Simple Strategies to Manage and Reduce Defense Costs

by Adam P. Doherty, Esq., Charles A. ("Tony") Jones and Matthew C. So

A claim has been tendered, reviewed and accepted. Now what? This is the oft-repeated question many liability insurance carriers ask themselves. The simple answer to this question is that it must now establish a clear strategy to move forward with the insured’s defense and manage the costs of the defense. Providing coverage, however, does not necessarily mean that a policyholder has a carte blanche right to defend the underlying litigation to his desire. Rather, the insurance carrier is only responsible for those defense costs that are reasonable and necessary.1 Accordingly, the insurance carrier may implement practical strategies to help manage and reduce the costs of the defense.

Rates and Hours

An effective way to manage defense costs is to set a reasonable maximum rate for the insured’s defense counsel. What constitutes “reasonable” is hardly an exact science, but courts have generally adopted a basic framework (with slight variations among jurisdictions) in determining the “reasonableness” of attorney’s fees: (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.2 Carriers typically set the maximum rate based on comparable rates of its panel attorneys, on the basis that such panel attorneys have like skill and experience and defend claims of similar nature. However, carriers should be mindful that a higher rate may nonetheless be deemed reasonable,3 and therefore, should make each determination on a case-by-case basis. An insurance carrier can also reserve itself the sole and absolute discretion in determining what is “reasonable,” which may be achieved through proper policy language.4

In addition, insurers may set forth guidelines to limit defense counsel’s time on certain discreet legal tasks because the amount of hours spent on such tasks must also be reasonable.5 For example, insurers may limit defense counsel’s in-office conferences and communications, which are often excessive and unproductive.6

Staffing

Defense counsel must also staff the insured’s case in a reasonable manner. A large staff may result in wasting time keeping the whole team apprised of the case, reviewing each others’ work, and assigning work to different team members.7 For example, an associate may waste time redoing similar work of another associate and a partner may duplicate the work of an associate, not knowing that the work has already been done. Moreover, in certain circumstances, an insured may request to staff a case with two sets of attorneys. In such an event, an insured should justify having two sets of attorneys, especially where one set of attorneys has a substantially higher rate than the other set of attorneys, because such staffing often lends to wasted time or disproportional contribution by the attorneys.8 Thus, another effective strategy is to provide clear guidelines regarding attorney staffing.

Enforcement of Litigation Management Guidelines

Insurance carriers commonly implement the foregoing strategies by requiring defense counsel to follow their litigation management guidelines. Such guidelines generally include a statement of the insurance company’s goals, a breakdown of the respective duties of the claims professional and defense counsel, and standard procedures for handling lawsuits. They also describe certain tasks that require the insurer’s prior approval, including, but not limited to, selection and retention of investigators and experts, filing of motions, discovery, performance of computer research, intra-office conferences and staffing. But are these litigation management guidelines really enforceable?

On one hand, many state bar association opinions believe that insurer-imposed guidelines are not enforceable because they violate the defense attorney’s ethical responsibilities to exercise independent professional judgment.9 At least one court has agreed with this rationale, noting that “[u]nder no circumstances can such guidelines be permitted to impede the [defense] 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 the insured, not the insurer, who should make that decision.”10 Other courts have refused to enforce litigation management guidelines on alternative grounds. For example, one court has simply rejected the use of litigation guidelines as a fair barometer by which to judge the insured’s fees because the court “can make its own determination in this regard.”11 Meanwhile, another court has suggested that compliance with an insurer’s litigation management guidelines are not dispositive on the issue of reasonableness where the insurer has not agreed to provide coverage—the rationale being that the insured has every incentive to keep the defense expenditures low.12

On the other hand, a minority of state bar association opinions take the position that an insurer’s litigation management guidelines is not a per se violation of a defense attorney’s professional responsibility.13 Under such an approach, defense counsel should probably follow the insurer’s litigation management guidelines provided that they do not appear to involve any substantial risk to any interest of the insured.14 In any event, defense counsel should inform the insurer at the outset that he may cease to follow the guidelines if they become harmful to the interests of the policyholder.15 If a conflict arises, defense counsel should disclose such risk to the insurer and the policyholder. Defense counsel should only continue representing the insured if the insurer changes its position or the policyholder provides written consent that defense counsel may continue to represent him in light of the conflict of interest. Otherwise, defense...
Recent civil opinions appear to be in line with the state bar association opinions that believe that litigation management guidelines are enforceable in appropriate circumstances. For example, in *Pepsi-Cola Metro. Bottling Co. v. Ins. Co. of N. Am., Inc.*, 2010 U.S. Dist. LEXIS 144401, at *32-33 (C.D. Cal. Dec. 28, 2010) (in the context of independent counsel), the District Court of the Central District of California appeared to agree with the insurance carriers’ use and enforcement of their billing guidelines, stating, “[t]his Court agrees that the use of ‘billing guidelines’ and reducing hourly rates was not a breach of the duty to defend in this case.” In *Pepsi-Cola*, the court suggested that as long as the litigation management guidelines do not impede the defense counsel’s professional judgment about how best to competently represent the insureds, the guidelines may be used to reduce overall fees based on objective standards relating to billing practices.

The court also noted that it is good practice for insurers to separate themselves from direct involvement in the management of the insured’s case by hiring a third-party auditor to make recommendations regarding the areas where determined costs may be duplicative, excessive, or unnecessary.

*Pepsi-Cola* is not alone. Several other courts have recently upheld the enforcement of an insurer’s litigation management guidelines. These cases, perhaps, show a shift in attitude towards the enforceability of litigation management guidelines.

Independent Counsel

Many of the strategies described above regarding insurer-retained defense counsel may also apply in situations involving independent counsel. For example, the insurer may consider setting a maximum rate for independent counsel because the insurer is only responsible to pay for those defense costs that are reasonable and necessary. In California, the Civil Code provides that defense costs of *Cumis* counsel are limited to those “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.” While the California independent counsel statute sets forth the basic parameters of independent counsel’s fees, it does not, however, provide any further guidance on what is “reasonable.” The lack of case law interpreting the statute is due to the fact that a dispute about independent counsel’s fees, including a dispute as to whether the insurer improperly reduced counsel’s billed hours and cut counsel’s hourly rates, is subject to arbitration.

Nevertheless, case law in other jurisdictions provides valuable insight. For example, in Louisiana, the reasonableness of independent counsel’s fees is determined by looking at the following factors: (1) the ultimate result obtained; (2) the responsibility incurred; (3) the importance of the litigation; (4) the amount of money involved; (5) the extent and character of the work performed; (6) the legal knowledge, attainment, and skill of the attorneys; (7) the number of appearances involved; (8) the intricacies of the facts involved; (9) the diligence and skill of counsel; and (10) the court’s own knowledge.

Courts in Texas use a similar multi-factor test to evaluate the reasonableness of independent counsel’s fees. Also, some states leave it up to the insurer to determine what is reasonable, while other states leave this role to the trial courts.

In addition, litigation management guidelines appear to be enforceable in California insofar as they do not impede *Cumis* counsel’s professional judgment about how best to competently represent the insured. In fact, consultation with the insurer is impliedly authorized by California’s independent counsel statute to the extent necessary to avoid the risk of breaching the insurance policy, so long as disclosure does not endanger any policyholder interests and so long as the policyholder has not directed that such information be kept confidential.

Conclusion

Once an insurer accepts a claim and agrees to provide coverage, it should develop a strategy not only to manage the insured’s underlying litigation but also to manage the costs of the defense. Accordingly, an insurance carrier should consider the issues and authorities cited herein in its preparation of an effective strategy to reduce defense costs.