning independent defense counsel to represent them in conflict situations, including: Arkansas: *Northland Ins. Co. v. Heck's Service Co.*, 620 F. Supp. 107 (D. Ark. 1985); Illinois: *Maryland Casualty Co. v. Peppers*, 355 N.E.2d 24 (Ill. 1976); New York: *Nelson Electrical Contracting Corp. v. Transcontinental Ins. Co.*, 660 N.Y.S.2d 220 (3d Dep't 1997); Mississippi: *Moeller v. Amer. Guar. And Liability Ins. Co.*, 707 So.2d 1062 (Miss. 1986); Louisiana: *Belangerr v. Gabriel Chemicals, Inc.*, 787 So.2d 559 (La. Ct. App. 2001); New Jersey: *Merchants Indem. Corp. v. Eggleston*, 179 A.2d 505 (N.J. 1962); Maryland: *Roossos v. Allstate Ins. Co.*, 655 A.2d 40 (Md. App. 1995); Utah: *Lima v. Chambers*, 657 P.2d 279 (Utah 1988). Courts in these jurisdictions preclude an insurer from having any role in the selection of counsel to ensure that the insurer exerts no influence on the way the defense is conducted in the underlying litigation. However, even in these jurisdictions, the insured is required to exercise good faith and act reasonably when selecting its defense counsel, which includes the retention of counsel who use ethical billing practices and are competent to represent the insured's interests in the litigation. *Center Foundation v. Chicago Ins. Co.*, 278 Cal. Rptr. 13 (Ct. App. 1991).

At the opposite end of the spectrum, some jurisdictions allow the *insurer* to select conflict counsel when a conflict exists. However, these courts typically impose special requirements on insurers to prevent abuse of this right to select defense counsel. For example, the insurer selecting the counsel may be precluded from raising collateral estoppel against the insured concerning coverage issues remaining after the resolution of the underlying action; the insurer may be required to select counsel for the insured who are not the insurer's usual "panel counsel;" and the insurer may have a heightened obligation to report to the insured of the progress and status of the defense, including settlement demands and other issues. See, e.g., *Tank v. State Farm Fire & Cas. Co.*, 715 P.2d 1133 (Wash.) (providing these and other requirements on the insurer); *Twin City Fire Ins. Co. v. Colonial Life & Ass.*, 839 So.2d 614 (Ala. 2002); *Federal Ins. Co. v. X-Rite, Inc.*, 748 F. Supp. 1223 (E.D. Mich. 1990).

Other jurisdictions permit the insurer and insured to *share* in the selection of conflict counsel. See *Employers Fire Ins. Co. v. Beals*, 240 A.2d 397 (R.I. 1968) (insurer provided with the right to approve the insured's selected independent counsel). By allowing the insurer a voice in the selection of the independent counsel, these jurisdictions attempt to minimize the abuses that may occur when an insured is given sole discretion to select its own counsel. Some jurisdictions define the insurer's and insured's respective roles in the selection of counsel through statutory guidelines. Cal. Civ. Code §2680 (2001); Fla. St. §627.426 (2000); Alas. St. §21.89.100 (1999). These statutes typically provide objective descriptions of the insured's and insurer's respective roles in the selection of conflict counsel. Cal. Civ. Code §2860 provides that an insurer has the right to require the counsel selected by the insured to have at least four years of experience; Fla. St. §627.426 provides that in a conflict situation, the insurer is entitled to retain independent counsel which is mutually agreeable to both the insurer and the insured; and Alaska St. §21.89.100 provides that if the insured selects counsel, the insurer may require the defense counsel to have 4 or more years experience. Courts in these jurisdictions have recognized that insurers have a legitimate interest in controlling the total costs of the litigation, so they require that the insured's selection of conflict counsel must be approved by the insurer, provided that approval is not unreasonably withheld. See *Beals, supra.*; see also *Hartford Ins. Co. v. A&M Associates, Ltd.*, 200 F. Supp. 2d 84 (D. R.I. 2000).

Determining a fair and reasonable rate for conflict counsel can be resolved through arm's length negotiations, to the extent that the insurer is permitted to select or provide input into the selection of conflict counsel. However, when an insurer is

excluded from participation in that selection process, the question of a reasonable rate becomes much more difficult to resolve. Consequently, securing a reasonable rate from conflict counsel is intrinsically more difficult in some jurisdictions than it is in others.

Legal Standards Defining the Duty to Defend

Regardless of who selects the defense attorney, an insurer is responsible for reimbursing only the *reasonable* attorneys' fees and costs that are actually incurred in the underlying defense. *First Jefferson Associates v. Ins. Co. of N. America*, 691 N.Y.S.2d 506 (1st Dep't 1999); *Chicago Title Ins. Co. v. F.D.I.C.*, 172 F.3d 601 (8th Cir. 1999) (interpreting Minnesota law and recognizing a duty to reimburse reasonable fees); *Aetna Cas. & Sur. Co. v. Dow Chemical Co.*, 44 F. Supp.2d 847 (E.D. Mich. 1997); *Chatterson v. Walker*, 938 P.2d 255 (Utah 1997); *Nisson v. Amer. Home Assur. Co.*, 917 P.2d 488 (Okl. Civ. App. 1996); *Northern Ins. Co. of N.Y. v. Allied Mut. Ins. Co.*, 955 F.2d 1353 (9th Cir. 1992); *Maryland Casualty Co. v. Peppers*, 355 N.E.2d 24 (Ill. 1976). This is a substantive standard of limitation on the rates that conflict counsel can charge and on the rates that the insurer may be expected to pay. This standard binds insurers, the defense attorneys who seek payment from the insurers, and the insureds who have selected the defense attorneys. The "reasonable fee" standard arises from state insurance law, and it is also a central tenet of the rules of professional responsibility that bind defense lawyers throughout the country. On one side of the coin, state insurance law principles provide that an insurer is not required to pay rates in excess of what is reasonable; on the other side of the coin, the rules of professional responsibility prohibit an attorney from attempting to charge and collect more than a reasonable fee.

A related rule is that an attorney may not unilaterally raise his or her rates during the course of litigation. See, e.g., *Perez v. Pappas*, 659 P.2d 475 (Wash. 1983) (modified fee agreement to increase attorney's compensation during course of representation is unenforceable unless attorney demonstrates new consideration to support the increase). This rule of professional responsibility is based on the concern that a lawyer seeking a rate increase in the midst of litigation would have an unfair advantage over the client in negotiating a rate increase, inasmuch as it may be difficult and expensive for a litigant to change defense counsel during the course of litigation.

Because disputes often arise concerning what constitutes a reasonable rate for a given case, the burden of proof can be critical. Ordinarily, insurers do not have the burden of proof on the reasonable rate issue. Under state insurance laws, the insured has the initial burden of establishing the reasonableness of the fee for which reimbursement is sought, as the insurer's obligation to reimburse incurred defense costs is limited and defined by the reasonable fee. *International Ins. Co. v. City of Chicago Heights*, 643 N.E.2d 1305 (Ill. Ct. App. 1994) (initial burden of demonstrating reasonableness of fees is on the party seeking recovery of the fees). As explained in *City of Chicago Heights*, the burden shifts if the party seeking reimbursement shows: 1) the services performed; 2) who performed each service; 3) the time spent; and 4) the hourly rate. See also *Curtis v. Nutmeg Ins. Co.*, 681 N.Y.S.2d 620 (3d Dep't 1998) (burden is on the insured to demonstrate reasonableness of the fees); *Benoit v. Fuselier*, 195 So.2d 679–83 (La. Ct. App. 1967) (same). Under the rules of professional responsibility, the burden of establishing the reasonableness of the fee rests upon the attorneys who charge the fee. Rule 1.5 of the ABA Model Rules for Professional Conduct provides that "a lawyer's fee must be reasonable." The ABA Formal Opinion 1993-379 explains that it is the attorney's responsibility to explain any changes to the client and convey the content of the legal invoice in a meaningful manner.

How to Determine a Reasonable Rate

The “reasonable fee” standard is a flexible standard. Because the standard is flexible, it is often misunderstood as a subjective measure lacking substance and vitality. To the contrary, the “reasonable fee” standard is actually a composite of several discrete objective criteria. It is a flexible standard, because it requires analysis of several factors that vary with the circumstances of each particular case. However, the criteria of the standard themselves are clear and objective.

A check list of the criteria relevant to determining a reasonable rate for conflict counsel include the following:

- the experience, reputation and ability of the particular defense attorneys;
- the undesirability of the case;
- the hourly rates of other attorneys doing similar work in the same or a comparable venue;
- the nature and length of the attorney’s professional relationship with the client and rates customarily paid by that client;
- the preclusion of other employment by the attorney due to acceptance of the particular case;
- the skill required by the defense attorney to properly perform the requested legal services;
- the attorneys’ customary fees charged to other clients;
- the time limitations imposed by the client or by the circumstances;
- the amount in controversy and the results obtained;
- the novelty and difficulty of the questions involved in the litigation;
- the time and labor required of the defense attorney;
- fee awards in similar cases; and
- the importance of the litigation to the client.

See Patrick v. Head of the Lakes Cooperative Electric Association, 295 N.W.2d 205 (Wis. Ct. App. 1980); *Baghrmain v. MFA Mutual Ins. Co.*, 315 So.2d 849 (La. Ct. App. 1975); *Ripepi v. American Insurance Companies*, 234 F. Supp. 156 (W.D. Penn. 1964).

Implementing the “Reasonable Fee” Standard

When the party who selects defense counsel is also the party who will pay for the services of the attorney, the market largely determines the reasonable rate through arm’s length negotiations. *See Vanguard Ins. Co. v. Guagenti*, 599 N.Y.S.2d 215 (N.Y. Sup. Ct. 1993) (finding the insured is entitled to select its own independent counsel to be paid only at the standard insurance defense rates). Absent a conflict of interest, if the insurer and the attorney seeking the assignment cannot agree on a rate, the insurer can simply find another attorney who shares the insurer’s views on the appropriate rate. However, in instances where local law permits the insured to select defense counsel at the insurer’s expense, this market influence is not active.

In situations in which the insured selects defense counsel but the insurer pays, the insured has virtually no interest in conserving defense expense. Instead, the insured’s interest is in getting the best defense that money can buy, because he wants to be well represented and does not have to worry about paying the defense bills. This dynamic is even more pronounced where the party who demands a defense is not a named insured on the policy issued by the insurer, but an additional

insured or a defined insured who is unconcerned about whether a big defense bill might increase future policy premiums.

Unfortunately (from the insurer's perspective), the defense attorney who is selected by the insured also has little interest in charging a conservative rate, because his or her loyalties run to the insured and he or she may have no preexisting relationship with the insurer. Conflict counsel stands to gain most by imposing an aggressive rate upon his or her client's insurer. It is more costly for an insurer to hire conflict counsel than to retain its own panel counsel because insurers have less ability to negotiate the rates of conflict counsel.

Yet, even against this backdrop, a liability insurer with a recognized duty to defend can gain bargaining power by enforcing the "reasonable fee" standard. Under the "reasonable fee" standard, an insurer should never be at the mercy of the insured's conflict counsel to pay whatever rate the defense attorney chooses to impose. A liability insurer's right and duty is to pay only the reasonable costs of the defense, which means that only a reasonable rate need be paid for defense counsel. Success in this effort requires a familiarity with the applicable standards. It also requires early action on the part of the insurer to insist that the insured and defense counsel sustain their respective burdens to establish the objective reasonableness of the attorney's rates.

As soon as the insured makes its selection of conflict counsel known, the insurer should begin the process of establishing a reasonable and acceptable rate. The first step is to make prompt and direct inquiry into the proposed rate to be charged by the insured's chosen defense attorney. If the quoted rate appears suspect in light of the nature of the case and qualifications of defense counsel, the insurer should immediately advise the insured that the rate is being questioned. The insurer should remind the insured that under the terms of the insurance policy, the jurisdiction's insurance law and applicable rules of professional responsibility, the insurer has no obligation to pay more than a reasonable fee. The best practice is to state this in writing, as a reservation of rights.

The second step is to ask the insured and defense counsel for information supporting the objective reasonableness of the proposed rate. Neither the insured nor the insured's chosen counsel is entitled to impose a suspect rate or unreasonable fee upon an insurer by fiat. The insured and its counsel have the initial burden of showing the reasonableness of the rates, and, upon proper inquiry, can be required to answer appropriate questions concerning the foundation for the rates to be charged to the insurer. A general inquiry will most likely elicit a general response, which will probably be of little assistance in the insurer's efforts to secure a reasonable rate. The better practice is for the insurer to ask the insured to identify the attorneys who are being retained for the work, and then to request the insured and defense counsel to justify the proposed rate in terms of specific criteria, including the following factors:

- The particular defense attorneys' experience, reputation and ability. Specific request may be made for each attorney's professional resume, jury verdict reports and a description of the attorney's experience in handling the particular type of case at issue ;
- The rates of other attorneys for similar work in the same or comparable venues;
- The rates charged by each retained attorney to other clients for similar work in the same or comparable venues;
- The nature and length of the attorneys' professional relationship with the client and the rate paid to the attorneys by that client in the past;
- The level of skill required by the defense attorneys to adequately perform the requested legal services;

- Any notable time limitations imposed by the circumstances;
- The amount in controversy;
- The novelty and difficulty of the questions involved in the litigation;
- The time and labor that will be required of the defense attorneys; and
- The amount of time the proposed rate will remain in effect.

The third step depends upon the response that the insurer receives to its rate information request. If the insured and/or its chosen defense counsel respond to the information request, the insurer should evaluate the substance of the response to determine whether the provided information fairly and objectively supports the proposed defense counsel rate. If the response to the information request supports the proposed rate, the inquiry will end and the insurer should advise the insured and its counsel that there is agreement as to the proposed rates.

If the response to the rate information request does not appear to justify the proposed rate, the insurer should propose an alternative rate and provide its rationale. This process is best started by informing the insured and its chosen defense counsel of the rate that the insurer typically pays to attorneys in the ordinary course of business to defend similar actions in the same venue. Comparison of the market rate to the conflict counsel's proposed rate is one widely recognized objective measure to determine the reasonableness of the proposed rate. Cal. Civ. Code §2860 provides that "the insurer's obligation to pay fees to the independent counsel selected by the insured is limited to the rates which are actually paid by the insurer to attorneys retained by it in the ordinary course of business in the defense of similar actions in the community where the claim arose or is being defended." *Id.* Additionally, several cases, outside of the insurance context, have discussed the impact of the "market rate" for the hourly rate, including *Moriarty v. Svec*, 233 F.3d 955 (7th Cir. 2000) (finding that the lawyer's regular rate is strongly presumed to be the market rate for his or her services); *Arquest Inc. v. Tracy*, 2003 WL 22012688 (N.D. Ill. 2003) (discusses elements involved in analysis of hourly rate and fees); *Glover v. Johnson*, 934 F.2d 703, 716 (6th Cir. 1991) (hourly rate can be established by proving that the rates sought are rates charged for similar services by lawyers of comparable skill, experience and reputation); *Blum v. Stenson*, 465 U.S. 886 (1984) (establishing that market rates are the appropriate basis for determining appropriate hourly rates). Under the California statute, this is the ultimate measure of the rate applicable to conflict counsel, but in most jurisdictions it is the only beginning point for the determination of an appropriate rate.

Beyond reference to the market rate, the insurer should attempt to use the information provided by the insured in response to the rate justification request as the substantive basis for negotiating an acceptable rate. Absent bargaining power in a conflict situation, an insurer's primary tool in rate negotiations is information. For every point offered by the insured and its conflict counsel in support of a proposed rate, the insurer may develop a counterpoint as grist for the negotiation. If reasonable counterpoints cannot be developed, the insurer should carefully consider whether any objective reason exists for declining to accept at the proposed rates of conflict counsel.

A more challenging situation is presented if the insured and its defense counsel fail to respond to the insurer's rate information request. The insurer should inform the insured that its failure to provide a response will be considered to be a waiver of any right to reimbursement for defense counsel fees under the insurance policy. This done, the insurer has essentially three options: 1) to abandon efforts to secure a reasonable rate and simply pay the proposed rate; 2) to pay the proposed rate under a reservation of rights, including the right to seek a refund of the amount of fees paid in excess of the reasonable rate; or 3) to file a declaratory judgment action to resolve the rate question as a component of the broader duty to defend issue. How an insurer should proceed depends upon a number of case-specific variables, including

the disparity between the proposed rate and a reasonable rate, the anticipated amount of defense counsel's time and labor, the other grounds on which the insurer has reserved its rights, and the degree to which the particular jurisdiction enforces the "reasonable fee" standard.

If the insured has overreached in proposing a rate for defense counsel, the insurer's reservation of rights or filing of a declaratory judgment action on the "reasonable fee" issue may influence the insured to compromise rather than contest the issue. The primary concern of the insured should be to obtain effective assistance of defense counsel, not to enrich its defense lawyers. Thus, the insured may be interested in finding alternatives to the risk and cost associated with a prolonged dispute on the rate issue, such as selecting less expensive defense counsel, or negotiating a better rate with its chosen defense counsel, or reaching a compromise on the rate to be paid by the insurer. In the absence of some early resolution of the issue, the rate issue will remain an unwanted cost and distraction for the insured, when its primary attention is upon achieving success in the underlying litigation.

Conclusion

While the particulars differ from case to case, the important thing is for the insurer to take early steps to affirmatively assert its expectation that the rate charged by conflict counsel must be an objectively reasonable rate. If the insurer fails to clearly assert this expectation and demand, by default the determination of the applicable rate will be left entirely to the insured and its counsel, neither of whom have any interest in establishing a conservative rate. Insurers are not powerless to secure reasonable rates from conflict counsel. The duty to defend arising under public liability policies encompasses rights as well as obligations.

It is the right of a liability insurer to defend its insured under reservation, if the insurer believes there are genuine questions concerning coverage. It is also the right of a liability insurer to pay no more than a reasonable fee for the defense of its insureds. While the insurer's assertion of a reservation of rights may affect its right to select defense counsel, it does not diminish its right to demand a reasonable rate. Yet, the right to pay only a reasonable rate is not self-executing. It is a right that is lost unless asserted promptly.

Contrary to common belief, there is a lot that insurers can do to ensure reasonable rates from conflict counsel. If the insurer seeks a reasonable rate, the law is emphatically in support. All that is required is that the insurer be prepared to do what is necessary to enforce its rights.

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