The Supreme Court of Ohio

BOARD OF COMMISSIONERS ON GRIEVANCES AND DISCIPLINE

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OPINION 2000-2

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[CPR Opinion-provides advice under the Ohio Code of Professional Responsibility which is superseded by the Ohio Rules of Professional Conduct, eff. 2/1/2007.]

SYLLABUS: Under DR 4-101(B)(3) and DR 4-101(C)(1), an attorney may not submit detailed legal bills to an outside audit company hired by an insurer without first obtaining client consent after full disclosure. Full disclosure includes informing the client of the type of information required by the insurer in the billing invoice, the type of supporting documentation, if any, required by the audit, and that waiver of attorney-client privilege might be raised as a consequence. Whether submission of legal bills to an audit company waives the attorney-client privilege or work product doctrine is a question of law beyond the scope of this opinion.

OPINION: This opinion addresses a question regarding the auditing of insurance defense bills for legal services rendered to an insured by an attorney.

> Is it proper for an insurance defense attorney to submit detailed legal bills incurred in defending an insured to an outside auditing company hired by an insurer?

The use of outside auditors by insurance companies to review insurance defense counsels' legal bills for defending insureds is causing considerable concern among attorneys. The primary ethical concern is whether the submission of detailed billing statements to outside auditors violates an attorney's duty to preserve client confidences and secrets.

Insurance defense attorneys are being asked to submit detailed billing invoices so that auditors hired by the insurer can scrutinize the information to determine what services the attorneys should be paid for and what should be denied. The use of legal audits stems from both fears of billing fraud and desires to monitor and control costs. For discussion of the trend toward auditing of legal bills see Claire H. Matturro*, Auditing Attorneys' Bills: Legal and Ethical Pitfalls of a Growing Trend*, 73-May Fla. B.J. 14 (1999).

Examples of the types of billing categories that may be questioned through a legal audit are:

1. Insufficient Detail/Vague Time Entries;
2. Undisclosed Timekeepers;
3. Excessive and/or Undisclosed Hourly Rates;

4. Block-Billing;
5. Minimum or Formula Time Charges;
6. Rounding Up;
7. Unusual Number of Long Billing Days;
8. Multiple Billers/Duplication of Effort;
9. Inefficient Staffing;
10. Excessive Reviews and Revisions;
11. Excessive Research;
12. Excessive Intra-Office Conferencing;
13. Excessive Abstracting, Summarizing and Indexing;
14. Fees in Excess of Budgeted Hours;
15. Lack of Description for Reported Expenses; and
16. Unapproved Overhead Expenses.

Robert C. Heist, *The Tripartite Relationship and the Insurer's Duty to Defend Contrasted With Its Desire to Manage and Control Litigation Through the Introduction of the Legal Audit*, 602 PLI/LIT 221, 246-47 (1999).

Auditors determine through the legal audit whether payment is justified for the attorney's services. Auditors make the determination by looking at the billing categories, using billing guidelines, detailed invoices, and sometimes supporting document review and interviews.

Four basic levels of analysis in legal audits have been described.

> The most comprehensive review available is an on-site review of all fee and expense entries, law firm work product, expense documentation, pre-bills and time sheets. Key law firm personnel are also interviewed. This on-site audit is the most expensive and time consuming, and many clients [or third party payers] decide not to use it for those reasons.
>
> Less comprehensive is a preliminary analysis based on a review of all the firm's fee and expense entries, and a review of any expense documentation, work product, pre-bills, and time sheets that can be provided by the client, although no on-site audit is conducted. This audit avoids the cost of the auditor's visit to the law firm, and while the auditor does not have the benefit of interviewing the attorneys, a great deal of information can be obtained through a review of all of the documents.
>
> Still less comprehensive is a review of all of the law firm's fee and expense billing without the review of any expense documentation, work product, pre-bills or time sheets. Although this type of audit can be beneficial in some instances, it lacks both on-site interviews and comprehensive document review.
>
> The least comprehensive review is a letter report that simply analyzes specific concerns or issues that can be identified from the client's billing entries or statements.

James P. Schratz, *Cross-examining a Legal Auditor*, 20 Am. J. Trial Advoc. 91, 93-4 (1996).

Concerns regarding the preservation of confidences and secrets may appear greater with increased levels of audit scrutiny. Yet, concerns exist even at the lowest level of audit, particularly when insurers require defense attorneys to submit detailed billing statements.

As described in a Kentucky advisory opinion, "these bills are now quite detailed, and contain information about the nature of the legal services performed, information about legal research conducted, and information which could contain strategic decisions made regarding the handling of the case. Sometimes legal bills could include information which would tend to embarrass the insured client." Kentucky Bar Ass'n, Op. E-404 (1998).

As described in a Maryland advisory opinion,

> [t]he auditing agency has made a request for supplemental materials to support these invoices including specific descriptions of work performed, settlement offers, and estimates of the insured's percentage of liability. Specifically, the auditing agency has requested such items as the identity of participants, as well as the substance of a variety of communications, specific issues researched, the identity of materials and documents reviewed, specific trial preparation performed and specific non-deposition discovery.
>
> Recently, the auditor has requested that the Firm forward certain documentation which could be classified as attorney work product to support the Firm's invoices."

Maryland State Bar Ass'n, Op. 99-7 (1998).

As described in a Rhode Island opinion, "[e]xamples of the level of detail the insurer requires include the subject matter of all written or oral communication, the identity of participants including witnesses and clients, the specific issues researched, the identity of materials and documents reviewed, the specific trial preparation performed, and a description of the specific issues central to pleadings, motions, or memoranda prepared." Rhode Island Sup Ct, Ethics Advisory Panel, Op. 99-17 (1999).

In the request presented to this Board, the level of scrutiny used in the audit of insurance defense attorneys' bill is described as a review of invoices submitted by the defense attorneys. Auditors review the invoices to assure compliance with the insurer's billing guidelines and have authority to disallow charges for legal services that the auditors deem inappropriate. While this request refers to the least comprehensive review, the Board is cognizant that more comprehensive reviews could be undertaken.

Across the nation, attorneys seek guidance from advisory bodies as to whether the submission of insurance defense bills to outside auditors comports with the professional rules of ethics. Ethics opinions have been issued in at least twenty-two states.

Alabama State Bar, Op. RO-98-02 (1998)
Alaska Bar Ass'n, Op. 99-1 (1999)
Hawaii, Office of Disciplinary Counsel, Sup Ct of Hawaii, Formal Op. 36 (1999)
Indiana State Bar Ass'n, Op. 4 of 1998
Kentucky Bar Ass'n, Op. E-404 (1998)
Maine, Board of Overseers, Op. 164 (1998)
Maryland State Bar Ass'n, Op. 99-7 (1998)
Mississippi State Bar, Op. 246 (1999)
Missouri, Office of Chief Disciplinary Counsel, Sup Ct of Missouri, Informal Opinion Summary, 980188
North Carolina State Bar Ass'n, 98 Formal Ethics Opinion 10 (1998)
Ohio, Cincinnati Bar Ass'n, Op. 98-99-02
Oregon State Bar, Formal Op. 1999-157 (1999)
Pennsylvania Bar Ass'n, Informal Op. 97-119 (1997)
Rhode Island Sup Ct, Ethics Advisory Panel, Op. 99-17 (1999)
South Carolina Bar, Op. 97-22 (1997)
Tennessee Sup Ct, Bd of Prof Resp, Formal Ops. 99-F-143 and 99-143(a) (1999)
Utah State Bar, Op. 98-03 (1998)
Virginia, LEO 1723 (1998)
Vermont Bar Ass'n, Op. 98-7 (undated)
Washington State Bar Ass'n, Formal Op. 195 (1999)
West Virginia Lawyer Disciplinary Board, Office of Disciplinary Counsel, LEI 99-02 (1999)
Wisconsin, State Bar of Wisconsin, Op E-99-1 (undated)

The majority view of the ethics advisory committees is that an insurance defense attorney may not submit legal bills to an outside audit company without first obtaining the fully informed consent of the insured. [*See e.g.*, Kentucky, South Carolina, Tennessee, Utah, Ohio (Cincinnati Bar Ass'n), Pennsylvania, Missouri, Maryland, Wisconsin, Hawaii, Vermont, Maine, Washington, West Virginia, Mississippi, Alaska, Indiana, North Carolina, Rhode Island].

Within the advisory opinions, important concerns are raised. First, the feasibility of *obtaining informed consent* for revealing confidences and secrets is a concern. One state explains that "[a]ll client information is confidential, and as a practical matter, obtaining the informed consent necessary to such a disclosure is highly problematic. The client's consent to the release of confidential information has to be completely informed, based upon more than the mere fact that his or her billing record will be released to the auditors. The lawyer must make clear to the insured the kind of information to be found in the billing records, as well as the possible legal effects of the release of such information upon the insured client's rights." (Vermont). Several states caution attorneys that the insurance contract itself is not sufficient to constitute consent. (Tennessee, Utah, Hawaii, West Virginia, Rhode Island).

Second, the ethical propriety of even *seeking informed consent* is a concern. One state's view is that seeking the client's consent when there are client confidences and secrets in billings puts the attorney in an impossible situation for "[i]t is almost inconceivable that it

would ever be in the client's best interests to disclose confidences or secrets to a third party." (Washington). Another state advises that "[i]n ordinary circumstances, the request to submit Client confidences and secrets in a detailed bill to a third party auditor will create an actual conflict of interest between insured and insurer. . . . If an actual conflict exists between insurer and insured regarding the advisability of releasing the billing information, DR 5-105(E) prohibits Attorney from asking Client for permission to send the bills to the third-party auditor." (Oregon). Another state advises that "consent may not be requested by a lawyer if a disinterested lawyer would conclude that the client should not agree to such disclosure." (Mississippi). One state advises that "the lawyer must reasonably conclude that there is some benefit to the insured to outweigh any reasonable expectation of prejudice, or that the insured cannot be prejudiced by a release of the confidential information, before the lawyer may seek the informed consent of the insured after adequate consultation." (North Carolina). One state notes that "pursuant to the attorney's duty of loyalty to the client, as prescribed by DR 7-101, the insured's attorney should not recommend that the client provide such consent if the disclosure to the auditors would in some way prejudice the client." (Virginia).

Third, the possibility of *waiver of attorney-client privilege* is a concern. Two states advise that the lawyer may submit the bills only with informed consent of the insurer and only so long as the lawyer reasonably believes that doing so will not substantially affect the representation of the insured client. (Kentucky, South Carolina). One state advises that "if a waiver of privilege is caused by such submission to independent auditor, and if such waiver is detrimental to the insured's cause" disclosure may constitute unethical conduct. (Indiana). Another state advises that "a lawyer should not permit the disclosure of information relating to the representation to a third party, such as a billing auditor, if there is a possibility that waiver of confidentiality, the attorney-client privilege or the work product privileges would occur." (Alabama).

Of course, advisory bodies cannot answer the legal question of whether there is or will be waiver of attorney-client privilege. Case law develops that issue. In particular, one case is noted herein because it is of related interest to advisory bodies. In *United States v. Massachusetts Institute of Technology*, 129 F. 3d 681 (1997), Massachusetts Institute of Technology (MIT) attempted to assert the attorney-client privilege and work-product doctrine in response to a document request by the Internal Revenue Service (IRS). The IRS sought billing statements of the law firms that had represented MIT and minutes of the MIT corporation and its executive and auditing committees. Earlier, the billing statements and some or all of the minutes sought by the IRS had been provided to an audit agency pursuant to contracts between MIT and entities in the Department of Defense. The First Circuit Court of Appeals upheld the district court's holding that the disclosure of the legal bills to the audit agency forfeited the attorney-client privilege. *Id.* at 683, 688.

In Ohio, DR 4-101 of the Ohio Code of Professional Responsibility governs the preservation of confidences and secrets of a client.

DR 4-101 PRESERVATION OF CONFIDENCES AND SECRETS OF A CLIENT

(A) "Confidence" refers to information protected by the attorney-client privilege under applicable law, and "secret" refers to 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.
(B) Except when permitted under DR 4-101(C), a lawyer shall not knowingly:
  (1) Reveal a confidence or secret of his client.
  (2) Use a confidence or secret of his client to the disadvantage of the client.
  (3) Use a confidence or secret of his client for the advantage of himself or of a third person, unless the client consents after full disclosure.
(C) A lawyer may reveal:
  (1) Confidences or secrets with the consent of the client or clients affected, but only after a full disclosure to them.
  (2) Confidences or secrets when permitted under Disciplinary Rules or required by law or court order.
  (3) The intention of his client to commit a crime and the information necessary to prevent the crime.
  (4) Confidences or secrets necessary to establish or collect his fee or to defend himself or his employees or associates against an accusation of wrongful conduct.
(D) A lawyer shall exercise reasonable care to prevent his employees, associates, and others whose services are utilized by him from disclosing or using confidences or secrets of a client, except that a lawyer may reveal the information allowed by DR 4-101(C) through an employee.

Ethical Consideration 4-3 provides guidance as to disclosures to outside agencies. The information must be "limited" and "necessary for statistical, bookkeeping, accounting, data processing, banking, printing, or other legitimate purpose."

EC 4-3 DISCLOSURE TO CERTAIN OUTSIDE AGENCIES

Unless the client otherwise directs, it is not improper for a lawyer to give limited information from his files to an outside agency necessary for statistical, bookkeeping, accounting, data processing, banking, printing, or other legitimate purposes, provided he exercises due care in the selection of the agency and warns the agency that the information must be kept confidential.

In this Board's view, ethical Consideration 4-3 does not authorize disclosure of legal bills without client consent to an outside auditing company. The information sought in a legal audit often goes beyond "limited" information. Depending upon the information contained therein, a billing invoice might reveal client confidences and secrets. Revealing confidences and secrets of an insured to an outside audit company serves the economic

advantage of the insurer. The economic benefit of an insurer is not considered a "legitimate purpose" under EC 4-3.

In conclusion, the Board advises that under DR 4-101(B)(3) and DR 4-101(C)(1), an attorney may not submit detailed legal bills to an outside audit company hired by an insurer without first obtaining client consent after full disclosure. Full disclosure includes informing the client of the type of information required by the insurer in the billing invoice, the type of supporting documentation, if any, required by the audit, and that waiver of attorney-client privilege might be raised as a consequence. Whether submission of legal bills to an audit company waives the attorney-client privilege or work product doctrine is a question of law beyond the scope of this opinion.

Advisory Opinions of the Board of Commissioners on Grievances and Discipline are informal, nonbinding opinions in response to prospective or hypothetical questions regarding the application of the Supreme Court Rules for the Government of the Bar of Ohio, the Supreme Court Rules for the Government of the Judiciary, the Code of Professional Responsibility, the Code of Judicial Conduct, and the Attorney's Oath of Office.