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Survival Guide for *Cumis* Counsel: How to Address Insurers' Challenges to Fees Owed to Independent Counsel

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The question of who gets to select defense counsel routinely arises when a liability insurer owes a duty to defend an insured against a third-party claim. Generally speaking, the insurer has this selection right. There are, however, several important exceptions to this general rule that allow the insured to select an attorney who is "independent" of the insurer. [1]

When an insured exercises its right to independent counsel, issues invariably arise concerning the amount of fees and costs the insurer has to pay. This article discusses the propriety of three techniques used by insurers to control or challenge the fees and costs billed by an insured's independent counsel.

A. Hourly Rates

1. The Statutory Limitation

California Civil Code Section 2860(c) governs the financial relationship between an insurer and its insured's independent counsel: *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. This subdivision does not invalidate other different or additional policy provisions pertaining to attorney's fees.*

[1] *The most common exception being where defense counsel selected by the insurer could manipulate the litigation so as to result in a forfeiture of coverage for the insured by "defending" the case in a manner that results in a finding of intentional conduct against the insured. San Diego Navy Federal Credit Union v.Cumis Ins. Soc., 162 Cal.App.3d 358 (1984); California Civil Code §2860.*

While insurers need only pay independent counsel the same rates they pay other lawyers to defend similar actions in the same locale, there are nonetheless several important issues for independent counsel to consider when negotiating such fee agreements.

First, insurers typically impose a "panel rate" on independent counsel without discussing, or even contemplating, that the rate may be increased at some future point in time. Independent counsel should request, in writing, that the rate be increased in line with any increases paid to the insurer's panel counsel.

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Second, both insureds and their independent counsel should ask the insurer to verify, in writing, that the rate offered equates to the highest rate currently being paid to panel counsel to defend similar actions in the same geographic area.

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Insurers arguably have an implied-in-law duty to disclose the rates they pay to panel counsel — otherwise, how is an insured to verify that the rate offered by the insurer is correct?

Moreover, the statutory reference only to "rates" indicates there is no limitation on the insurer's duty to pay "costs" incurred by independent counsel. See, *Gray Cary Ware & Freidenrich v. Vigilant Ins. Co.*, 114 Cal.App.4th 1185 (2004).

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2. Section 2860 Only Applies To Insurers With A "Duty To Defend"

Section 2860 by its own terms applies only where "the provisions of a policy of insurance impose a *duty to defend*" on the insurer. *See Cal. Civ. Code §2860(a).* Consequently, section 2860 – and its rate limitation provision - has no application to a policy of insurance (*e.g.*, a typical Directors and Officers policy) that only obligates the insurer to "indemnify" the insured against defense expenses. See, *e.g.*, *National Union Fire Ins. Co. of Pittsburgh, PA v. StilesProfessional Law Corporation*, 235 Cal.App.3d 1718, 1727 (1991). Arguably, an insurer with a duty to "indemnify" defense expenses has no legal basis for reducing the hourly rates of its insured's defense counsel.

3. The Statutory Language Permits Reference To The Attorney Rates Insurers Pay To Defend Themselves.

Insurers typically argue that they pay independent counsel no higher rates than they pay to their panel counsel to defend *other insureds* against similar actions. Since such rates are usually deeply discounted, independent counsel is thus forced to either accept these lower panel rates or look to the insured to make up the rate differential. However, the language of Section 2860 – limiting rates to those paid by the insurer "*in the ordinary course of business*" to defend "*similar actions*" – arguably permits reference to the higher rates insurers typically pay lawyers when defending *themselves* in business litigation.

B. Audits and "Billing Guidelines"

Despite the absence of any mention in Section 2860 of any "billing guidelines", it is common practice for insurers to insist upon independent counsel's chapter-and-verse compliance with such guidelines. Oftentimes, legal auditors are brought in to scrutinize the bills and adjust down any fee or cost entries they determine are not in compliance, despite (except on rare occasions) the fact there is no policy provision requiring such compliance.

1. Insurer Billing Guidelines Should Not Apply To Independent Counsel.

While no California case has yet addressed this issue, billing guidelines arguably should not apply to independent counsel, since there exists no statutory or contractual basis for requiring such compliance. They are not mentioned in either section 2860 or in standard insurance policies. Billing guidelines are also only intended to apply to an insurer's panel counsel; this is often reflected in the language of the guidelines themselves. Panel counsel agree to comply with the billing guidelines as a condition of their employment. Such a condition does not exist for independent counsel who are hired by the insured, not the insurer.

While insurers have no duty to pay unreasonable fees and costs, the proper measure of reasonableness is not insurer billing guidelines. In fact, such guidelines are designed to minimize litigation costs for insurers, often at the expense of providing the insured a full and complete defense.

The proper measure of "reasonableness" has been developed in a wide body of decisional law. *See*, ABA Disciplinary Rule No. 2-106; see also, California Rule of Professional Conduct No. Rule 4-200; *Glendora Community Redevelopment Agency v. Demeter*, 155 Cal. App. 3d 465, 474-481 (1984); *People ex rel. Dept. of Transportation v. Yuki*, 31 Cal. App. 4th 1754, 1767 (1995). Such common law requires the examination of numerous factors in determining reasonableness, such as: (1) the novelty and difficulty of the questions involved and the requisite skill to perform the legal service properly; (2) the fee customarily charged in the locality for similar legal services; (3) the amount of the fee in proportion to the value of the legal services performed; (4) the amount involved and the results obtained; and (5) the experience, reputation, and ability of the lawyer or lawyers performing the services. Insurer billing guidelines do not supplant this body of law in measuring the reasonableness of independent counsel's fees and costs.

2. The Ethical Implications Of Insurer Billing Guidelines.

Complying with insurer "billing guidelines" can impact upon counsels' ethical obligations to their clients. For this reason, one California appellate court has questioned "the wisdom and propriety" of using billing guidelines to limit counsel compensation:

[W]e question the wisdom and propriety of so-called "outside counsel guidelines" by which insurers seek to limit or restrict certain types of discovery, legal research, or computerized

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legal research by outside attorneys they retain to represent their insureds where there is a potential for an uncovered claim. Some guidelines go so far as to call for the use of paralegals, rather than attorneys, to respond to "routine" discovery requests or prohibit the retention of experts or the filing of certain pretrial motions until shortly before trial. Under no circumstances can such guidelines be permitted to impede the attorney's own professional judgment about how best to competently represent the insureds. If the attorney's representation is to be limited in any way that unreasonably interferes with the defense, it is theinsured, not the insurer, who should make that decision.
Dynamic Concepts, Inc. v. Truck Insurance Exchange, 61 Cal.App.4th 999, fn. 9 (1998).

Furthermore, ethical considerations may prohibit independent counsel, who has no attorney client relationship with the insurer, from complying with billing guidelines to the extent such compliance would interfere with his or her exercise of professional judgment. ABA's Canon No. 5 ("A lawyer should exercise independent professional judgment on behalf of a client."); see also, ABA's Ethical Consideration No. 5-1 ("The professional judgment of a lawyer should be exercised, within the bounds of the law, solely for the benefit of his client and free of compromising influences and loyalties. Neither his personal interests, the interests of other clients, nor the desires of third persons should be permitted to dilute his loyalty to his client.");ABA's Disciplinary Rule No. 5-107 (B) ("A lawyer shall not permit a person who recommends, employs, or pays him to render legal services for another to direct or regulate his professional judgment in rendering such legal services.")

C. Allocation

"Allocation" is another common technique utilized by insurers to reduce the fees and costs billed by independent counsel. For example, where an insured is both a defendant and plaintiff in the same lawsuit, the insurer will often argue that the independent counsel's fees should be allocated one-half to defense (payable by the insurer) and one-half to prosecution (payable by the insured). Alternatively, where independent counsel defends both an insured defendant and a non-insured defendant in the same lawsuit, the insurer may try to allocate one-half of the fees to the defense of the insured and one-half to the defense of the non-insured.

Such arbitrary allocations are likely inappropriate for two reasons. First, fees and costs that are "inextricably linked" to both prosecuting an insured's action and defending a covered crossaction must be paid by the insurer. See, *California v. Pacific Indemnity*, 63 Cal.App.4th 1535, 1548-1549 (1998). This rule parallels the common law rule of apportionment that is applied in non-insurance cases. See, *e.g.*, *Reynolds Metals Company v. Alperson*, 25 Cal.3d 124, 129-130 (1979).

Second, an insurer is required to pay fees and costs that are "reasonably related" to the defense of its insured. See, *Safeway Stores v. National UnionFire Ins. Co.*, 64 F.3d 1282, 1289 (9th Cir. 1995).

Thus, where independent counsel also represents non- insured defendants, it is only appropriate to allocate fees to the extent this joint representation results in an *increase* in the fees and costs billed. *Id.*, at 1287, citing *Raychem Corp. v. Federal Ins.Co.*, 853 F. Supp. 1170, 1180 (N.D. Cal. 1994).

D. Conclusion

Insureds and their independent counsel can use the above authority to resist their insurer's unilateral attempts to inappropriately limit rates and/or to discount fees and costs via billing guidelines, audits and allocation.