

NEW HAMPSHIRE BAR ASSOCIATION
Ethics Committee Advisory Opinion # 2000-01/05
Release Of Billing Statement To Third Party Auditors
Presented to the Board of Governors 11/16/00

RULE REFERENCES:

- * Rule 1.4(b)
- * Rule 1.6
- * Rule 1.7
- * Rule 1.8(f)(3)

SUBJECTS:

- * The tripartite relationship between insured, insurance defense counsel, and insurance company.
- * Review of confidential billing statements by outside auditors.
- * Informed consent for release of client confidences.
- * Attorney/client privilege/waiver.
- * Work product doctrine/waiver.

ANNOTATIONS:

A lawyer shall not reveal information relating to representation of a client unless the client consents after consultation, except for disclosures that are impliedly authorized to carry out the representation. (Rules 1.6(a); 1.6(b)).

An insurance defense lawyer may not disclose billing statements to third party auditors employed by the insurance company unless the client consents after consultation. (Rule 1.6(a)).

The “implied authorization” exception to Rule 1.6(a) must be narrowly construed. (Rule 1.6(b)).

The “implied authorization” exception to Rule 1.6 does not extend to, or allow, disclosure of confidential information protected by the Rule to third party auditors.

An attorney may not ethically comply with a request or requirement to seek the consent of the client/insured to disclose billing statements to a third party auditor. (Rules 1.7 and 1.8).

Within the tripartite relationship of insurer, insurance defense counsel, and insured, defense counsel’s paramount duty extends to the insured.

I. QUESTION:

Can an attorney retained by an insurance company (“carrier”) to defend its insured ethically disclose detailed billing statements to an outside auditor for review on behalf of the carrier?¹

II. FACTUAL SETTING:

The use of outside audit agencies to review the bills of insurance defense counsel has become an increasingly common, cost-cutting practice within the insurance industry.² These companies review bills to ensure compliance with detailed billing guidelines of the carrier; and to identify perceived inefficiencies and billing errors.

The methodologies of audit companies will vary. See e.g. Baker, “You Charged How Much?” ABA Journal (Feb., 1999); Bradley, Charlton & Knowles, “The Debate Surrounding Third Party Analysis of Bills,” Spring, 1999 ABA National Legal Malpractice Conference Materials. However, employees of audit companies – unlike claims adjusters or claims counsel – generally have no familiarity with the cases that generate the bills. Rather, they perform the audit function and check for billing guideline compliance based on detailed billing statements required by the carrier.

These billing statements regularly disclose the substance of communications between insurance defense counsel and client (the insured); ongoing trial preparation; witness identity; investigative activities, etc. Some audit companies also require submission of file materials before authorizing payment of related fees. When the initial audit of a bill results in exceptions to entries on the statement, defense counsel will frequently be asked to provide further information about the case to justify the time devoted to the task. In short, the billing information and file materials required by audit companies inevitably contain confidential information protected by Rule 1.6 of the New Hampshire Rules of Professional Conduct and/or by the common law attorney client privilege and work product doctrine.

III. DISCUSSION:

A. Background: The Tripartite Relationship Between Insurance Defense Counsel, Insurer and Insured:

While the New Hampshire Supreme Court has not undertaken an exhaustive examination of the tripartite relationship, the Court has held--in resolving a dispute regarding discovery of the insurance company file in a negligent failure to settle case--that the company’s claim of privilege against its insured was without merit since it “fails to take into account that the attorney (the insurance company) engaged represented both the (insurance company) and the present plaintiff Dumas (the insured).” Dumas v. State Farm Automobile Insurance, 111 N.H. 43, 49 (1971). The Court reasoned that:

(W)here two parties are represented by the same attorneys for their mutual benefit, the communications between the parties are not privileged in later action between such parties or their representatives. (Emphasis supplied.) Id. (Citations omitted.)

The Court’s rationale is consistent with the traditional view that the tripartite relationship between insurer, insurance defense counsel and insured involves dual representation of “co-clients.”³ Under the dual client doctrine, “so long as the interests of the insurer and the insured coincide, they are both the clients of the defense attorney and the defense attorney’s fiduciary duty runs to both the insurer and the insured.” National Union Fire Insurance Co. v. Stites Professional Law Association, 1 Cal Rptr. 2d. 570, 575 (Cal. App. 1991). See also Mallen, “Looking to the Millennium: Will the Tripartite Relationship Survive?”, Defense Counsel Journal, October 1999 at 481-82 (tripartite relationship has traditionally been seen as one composed of dual attorney-client relationships with both the insured and the insurance company.) Alternatively, courts have ruled that only the insured is the client, while the insurer is a third party payor. See, e.g. Atlanta International Insurance Co. v. Bell, 475 N.W. 2d. 294 (Mich. 1991). See also Gibbs v. Lappies.

The Restatement (Third) of the Law Governing Lawyers, now published in final form after several drafts, chose neither the dual representation nor the third party payor model. While emphasizing the paramount duties of insurance defense counsel to the insured, the Restatement leaves the nature of the tripartite relationship to the facts of the given case:

It is clear in an insurance situation that a lawyer designated to defend the insured has a client-lawyer relationship with the insured. The insurer is not, simply by the fact that it designates the lawyer, a client of the lawyer. Whether a client-lawyer relationship also exists between the lawyer and the insurer is determined under Section 14.

Restatement (Third) of the Law Governing Lawyers, §134, cmt. f at 408.⁴

The Restatement also enumerates several potential conflicts between the interests of the insured and the insurer in which the lawyer's duty to the insured would be paramount. These would include an attorney's obligation to disobey insurance company litigation instructions where they could result in significantly increased risk of liability in excess of policy limits; and an obligation not to disclose confidential information regarding the insured's case that may jeopardize the insured's insurance coverage. Id. at 409-10.

The Restatement also discusses situations in which the defense counsel, because of conflicting duties to the insured and the carrier, would be required to withdraw from representation of both "clients":

With respect to events or information that create a conflict of interest between insured and insurer, the lawyer must proceed in the best interests of the insured consistent with the lawyer's duty not to assist client fraud ... and, if applicable, consistent with the lawyer's duties to the insurer as co-client If the designated lawyer finds it impossible so to proceed, the lawyer must withdraw from representation of both clients Id. at 410.

In short, while state and federal decisions in New Hampshire and the Restatement provide no definitive answer to the nature of the tripartite relationship, the Dumas decision suggests that New Hampshire has adopted the "dual client" model. More importantly, under either model, the relationship between insured and designated defense counsel is always that of attorney-client. The duties that arise out of this relationship provide the basis for a definitive response to the question before the Committee.

B. The Attorney's Duty to Maintain Client Confidences:

The employment of third-party auditors to review the billing records of insurance defense counsel implicates professional conduct rules and common law evidentiary doctrines that protect the confidentiality of attorney-client communications and attorney work product.

Rule 1.6(a) of the New Hampshire Rules of Professional Conduct states:

A lawyer shall not reveal information relating to representation of a client unless the client consents after consultation, except for disclosures that are impliedly authorized in order to carry out the representation

Comments to the ABA Model Code and separate comments to the New Hampshire rule underscore the "inviolable" character of client confidences and the "extreme and irrevocable" nature of an act of disclosure. The duty to protect client confidentiality (and the duty of undivided loyalty) also constitute the two essential components of a lawyer's fiduciary duty to his or her client.

The rule of confidentiality of Rule 1.6(a) is greater in scope than the common law, attorney-client privilege. Most significantly, the latter extends only to confidential "communications" of the client that are "made for the purpose of facilitating the rendition of professional legal services to the client"

NHRE 502(b). Rule 1.6(a), by contrast, applies “to all information relating to the representation, whatever its source.” ABA Model Code Comments.

Similarly, material protected by the attorney work product doctrine is encompassed by, but less extensive than, material falling within the broad parameters of Rule 1.6. The work product doctrine appears, among other places, at Rule 35(b)(2) of the New Hampshire Superior Court Rules, which allows discovery of “trial preparation” materials of an attorney “only upon a showing that the party seeking discovery has substantial need of the materials in the preparation of his case and that he is unable without undue hardship to obtain the substantial equivalent of the materials by other means.” Even greater protection is afforded to “opinion work product,” which includes the “mental impressions, conclusions, opinions, or legal theories of any attorney or other representatives of a party concerning the litigation.” Rule 35(b)(2). See also, United States v. Massachusetts Institute of Technology, 129 F.3d. 681, 688 (1st Cir. 1997) (recognizing, but not resolving, issue of whether confidentiality of attorney “opinion work product” can be waived through selective disclosure of material to audit agency.)

An attorney’s billing records--particularly those generated by insurance defense counsel in the detail required to meet typical billing guidelines--will inevitably contain information protected by the broad reach of Rule 1.6. In most cases, the billing records will also contain either direct or implicit descriptions of privileged client communications; and will reveal steps of trial preparation that under most circumstances would not be discoverable by the opposing party.

Whether the tripartite relationship is seen as one of “dual representation” or of client/third party payor, the ethical and fiduciary duties of insurance defense counsel mandate that these confidential and strategically-sensitive materials be protected from disclosure unless their release is “impliedly authorized” to carry out the representation; or the client (the insured) “consents after consultation.” Rule 1.6(a).

1. Implied Authorization: Rule 1.6(a) eliminates the requirement for client consent where the disclosures are “impliedly authorized in order to carry out the representation.” Examples of such implied authorizations include discussions within a law firm and disclosures made in settlement negotiations. ABA Model Code Comments.

In addition, if the insured is considered the sole client in the tripartite relationship, submission of the bills to the insurer for payment would be “impliedly authorized” since the insured has contracted, in part, for a defense funded by the carrier. In further support of this conclusion, the Committee notes that most insurance contracts include a “cooperation clause” whereby the insured agrees to cooperate in its defense under the insurance agreement⁵, and that New Hampshire extends the work product protection to disclosures made to the insurer in the course of trial preparation. See also Colorado Ethics Opinion 107 (9/18/99) (disclosure to insurer/third party payor impliedly authorized).

However, regardless of the tripartite model adopted within a jurisdiction, disclosure of detailed bills to outside agencies does not further, or “carry out,” the client’s representation. Third-party auditors are used not to advance the course of the litigation, but rather to assist the insurer in monitoring compliance with billing guidelines and cutting the overall cost of litigation. The “implied authorization” exception to Rule 1.6(a)’s general prohibition of release of confidential information must be narrowly construed in light of the fundamental importance of confidentiality to the effective representation of the client. See also, South Carolina Ethics Adv. Op. 97-22 (“the comments regarding ‘disclosures impliedly authorized’ are narrowly written.”)

One commentator has noted:

It cannot reasonably be argued . . . that an insured “impliedly authorizes” disclosure of information relating to the representation to outside auditors. Inasmuch as defense attorneys’ provision of their bills to outside legal auditors does not enhance that quality of the insured’s representation, does not increase the likelihood of success, does not strengthen or promote the attorney-client relationship, and does not otherwise benefit the insured, the narrow implied authorization exception surely is not wide enough to allow disclosures to outside legal auditors.

Richmond, "Of Legal Audits and Legal Ethics," Defense Counsel Journal, October 1998 at 520.

The ethical obligations of insurance defense counsel would not be different if the bills were submitted to the insurer for transmission to a third-party auditor, rather than directly by the lawyer to the third-party auditor. An attorney's obligation to protect client confidentialities cannot be met simply by avoiding direct, personal involvement in the disclosure. "The Rules of Professional Conduct, and in particular the duties of loyalty, communication and competence, do not allow an attorney tacitly to participate in conduct that may jeopardize his or her client's legal interests." Colorado Ethics Op. 107 (9/19/99), (citing Maryland State Bar Ass'n Comm. on Ethics Op. 99-7 for proposition that the attorney must "request that an insurer not forward confidential material to a third-party auditor.")

In sum, an attorney may not ethically disclose billing statements to a third-party auditor--or to the insurer for transmission to the third-party auditor-- without first meeting the "consent after consultation" requirement of Rule 1.6(a).

2. Consent After Consultation: "'Consultation' denotes communication of information reasonably sufficient to permit the client to appreciate the significance of the matter in question." (NHBA Ethics Opinion #1988-89/13 Confidentiality: Provision of Information to Funding Source, 2/9/89). At a minimum, informed consent would require the attorney to advise the insured that disclosure of billing statements to third-party auditors creates a risk of waiver of evidentiary privileges that could allow access to, and adverse use of, the information by the opposing party. See United States v. Massachusetts Institute of Technology, 129 F.3d 681 (1st Cir. 1997) (holding that in providing billing statements of law firms to the Defense Contract Auditing Agency [the auditing arm of the Department of Defense], MIT waived the attorney-client privilege and traditional work product doctrine protections otherwise applicable to the billing statements.)

In addition, while the insured's consent might be sought at the outset of the representation (or even as a provision in the insurance agreement itself), serious questions could be raised about the sufficiency of the "consultation" and examination of the consequences of disclosure that could occur at these very early stages. The preferable course would be to obtain approval at the time of billing--when the contents of the statements are available for review by the client.

C. The Attorney's Duty to Exercise Independent Judgment:

An attorney's duty of undivided loyalty to the client is the second underpinning of the attorney's fiduciary duty; and finds expression in professional conduct rules relating to conflicts of interest.

Rule 1.7 sets forth the general rule.⁶ Rule 1.8 then lists specified problem areas -- including the conflict that can arise in a third party payor situation such as that involved in the tripartite relationship - - and mandates that the attorney not accept compensation from another if it will interfere with the independent judgment of the attorney for his or her client:

(f) A lawyer shall not accept compensation for representing a client from one other than the client unless:

(1) the client consents after consultation;

(2) there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship; and

(3) information relating to representation of a client is protected as required by Rule 1.6.

As has been discussed previously, it is difficult to identify a benefit to the insured in the submission of defense bills to third party auditors. On the other hand, the downside -- both in the potential waiver of common law protections and the increased circulation of sensitive and potentially embarrassing information -- is clear.

Under these circumstances, the insurance defense counsel asked, or required, to seek the consent of the insured for outside review of billing statements is placed in a serious ethical dilemma. This has led several jurisdictions to question, and in some cases find unethical, the lawyer's participation in the process:

(A) requirement that defense counsel seek or obtain the informed consent of the insured to disclose client confidences or secrets in billings to be submitted to the . . . outside auditing service would invoke the prohibitions in RPC 1.7(b) and 1.8(f) and place defense counsel in an impossible situation, requiring withdrawal from the representation. This is because it is almost inconceivable that it would ever be in the client's best interests to disclose confidences or secrets to a third party.

The issue is not, "what does it matter or does the client care?" Rather, the question may be, "under what circumstances, if any, would independent counsel for the client recommend that the client consent to disclosure of confidences or secrets to third persons?" If there is the slightest risk of embarrassment to the client or waiver of privileged information, independent counsel would have an affirmative duty to recommend against disclosure.

Silence in the face of an affirmative duty to recommend against disclosure would be as egregious as a recommendation to consent to disclosure. Defense counsel who was required to seek or to obtain the insured's consent to disclosure would proceed to do so only by advancing counsel's own self-interests or the interests of a third party, the insurer, in contravention of rules 1.7(b) and 1.8(f). Thus, a "requirement" to seek or obtain the client's consent to disclosure would put defense counsel in an ethical dilemma requiring withdrawal from the representation.

Washington State Bar Ass'n Formal Opinion No. 195 (8/16/99). Applying the same objective, "disinterested lawyer" standard, Mississippi and North Carolina have expressed similar concerns. State Bar of North Carolina proposed Ethics Opinion 10. See also Opinion of the Mississippi Bar No. 246 (4/8/99) ("consent may not be requested by the lawyer if a disinterested lawyer would conclude that the client should not agree to such disclosure.")

The rationale of these opinions are persuasive.⁷ New Hampshire applies the same "disinterested lawyer" standard in determining whether an attorney may ask a client to proceed with representation despite an existing, disclosed conflict. In re Boyle's Case, 136 N.H. 21, 24 (1992). Barring circumstances in which the benefits of disclosure to the insured would outweigh any potential harm -- circumstances that are difficult to imagine -- an attorney may not, ethically, comply with an insurer's request to seek the consent of a client to disclose billing statements to third party auditors even when informed consent is possible. Rule 1.7 and 1.8(f).⁸

D. The Exchange of Billing Statements and Case Information Between Insurance Defense Counsel and the Carrier:

Because of the unique nature of the tripartite relationship between defense counsel, client/insured and insurance carrier, the same ethical concerns are not implicated by the exchange of case information

(and billing materials) between insurance defense counsel and the carrier. Several factors support this conclusion.

First, the insurance contract will typically obligate the company to defend and indemnify claims falling within policy coverage (subject to deductible provisions). The policy also will typically contain a provision requiring the insured's cooperation in its defense. Accordingly, the insured's execution of this contract will generally constitute an implicit consent (or "implied authorization" for purposes of Rule 1.6(a)) for the exchange of information necessary for the carrier to monitor and evaluate the case; and meet its own contractual obligation to reimburse defense counsel.

In addition, New Hampshire Superior Court Rule 35(b)(2) provides explicit protection for trial preparation materials of a party's insurer; the Restatement similarly recognizes common law protection for information exchanged between defense counsel and carrier; and the Dumas decision, through its adoption of a "dual client" model, would appear to extend the protection of the attorney/client privilege to communications between defense counsel and carrier.

These established protections may well disappear, however, if privileged information is provided to a third party auditor. This risk of irreparable harm to the client/insured, which arises uniquely on third party auditor scenario, is a substantial basis for the Committee's opinion.

CONCLUSION:

The Committee concludes (1) that an attorney may not ethically submit detailed billing statements to outside auditors without prior consultation and informed consent of the client, Rule 1.6(a); and (2) that an attorney may not ethically comply with a request by or requirement of, an insurance company to seek consent for, or recommend, disclosure of detailed billing statements to a third party auditor unless a disinterested attorney, based on the circumstances of the case, could conclude that the benefits of disclosure to the client would outweigh any potential risks.⁹ Such circumstances would rarely, if ever, exist.

¹ Ethical issues relating to the use of outside auditors have now been addressed in a multitude of jurisdictions. See, e.g. Alabama Office of General Counsel Opinion Letter (June 1988); Alabama Ethics Op. RO-98-02 (Oct. 1998); Alaska Bar Ass'n Ethics Op. 99-1 (1999); Colorado Bar Ass'n Ethics Committee Op. No. 107 (Sept. 18, 1999); District of Columbia Bar Legal Ethics Comm. Op. 290 (Apr. 20, 1999); Florida Bar Staff Op. 20591 (Dec. 31, 1997), Hawaii Office of Disciplinary Counsel Formal Op. No. 36 (March 25, 1999); Indiana Ethics Op. No. 4 of 1998; Kentucky Ethics Op. E-368 (1994); Kentucky Ethics Op. R-404 (June 1998); Maryland State Bar Ass'n Comm. on Ethics Op. 99-7 (Dec. 1998); Massachusetts Ethics Op. 1997-T53 (1997); Massachusetts Ethics Op., Mass. Lawyers Weekly No. 24-004-00. Opinion of the Mississippi Bar No. 246; Missouri Ethics Informal Op. 980124 (1998); New York State Bar Ass'n Op. 716 (March 1999); North Carolina State Bar Formal Ethics Op. 98-10 (July 16, 1998); Oregon State Bar Legal Ethics Comm. Formal Op. 1999-157 (June 1999); Pennsylvania Comm. Informal Op. 97-119 (Oct. 7, 1997); South Carolina Ethics Op. 97-22 (1997), Tennessee Formal Ethics Op. 99-F-143 (June 14, 1999); Utah Ethics Op. 98-03 (April 17, 1998); Vermont Bar Op. 98-7 (1998); Virginia Ethics Op. 1723 (Nov. 1998); Washington State Bar Ass'n Formal Op. 195 (1999); and Washington State Bar Ass'n Informal Op. Re: Inquiry No. 1758 (April 1997); Wisconsin State Bar Comm. on Professional Ethics Formal Op. E-99-1 (1999).

² It is reported that "14 cents of every liability claim dollar goes to defense costs." Richmond, "Of Legal Audits and Legal Ethics," Defense Counsel Journal, October 1998 at 512, n. 3, citing The Fact Book 1998: Property/Casualty Insurance Facts 54 (Insurance Information Institute 1997).

³ In Gibbs v. Lappies, slip op. No. 92-159-M, (D.N.H. 8/10/93), the court (McAuliffe, J.) reached a different conclusion regarding the nature of the tripartite relationship. The court held, as part of an order denying a law firm's motion to withdraw due to failure of the insurance company to pay its bills that "when an attorney is retained by an insurance company to provide a defense under a liability policy, the attorney's client is the insured, not the insurer." The court cited treatise authority and decisions from Mississippi (federal) and New York (state) for this conclusion. The Dumas decision was neither cited nor analyzed.

⁴ Section 14 outlines the requirements for formation of an attorney client relationship:

A relationship of client and lawyer arises when:

- (1) a person manifests to a lawyer the person's intent that the lawyer provide legal services for the person; and either
 - (a) the lawyer manifests to the person consent to do so; or
 - (b) the lawyer fails to manifest lack of consent to do so, and the lawyer knows or reasonably should know that the person reasonably relies on the lawyer to provide the services; or
- (2) a tribunal with power to do so appoints the lawyer to provide the services.

⁵ See In Re: Environmental Ins. Declaratory Judgment Actions, 612 A.2d 1338, 1342 (N.J. Super. 1992) (“insureds are generally required to provide all such information and assistance as the insurer may require.”)

⁶ Rule 1.7 states:

- (a) A lawyer shall not represent a client if the representation of that client will be directly adverse to another client, unless:
 - (1) the lawyer reasonably believes the representation will not adversely affect the relationship with the other client; and
 - (2) each client consents after consultation and with knowledge of the consequences.
- (b) A lawyer shall not represent a client if the representation of that client may be materially limited by the lawyer's responsibilities to another client or to a third person, or by the lawyer's own interests, unless:
 - (1) the lawyer reasonably believes the representation will not be adversely affected; and
 - (2) the client consents after consultation and with knowledge of the consequences. When representation of multiple clients in a single matter is undertaken, the consultation shall include explanation of the implications of the common representation and the advantages and risks involved.

⁷ In Opinion No. 1988-89/13, Confidentiality: Provision of Information to Funding Source, the Committee reviewed the ethical obligations of New Hampshire Legal Assistance (NHLA) and the New Hampshire Pro Bono Referral System in connection with periodic, on-site audits by the Legal Service Corporation (a quasi-governmental agency). The audits are conducted by the LSC to ensure the “integrity” of programs that it supports through financial grants. The Committee concluded, under Rule 1.6 that NHLA must protect the identify of clients, addresses of clients, client eligibility information, client trust fund information, and client identifying information in other files – including client grievance files – unless the client consents after consultation or has impliedly authorized the release.

The Committee found, however, that NHLA or Pro Bono could ethically request clients to waive the protections found in Rule 1.6 – assuming “extreme care (is) employed in soliciting client consent” to reveal the information. The Committee noted:

It would be irresponsible to ignore the important part such audits and reviews play in guaranteeing that the limited funds available for legal assistance to be indigent are not squandered, wasted or purloined.

The public policy underpinnings of this opinion (the need for governmentally-funded legal services for the indigent), do not exist in the situation now before the Committee. Moreover, readily available alternatives exist for insurance carriers (in-house auditing, for example) that would eliminate the risks and related ethical concerns triggered by providing privileged information to third party auditors.

⁸ One solution to the defense counsel's conflict would be to recommend that the insured obtain independent counsel for advice on whether to consent to the audit process (and for advice regarding whether refusal to provide consent would violate the cooperation clause of the policy).

⁹ Variations in the audit process could affect its analysis. This opinion addresses only the use of independent, third party auditors to review detailed billing statements during the course of ongoing litigation. No effort has been made to analyze, in detail, modifications to the current system discussed in recent commentaries including (1) the employment of in-house auditors by insurance companies; (2) modification of insurance contracts to include consent to the submission of bills to outside auditors; (3) delay of the audit process until the completion of the litigation; (4) notification to the insured in retainer letters that auditors will be used to review defense bills; or (5) elimination of specificity requirements in billing statements. See generally, Richmond, supra at 522-23.