

The Not-Often-Discussed Insurer Tricks Related to Hourly Rates

The Dependent Clauses of Independent-Counsel Coverage

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Time and again, I see insureds who are entitled to a defense under their liability policies forced to pay a substantial portion of their own defense costs because their brokers have overlooked a simple issue that, in my judgment, every broker should know. So far, none of my clients has made claims against a broker for overlooking this issue, but I would imagine that a broker would rather address this issue now than learn about it for the first time because a client is making an errors-&-omissions claim.

So what's the issue? It all relates to an insurer's obligation to provide, and an insured's entitlement to, "independent counsel" for certain underlying claims. Many states provide that if a "duty-to-defend" liability insurer accepts the tender of a claim pursuant to a reservation of rights that creates a conflict of interests between the insurer and insured, then the insurer is obligated to provide, at the insurer's own cost, "independent counsel" for the insured.

Such representation is called "independent counsel" because the insured selects the attorney, and the counsel has only one client -- the insured -- rather than the two clients that exist in a typical tripartite defense counsel relationship (where both the insurer and insured are clients of the insurer's chosen defense counsel). Where the insurer has to provide such independent counsel, the insurer has to pay that counsel's hourly rate, unless the rate is unreasonable.

Legislative 'Solution'

However, problems occurred when the California Legislature thought it

would be a good idea to codify a liability insurer's obligation to provide independent counsel.

Several industry representatives have advised me that the legislation was needed to curb overbilling abuses by independent counsel.

In any event, when the legislation was being drafted, certain insurance-company lobbyists did a number on the Legislature, so that the final version of the bill as it was enacted as California Civil Code Section 2860 limited the insurer's obligation to provide independent counsel in one extremely important way.

Rather than being obligated to pay the insured's selected independent counsel's hourly rate (limited only by reasonableness), the insurer had to pay only "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."

The statute also removed the insured's rights to sue its insurer if it disputed the hourly rates the insurer contended it had to pay; the statute requires that disputes regarding the rate have to be resolved by binding arbitration.

In my opinion, the argument that "legislation was needed to curb overbilling abuses" cannot be used to justify these two important limitations. I am reminded of that tired cliché, "You don't throw the baby out with the bath water." But that is indeed what the California Legislature did, whether it knew it or not.

What Insurers Actually Pay

What the insurance company lobbyists didn't tell the Legislature is that the rates many insurance companies "actually pay" defense counsel are close to half the rates charged by lawyers that an insured would be selecting as its independent counsel. In California, for example, insurance defense lawyers typically charge \$110 per hour, whereas defense lawyers who do not have insurance companies as clients typically charge \$225 per hour or more.

It's also interesting to note that in many insurance defense law firms, a partner with 20 years experience can bill out at \$110 per hour, whereas a first-year associate is billed out at \$100 per hour. So either the insurance company is paying only \$10 per hour more for 20 years of experience, or the first-year as-

sociate is being paid a whole lot more than the associate is worth.

In my opinion, in many cases there is a scam being perpetrated on the policyholder public.

Some insurance-company defense lawyers use billing "tricks" (that other lawyers who are not part of this scam do not use) that make the \$110-per-hour rate functionally much more. For example, if an unethical insurance defense lawyer has appearances in three cases in court one morning, and he makes all three appearances in one hour, he bills one hour to each case. So the \$110-per-hour rate functionally becomes \$330 per hour. Even if the unethical defense lawyer merely "double-bills" (bills the same hour to two different cases), the \$110-per-hour rate functionally becomes \$220 per hour.

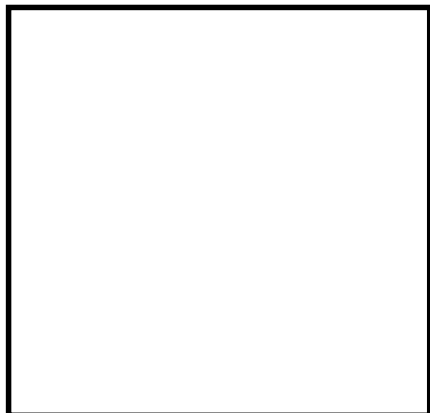
That doesn't sound fair, you say? Well, what about the fact that many times insurance companies don't pay anything near \$110 per hour for their own attorneys to defend claims made against them. Some insurance-defense law firms charge their insurance-company clients \$110 per hour to do defense work, but in excess of \$170 per hour to defend the insurance company in coverage disputes against their policyholders.

That's right, many insurance companies pay more than \$170 per hour for their own lawyers, but insist on paying no more than \$110 per hour for their insureds' independent counsel. It gets comical when insurers using \$200-per-hour lawyers are "caught" by judges when the company attorneys argue that the insurer has to pay only \$110 per hour for an insured's independent counsel.

No Admittance of This Trick

This lunacy has been going on for years, although no insurance-company defense lawyer or insurance company will admit it in public. How do I know this is going on? Defense lawyers tell me and laugh about it. I've also been involved in enough coverage litigation and arbitrations to obtain evidence that shows that insurance companies pay top hourly rates (at least in the mid-\$200-per-hour range) when their own butts are on the line and they are defending themselves against claims.

So what is the impact of this? Just imagine an underlying claim where your client is entitled to independent



counsel. The going rate for counsel where the underlying claim is pending is \$220 per hour. The insurer says that it pays only \$110 per hour for the lawyers it uses for those types of claims. Assume that the attorney fees for the underlying claim ultimately total \$200,000. The insured could be forced to pay \$100,000 of those costs.

That's right, even though the claim is covered and the insurer is obligated to defend, your client can get stuck with half the cost of defense. Can you smell an E&O claim coming? I can.

So you think this is just a problem for California brokers? It is not. I recently came across a liability policy that is being marketed nationally that contains language incorporating parts of California Civil Code Section 2860. The policy language reads in part as follows:

"In the event the Insured is entitled by law to select independent counsel to defend an Insured at the Company's expense, the defense costs the Company must pay to that counsel are limited to the rates the Company actually pays to counsel the Company retains in the ordinary course of business in the defense of similar claims in the community where the claim arose or is being defended."

In my opinion, any insurer using this type of provision is looking to pull the same type of scam that has gone on in California ever since the enactment of Civil Code Section 2860.

Avoiding E&O Exposures

What can brokers do to avoid E&O exposures on this issue? Here are my suggestions.

First, be on the lookout for the provision quoted previously. If you see it in any liability policy you are placing, negotiate it out of the policy! If you cannot negotiate it out of the policy, advise your client of the provision and the potential problems that I have outlined in this article. If the client is willing to take the policy with the potentially problematic provision, then confirm that in writing.

Second, if you are in California, in addition to checking for the provision quoted above, you should take note of the fact that California Civil Code Section 2860, in addition to limiting an insured's rights, also provides that "[t]his subdivision does not invalidate other different or additional policy provisions

pertaining to attorney's fees or providing for methods of settlement of disputes concerning those fees."

So the California Legislature left the door open for the parties' to the insurance contract to negotiate better provisions. Accordingly, you should try to negotiate into the policy a provision that removes (1) the limitation that the rates the insurer must pay for independent counsel are limited to rates the insurer actually pays (the only stated limit, if there has to be one, should be something like "a reasonable hourly rate charged by law firms to non-insurance company clients"), and (2) the requirement that disputes relating to what rates are to be paid by the insurer must be resolved by binding arbitration (the optimal provision is one that gives the policyholder the right to force the insurer to arbitrate or litigate coverage disputes).

If you cannot negotiate such provisions into the policy, then advise your client of the potential problems. If the client is willing to take the policy without the added protection of such negotiated-in provisions, then confirm that in writing.

A final note: Whether you think this independent-counsel issue is a scam (as I do) or not, please do not lose sight of the fact that policyholders every day are losing out on thousands of dollars of coverage they otherwise would be entitled to but for the fact that the broker overlooked this issue.

And even assuming that you really don't face any E&O exposure with respect to this issue (an assumption I believe is dubious, but I'm trying to make a point here), at the very least it would seem that the efforts you undertake to address this issue in initial placements and renewals might result in a policy enhancement that your clients will appreciate and that sets you apart from those brokers and agents who don't even know about this issue.

That might be the most important point of this article.

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