

# NEW YORK STATE BAR ASSOCIATION

## Committee on Professional Ethics

Opinion 716 – 3/3/99 (12/12a-98)

Topic: Lawyer's submission of client billing records to outside auditor employed by insurance company.

Digest: A lawyer representing an insured may not submit legal bills to an independent audit company employed by the insurance carrier without the consent of the insured after full disclosure.

Code: DR 4-101, 5-107; EC 4-4, 5-1, 5-21.

### FACTS

A lawyer has been retained to defend individuals in civil litigation. The clients are insured under contracts of insurance providing for the payment of legal fees by the insurer. The insurance companies in question engage in the following practices with regard to the legal fees of lawyers who have been retained to defend their policyholders.

The insurer retains an independent auditor to review bills submitted by those defense lawyers who have been retained to represent a policyholder. Unless the insurance agreement provides otherwise, the insurer requests the defense lawyer to submit defense bills directly to the auditor either by hard copy or by disk. Neither the auditor nor the insurer seeks specific consent from the insured client to review the bills.

The auditor reviews the lawyer's bills for "compliance" with the insurance company's general requirements and billing guidelines. The auditor evaluates the defense bills to determine whether certain charges conform to the insurance company's guidelines and adjusts defense bills downward or rejects them outright if the work performed or the charges for that work deviate from the guidelines. In some situations, the auditor limits or rejects charges even if the legal work was performed with the agreement of one of the insurance company's claims representatives.

If the lawyer's bills are reduced or rejected, the lawyer is given an opportunity to ask for reconsideration, but must submit additional documentation and justification of events and services in order to receive payment. Routinely, the auditor requires information indicating the liability carrier's pre-approval of the defense lawyer's activities. The required documentation may include the lawyer's evaluation of the merits of a case or the lawyer's tactical and legal strategy that justifies certain work.

Some auditors charge insurers a flat fee, while others charge a contingent fee for their services. Those charging a contingent fee receive a percentage of the difference between the amount of the lawyer's bill and the amount approved, and thus have a financial interest in curtailing legal fees.

### **QUESTION**

When an insurance company compensates a lawyer for defending its policyholder in civil litigation pursuant to an insurance contract that requires the insurer to pay for the policyholder's defense, must the lawyer obtain the client's informed consent before submitting legal bills to an auditor employed by the insurance company?

### **OPINION**

DR 4-101 of the Code of Professional Responsibility establishes the lawyer's duty of confidentiality. It generally provides that "a lawyer shall not knowingly ... [r]eveal a confidence or secret of a client" except "with the consent of the client or clients affected, but only after a full disclosure to them." DR 4-101(B)(1) and (C)(1). For purposes of the confidentiality rule, "confidences" include information protected by the attorney-client privilege and "secrets" include "other information gained in the professional relationship that the client has requested be held inviolate or the disclosure of which would be embarrassing or would be likely to be detrimental to the client." DR 4-101(A). Thus, a lawyer generally must preserve the confidentiality of information learned in the course of representing a client, unless the client provides informed consent to the lawyer's use or disclosure of the information. This rule governs the question of whether a defense lawyer may submit the client's legal bills and supporting documentation to outside auditors who are retained by an insurance company that has contracted to pay the client's legal fees.

For the reasons discussed below, we conclude that the client's legal bills and related records are subject to the lawyer's duty of confidentiality. Consequently, under longstanding principles governing the lawyer-client relationship, these documents may be disclosed only with the client's informed consent. To enable the client to make a voluntary, informed decision whether to authorize the lawyer to submit the client's legal bills to the auditor, the lawyer

must provide advice that is competent and that is designed exclusively to promote the client's interests, not those of the insurer or the lawyer. If consent is given, the lawyer must continue to act in accordance with the client's interests.

A. *Billing Records Contain "Confidences" or "Secrets" That Are Subject to the Duty of Confidentiality*

When a lawyer defends a policyholder in civil litigation, the client is the policyholder, not the insurance company. This is true even though the insurance company has retained the lawyer pursuant to its contractual duty to defend the policyholder. The lawyer "is obligated to represent [the insured] with undivided fidelity regardless of the fact that his fee for legal services is being paid by another." N.Y. State 73 (1968); *see also Feliberty v. Damon*, 72 N.Y.2d 112, 120 (1988) ("[T]he paramount interest independent counsel represents is that of the insured, not the insurer. The insurer is precluded from interference with counsel's independent professional judgment on behalf of its client").

Although not every individual bill, and not every particular item of information contained in supporting documentation, will itself comprise a "secret" or "confidence" of the insured who is the client, much of the information contained in a defense lawyer's bills and related records will constitute a "secret of a client," if not a confidence. Therefore, documents requested for review by the insurer's outsider auditor are generally protected from disclosure by DR 4-101.

Billing records typically contain "secrets" within the meaning of DR 4-101(A). That is because they almost invariably include information "gained in the professional relationship" with the client; often, this will be information that the client would want to be "held inviolate" or that, if disclosed, would be embarrassing or detrimental to the client. *See Nassau County Op. 96-15 (1996)* (billing records are ordinarily "secrets" that a lawyer must not reveal unless authorized by DR 4-101; therefore, the lawyer must obtain client consent before providing billing records pursuant to an IRS request); *cf. Nassau County Op. 97-3 (1997)* (finding that, without client consent, lawyer could not disclose to the IRS copies of checks the lawyer had made out to the client as part of the settlement of an action, because "[u]nless otherwise instructed by the client, it should be presumed that information contained upon [the] checks ... constitute[s] client's 'secrets' under DR 4-101[A]"); ABA Informal Op. 1137 (1970) (without the client's consent, legal aid lawyer may not reveal financial information concerning the client to the local bar association's lawyer-audit committee).

Much of the information included in billing records and underlying documentation sought by auditors may also comprise client "confidences," that is, "information protected by the attorney-client privilege under applicable law." DR 4-101(A). The question of whether disclosing a document would explicitly or implicitly reveal attorney-client privileged communications is a question of

evidence law<sup>1</sup> that ordinarily calls for a fact-specific determination. *Cf. Rossi v. Blue Cross and Blue Shield of Greater New York*, 73 N.Y. 2d 588, 593 (1989). Thus, the extent to which billing records are protected by the attorney-client privilege would require carefully analyzing the records line-by-line. In general, decisions have recognized that legal bills ordinarily are not privileged insofar as they contain only the identity of the client, the fee amount, and the general nature of the services rendered, but that the attorney-client privilege would protect correspondence, bills, ledgers, statements and time records insofar as they reveal the motive of the client in seeking representation, litigation strategy, or the specific nature of the services provided, such as researching particular areas of law. *Licensing Corp. of America v. National Hockey League Players Assn.*, 153 Misc. 2d 126, 127-28 (Sup. Ct. N.Y. Co. 1992); *Clarke v. American Commerce Nat. Bank*, 974 F.2d 127, 129 (9<sup>th</sup> Cir. 1992).

*B. Billing Records May Not Be Disclosed Without the Client's Consent*

To the extent that billing records or other records sought by the insurance company's auditors contain "secrets" or "confidences" of the insured, DR 4-101 forbids the insured's lawyer from disclosing them "except with the consent of the client ... after a full disclosure." Because the records generally sought by auditors are likely to include some amount, if not a considerable amount, of information that must be kept confidential under DR 4-101, the insured's lawyer may not embark on a general practice of disclosing documentation to the insurance company's auditors without first making "full disclosure" to the client and securing the client's consent to this course of conduct.

Under DR 4-101, the fact that the insurance company has contracted to pay for the client's defense does not obviate the need for the lawyer to obtain the client's consent before disclosing the client's confidences and secrets to the insurance company's auditor. This is true even if provisions of the contract of insurance might be interpreted implicitly, or even explicitly, to require the client to disclose certain information to an outside auditor as a condition of the insurance company's duty to defend the insured. *See Utah Op. 98-03 (1998)* (when the insurance contract provides for outside audits of lawyer's bills, "the lawyer must

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<sup>1</sup> CPLR 4503, which codifies the common law attorney-client privilege in New York, provides in pertinent part:

Unless the client waives the privilege, an attorney or his employee, or any person who obtains without the knowledge of the client evidence of a confidential communication made between the attorney or his employee and the client in the course of professional employment, shall not disclose, or be allowed to disclose such communication, nor shall the client be compelled to disclose such communication, in any action, disciplinary trial or hearing, or administrative action, proceeding or hearing conducted by or on behalf of any state, municipal or local governmental agency or by the legislature or any committee or a body thereof.

consult with the client to make sure that the client understands and renews the consent”). Such a provision in the insurance policy ordinarily would not constitute “consent ... after a full disclosure” within the meaning of DR 4-101(C)(1), because it would not have been preceded by the type of disinterested explanation, described below, that would be necessary to make the client’s decision fully informed. Further, even if the client’s advance consent to share information with the insurer’s auditor was sufficiently informed, the client would be free to revoke the advance consent. See N.Y. City 1997-2. For example, after being fully informed by the lawyer, the client might elect to challenge whether the provision is enforceable or to forego the benefits of the insurance policy rather than consent to the disclosure of certain information by the lawyer.

Likewise, the fact that the insurance company has agreed to pay the lawyer’s fee does not in itself authorize the lawyer to disclose information to the auditor that would otherwise be protected by DR 4-101. Cf. ABA Model Rules of Professional Conduct, Rule 1.8(f)(3); D.C. Op. 223 (1991) (lawyers for legal services support center must refuse to allow representatives of a funding agency to see materials that include confidences and secrets of clients). Finally, the fact that the insurance company has a financial interest in the outcome of the litigation does not justify disclosing otherwise confidential information to its auditor without client consent.<sup>2</sup>

### C. *The Requirement of “Voluntary” Consent to Disclosure*

Although some authorities have suggested that a lawyer may not disclose information to the insurance company’s auditor even with client consent, we agree with the majority who have concluded that a fully informed client may consent to such disclosures. Compare, e.g., Vt. Op. 98-7 (1998) (lawyer retained by an insurance company to represent a policy holder may not provide billings containing confidential information to an outside auditor employed by the insurance company except with the client’s informed consent, given after full disclosure as to the type of information which may be found in billing records);

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<sup>2</sup> Even if the insurer and its policyholder were to be regarded as co-clients, it does not necessarily follow that confidences may be shared between them. See, e.g., *Parsons v. Continental Nat’l Am. Group*, 550 P.2d 94, 98 (Ariz. 1978); Kansas Op. 94-7 (1994) at n. 70. On the contrary, this Committee has recognized that a co-client relationship does not in itself authorize a lawyer to share confidences among co-clients without client consent. See N.Y. State 555 (1984). In any event, although the understanding may be different in other jurisdictions, see generally Charles Silver & Kent Syverud, *The Professional Responsibilities of Insurance Defense Lawyers*, 45 Duke L.J. 255 (1995), at least in New York, the policyholder’s agreement to be represented by a lawyer who is compensated by the insurer does not itself make “co-clients” of the policyholder and the insurer for purposes of the Code of Professional Responsibility. Rather, as noted above, the policyholder alone is the client.

Indiana Op. 4-98 (1998) (insurance defense counsel's release of detailed billing statements to independent auditor for insurance carrier without client's consent is breach of lawyer's duty to maintain client confidentiality and may waive attorney-client and work product privileges); S.C. Op. 97-22 (1997) (insured must consent to the disclosure); N.C. Op. 10 (1998) (permitting disclosure with informed consent) *with* Alabama Op. 98-02 (1998) (opining that disclosure of detailed billing information to a third party auditor could present such a high risk to confidentiality that the lawyer should not even ask the client for consent); Utah Op. 98-03 (stating the lawyer should ensure "that no confidential information revealed by the client is in the billing statement").

No doubt, a client's desire to take advantage of the insurance company's duty to defend will heavily influence the client to consent. Particularly where other important interests of the client would be placed at risk by disclosing information to the auditor, however, the lawyer must take care to ensure that the client's consent is uncoerced as well as informed. *Cf.* N.Y. City 1997-2 (lawyer seeking minor client's consent to disclose information to social service agency "must consider whether the minor perceives, accurately or not, that in the absence of consent, he will not be able to secure legal assistance"); N.Y. State 490 (1978) (legal services lawyers seeking consent to disclose client confidences to the organization's board of directors "should be particularly sensitive to any element of submissiveness on the part of their indigent clients; and, such requests should be made only under circumstances where the staff is satisfied that their clients could refuse to consent without any sense of guilt or embarrassment"). Nonetheless, it cannot be concluded that policyholders' informed consent to disclose information to insurance companies' auditors will invariably, or even generally, be involuntary.

#### *D. The Requirement of "Full Disclosure"*

As noted, DR 4-101 permits a lawyer to disclose client confidences and secrets with the client's consent after "full disclosure." The nature of the necessary disclosure will vary somewhat from case to case and client to client. Therefore, it is not possible to identify a comprehensive list of specific considerations that the lawyer should bring to the client's attention and discuss with the client to enable the client to decide whether to authorize the lawyer to provide documents to the auditor.<sup>3</sup> Ordinarily, however, the lawyer should at

<sup>3</sup> In N.C. Op. 10 (1998), the North Carolina ethics committee identified the following considerations: the contents and nature of the agreement between the audit company and the insurance company; whether the audit company or the auditor may use or share the information with any other third party, including another insurance company; how the audit company controls access to the information; the level of security provided by the audit company; the assurances given that the confidentiality of the information will be maintained; and the consequences for the client, if the release of the confidential information waives the attorney-client or the work product privileges.

least discuss the nature of the information to be found in the billing records sought by the auditor as well as the relevant legal and non-legal consequences of the client's decision. This would include giving advice concerning the extent of the client's obligation under the insurance contract to authorize such disclosures and the risk that the insurance company would refuse to indemnify the client and to pay the client's attorney's fees if the client does not consent. This would also include giving advice concerning the risk that the information disclosed to the auditor would be obtained by others directly or indirectly as a result of the disclosure, the risk that a disclosure will involve a waiver of the lawyer-client privilege, and, ultimately, the risk that a disclosure could be used to the client's disadvantage. The extent and nature of additional advice that must be provided, so that the lawyer will have provided competent and "full" disclosure, depends on the context.

In some cases, after the client initially authorizes disclosures to the auditor, there may be a need to revisit the question. For example, the auditor may seek information of which the client did not initially authorize disclosure. Or, there may be a clearer danger that disclosures will be used against the client by the adverse party in litigation or by another. In such situations, it would be wrong for the lawyer to rely on the client's previous consent.

#### *E. The Requirement of Disinterested Advice*

Finally, we note that, in advising the client whether or not to authorize disclosures to the insurance company's auditor, as in rendering other advice with regard to decisions that are entrusted to the client, the lawyer must avoid being influenced either by the interests of the insurance company, which may have selected the lawyer, or by those of the lawyer, who may have an ongoing relationship with the insurance company.

Although an insurance contract may give the insurer the unfettered right to control the defense of a claim, the lawyer must exercise independent judgment on behalf of the client, especially when rendering advice about decisions that are entrusted to the client. As stated in EC 5-1:

The professional judgment of a lawyer should be exercised, within the bounds of the law, solely for the benefit of the client and free of compromising influences and loyalties. Neither the lawyer's personal interests, the interests of other clients, nor the desires of third persons should be permitted to dilute the lawyer's loyalty to the client.

Consistent with this principle, DR 5-107(B) provides: "A lawyer shall not permit a person who recommends, employs or pays the lawyer to render legal service for another to direct or regulate his or her professional judgment in rendering such legal services."

Thus, the lawyer's primary allegiance is and must remain to the client, the insured. See N.Y. State 519 (1980). In rendering advice, the lawyer must seek exclusively to promote the client's various interests, which may include interests in prevailing in the litigation, in avoiding embarrassing disclosures, and in receiving the benefits of the insurance contract. The lawyer may not seek to promote the insurance company's interest in gaining access to information concerning this representation in order to control or reduce the cost of litigation. Likewise, the lawyer must not seek to promote either his or her own interest in receiving attorney's fees for undertaking the representation<sup>4</sup> or his or her own interest in receiving future referrals from the insurance company.

*F. In Providing Information an Outside Auditor, Pursuant to the Client's Voluntary, Informed Consent, the Lawyer Must Promote the Client's Interests*

If, after full disclosure, the client willingly authorizes disclosures to the insurance company's auditor, the lawyer must respond to the auditor's requests in a manner that safeguards the client's interests. This would include minimizing the extent to which client confidences and secrets are disclosed to the auditor and, especially, avoiding disclosures that could result in a waiver of the attorney-client privilege or otherwise prove embarrassing or detrimental to the client. See Alabama Op. 98-02 (1998) (the lawyer "should err on the side of non-disclosure"); Utah Op. 98-03 (1998) ("the lawyer should be careful about what information is included. ... The lawyer should make sure that no confidential information revealed by the client is in the billing statement."). To the extent that the auditor insists on receiving such information, this may require, as noted earlier, revisiting the question of client consent under DR 4-101. Further, to the extent that the auditor seeks information the client is not clearly obligated to provide under the insurance contract, this may also include advising the client about the possibility of opposing the request and, if the client directs, doing so. Cf. EC 4-4 ("A lawyer should endeavor to act in a manner that preserves the [attorney-client] privilege"); N.Y. State 528 (1981) (if requested by client, lawyer must make good faith assertion of attorney-client privilege in response to subpoena requiring disclosure of information concerning client).

Similarly, the lawyer's obligation is to render competent representation and, thus, to avoid any pressure that may be exerted by the insurance

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<sup>4</sup> In a given case, it may be in the client's best interest to decline to authorize disclosures to the insurance company's auditors, even though the client may therefore have to undertake personally the obligation to pay the attorney's fees. If the client so decides prior to the engagement, the lawyer may of course decline the representation. Moreover, if the client initially authorizes disclosures to the auditors in order to enable the lawyer to receive fee payments from the insurance company, but later revokes consent, the client may assume the obligation to pay the attorney's fee, and if the client fails to do so, the lawyer may be permitted to withdraw from the representation. See DR 2-110(A)(1) and (C)(1)(f).



company's auditors to reduce the level or quality of representation. It may be that an auditor, especially one influenced by a contingent fee agreement with the insurance company, will pressure the lawyer to reduce the amount of time spent in defending the policyholder. However, as recognized by EC 5-21:

A lawyer subjected to outside pressures should make full disclosure of them to the client; and if the lawyer or the client believes that the effectiveness of the representation has been or will be impaired thereby, the lawyer should take proper steps to withdraw from representation of the client.

Thus, the lawyer must not give in to pressures from the auditor that would undermine the lawyer's ability to exercise independent professional judgment or to provide competent legal representation on behalf of the client.

### **CONCLUSION**

For the reasons stated and subject to the qualifications discussed above, the question is answered in the affirmative.

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