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The Commodification of Insurance Defense Practice

Herbert M. Kritzer

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Drawing on a period of observation in an insurance defense law firm and a series of interviews with insurance defense lawyers in other firms, this paper presents an analysis of the work and relationships involved in insurance defense practice. The central argument of the paper is the insurance defense practice is viewed as a commodity by many, perhaps most, insurance companies. The result is to drive down the price for such services and to impose a variety of demands on lawyers providing insurance defense services that affect the work that the lawyers do. Specific topics discussed include fees and fee arrangements, working relationships between lawyers and insurance adjusters, marketing and client retention, and interactions between insurance defense lawyers and lawyers representing other insurers or plaintiffs.

The Commodification of Insurance Defense Practice*

*Herbert M. Kritzer***

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I. INTRODUCTION

There is a vibrant and growing empirical (and theoretical) literature regarding the plaintiffs' bar in the United States.¹ Much of

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this research has focused on the implications of the contingency fee structure for the work of lawyers representing individuals who pursue injury and other kinds of monetary claims. The interest in this work reflects both the growing political salience of the plaintiffs' bar and the argument that the contingency fee structure may create perverse incentives that produce significant conflicts between lawyers and their clients, and between lawyers and societal interests.

In contrast, there is relatively little research, either empirical or theoretical, focused specifically on the lawyers who routinely stand opposite the plaintiffs' bar: the insurance defense bar. Laurence Ross has written a seminal book on claims adjusters.² However, while Ross discusses the adjusters' relationships with claimants' lawyers, he does not discuss adjusters' relationships with outside counsel hired by the insurance company to represent insureds once a claim is in suit.³ There is also some theoretical and empirical literature related to hourly fee arrangements,⁴ which are the dominant way by which insurance defense lawyers charge for their services, but that literature does not focus on lawyers doing insurance defense work.⁵ And there is

1. See, e.g., DOUGLAS E. ROSENTHAL, *LAWYER AND CLIENT: WHO'S IN CHARGE?* (1974) (discussing the plaintiffs' bar in the United States); see also HERBERT M. KRITZER, *RISKS, REPUTATIONS, AND REWARDS: CONTINGENCY FEE LEGAL PRACTICE IN THE UNITED STATES* (2004) [hereinafter KRITZER, *RISKS, REPUTATIONS & REWARDS*]; Stephen Daniels & Joanne Martin, *It Was the Best of Times, It Was the Worst of Times: The Precarious Nature of Plaintiffs' Practice in Texas*, 80 TEX. L. REV. 1781 (2002); Stephen Daniels & Joanne Martin, "It's Darwinism—Survival of the Fittest:" *How Markets and Reputations Shape the Ways in Which Plaintiffs' Lawyers Obtain Clients*, 21 L. & POL'Y 377 (1999); Stephen Daniels & Joanne Martin, "We Live on the Edge of Extinction All the Time:" *Entrepreneurs, Innovation and the Plaintiffs' Bar in the Wake of Tort Reform*, in 3 SOCIOLOGY OF CRIME, LAW AND DEVIANCE, LEGAL PROFESSIONS: WORK, STRUCTURE AND ORGANIZATION 149 (Jerry Van Hoy ed., 2001); Herbert M. Kritzer, *From Litigators of Ordinary Cases to Litigators of Extraordinary Cases: Stratification of the Plaintiffs' Bar in the Twenty-first Century*, 51 DEPAUL L. REV. 219 (2001); Herbert M. Kritzer, *The Fracturing Legal Profession: The Case of Plaintiffs' Personal Injury Lawyers*, 8 INT'L. J. LEGAL PROF. 225 (2001); Jerry Van Hoy, *Markets and Contingency: How Client Markets Influence the Work of Plaintiffs' Personal Injury Lawyers*, 6 INT'L. J. LEGAL. PROF. 345 (1999).

2. H. LAURENCE ROSS, *SETTLED OUT OF COURT: THE SOCIAL PROCESS OF INSURANCE CLAIMS ADJUSTMENT* (1980) [hereinafter ROSS, *SETTLED OUT OF COURT*].

3. *Id.* at 215-224. Ross does briefly discuss the costs of outside defense counsel but nothing more is said regarding lawyers hired by the insurer. *Id.* at 139.

4. See Earl Johnson, Jr., *Lawyer's Choice: A Theoretical Appraisal of Litigation Investment Decisions*, 15 LAW & SOC'Y REV. 567, 569-602 (1980-81) (examining the incentives created by fee-for-service, contingent-fee, and third-party payment schemes); Herbert M. Kritzer et al., *Understanding the Costs of Litigation: The Case of the Hourly Fee Lawyer*, 1984 AM. B. FOUND. RES. J. 559, 563-70 (discussing the factors influencing the amount of time spent and the rates charged by hourly-fee lawyers).

5. There have been studies of areas of private practice where hourly fees are commonly charged, but these studies focus on lawyers who do work for individuals rather than corporations, and hence do not include insurance defense work. See LYNN MATHER ET AL., *DIVORCE LAWYERS AT WORK: VARIETIES OF PROFESSIONALISM IN PRACTICE* (2001) (exploring how divorce lawyers understand and arrive at their daily decisions); CAROLL SERON, *THE BUSINESS*

at least some recent interest in the implications, particularly the legal and ethical implications, of shifts in insurance defense practice toward alternative billing arrangements and the use by insurance companies of in-house or captive-firm counsel.⁶ However, none of the past work provides a good empirical or theoretical picture of insurance defense practice, either as it might have existed thirty to forty years ago or as it now exists.

In this paper, I present an analysis of insurance defense practice using the heuristic of a commodity.⁷ Essentially, I argue that many, perhaps even most, insurance companies have come to view the more routine work of insurance defense as something to be purchased in a marketplace where there are a large number of interchangeable providers.⁸ Loyalty between buyer and seller, to the extent that it had been an important element of the relationship, has faded. Today, insurance companies frequently shop for the best deal, which may include producing insurance defense services in-house rather than purchasing those services from an outside firm.⁹ As is true of any commodity seller, insurance defense firms seek to differentiate their product from their competitors; how successful they are in doing so is hard to ascertain. Insurance defense firms also seek to maintain the kinds of person-to-person loyalties that were probably the mainstay of insurance defense practice thirty to forty years ago, but insurance companies increasingly have adopted policies and changed management structures and in so doing have made this personal loyalty much more difficult to maintain.

The observation that insurance defense lawyers have less independence from their clients than might be expected given the professional ideal is consistent with Heinz and Laumann's recognition

OF PRACTICING LAW: THE WORK LIVES OF SOLO AND SMALL-FIRM ATTORNEYS (1996) (examining the practice of hourly-fee attorneys who are solo practitioners or work in small firms in New York City).

6. See William T. Barker, *Laying the Foundation for Staff Counsel Representation of Insureds*, 39 TORT TRIAL & INS. PRAC. L.J. 897, 899-904 (2004) (discussing legal and ethical standards necessary when insurance companies use staff counsel to defend clients); Charles Silver, *Flat Fees and Staff Attorneys: Unnecessary Casualties in the Continuing Battle Over the Law Governing Insurance Defense Lawyers*, 4 CONN. INS. L.J. 205, 211-16 (1997-98) (discussing flat fee arrangements and alternatives to hourly rates).

7. The idea that insurance defense has become a commodity practice has been expressed previously. See Gail Diane Cox, *Insurance Defense in a Shakeout*, NAT'L. L.J., Jan. 13, 1997, at A1 (discussing the trend that insurance defense is becoming a commodity practice).

8. See Gary Taylor, *Party's Over in Insurance*, NAT'L. L.J., Sept. 23, 1991, at 1 (discussing the reduced profitability for law firms in insurance defense).

9. See Michael A. Mack, *Insurance Companies Move Defense In-House*, NAT'L. L.J., Nov. 13, 1995, at C38 (discussing the increased use of staff counsel by insurance companies to defend customers in actions brought by third parties).

that lawyers working in the corporate services sector functioned more in line with a “patronage” image rather than the “collegiate” image of the autonomous professional.¹⁰ This distinction is based upon Johnson’s typology of collegiate and patronage occupations, with the latter being those occupations in which “the producer defines the needs of the consumer and the manner in which these needs are catered for,” while a patronage occupation is one in which “the consumer denies his own needs and the manner in which they are to be met.”¹¹ My argument is that the insurance industry has been able to push beyond even the patronage mode of lawyer-client relationship and thus achieve a level of control and dominance that is relatively unique in the provision of legal services.

II. RESEARCH DESIGN AND DATA COLLECTION

In the fall of 2003, Professor Les Boden of the Boston University School of Public Health brought together a group of researchers, whose work focused on civil justice issues, to brainstorm ideas for research on the impact of the *Daubert* decision (*Daubert v. Merrill Dow Pharmaceuticals* 509 U.S. 579 [1993]). Professor Boden was a member of a group based at The George Washington University called the Project on Scientific Knowledge and Public Policy (“SKAPP”),¹² which describes its goals as follows:

[To engage] scholars and scientists in the study of scientific evidence and its application in the legal and regulatory arenas in order to enhance the scientific community’s understanding of how science is used in public policy and legal proceedings; to inform decision-makers about the nature of scientific inquiry and opinion; and to advance the public’s understanding of the role of scientific evidence in government programs that seek to protect public health and the environment.¹³

I proposed a project that I called “*Daubert* in the Law Office.” The idea of this project was to observe for a period of months in a law firm in the Twin Cities area with a book of business that included cases where *Daubert* issues were likely to arise. Some initial explorations of this idea led me to decide to focus on the defense side

10. JOHN P. HEINZ & EDWARD O. LAUMANN, CHICAGO LAWYERS: THE SOCIAL STRUCTURE OF THE BAR 361 (1982).

11. *Id.* at 360 (quoting TERENCE JOHNSON, PROFESSIONS AND POWER 45-46 (1972)).

12. Major support for SKAPP is provided by the Common Benefit Trust, a fund established pursuant to a court order in the Silicone Gel Breast Implant Products Liability litigation, with additional support from the Alice Hamilton Fund and the Bauman Foundation. DefendingScience.org, <http://www.defendingscience.org/About-Us.cfm> (last visited Aug. 31, 2006).

13. DefendingScience.org, <http://www.defendingscience.org/about/index.php> (last visited May 10, 2005).

and to design the project to have two tracks, one focusing on *Daubert* and one focusing on insurance defense practice broadly defined. I eventually found a law firm that was willing to allow me “hang out” at their offices. During my time in the office, I was formally designated as a paralegal,¹⁴ and I took on any tasks assigned to me that were within my competence, logging any time devoted to paralegal tasks in the firm’s timekeeping/billing system.

The firm, which I call “Etling, Burke & Howe” (“EBH”), consists of sixty to seventy lawyers and is divided about evenly between a transactional practice and a litigation practice. The litigation and transactional groups are quite separate; it is almost as though there is an office sharing arrangement that includes sharing infrastructure support (information technology, overhead, human resources, etc.). There is some tension between the two groups: the transactional group is able to charge considerably higher rates to its clients, but they have both a higher overhead and a somewhat lower collection ratio; in contrast the litigation group charges lower rates, but the insurance clients generally pay their bills, at least after auditing.

Over three and a half months during the fall of 2004, I spent about two weeks with each of five different lawyers, plus shorter amounts of time with two other lawyers.¹⁵ These lawyers did a variety of types of insurance defense work, including workers compensation, auto accidents, products liability, professional liability, and other personal injury; the auto work included traditional liability, uninsured and underinsured motorist (“UM/UIM”) claims, and no-fault claims (“Personal Injury Protection or PIP”) where the insurer and the insured disagreed over whether treatment was reasonable and necessary. In addition to insurance defense work, the firm also handled insurance subrogation cases and insurance coverage matters, plus some commercial litigation.

14. The paralegal designation brought me under attorney-client privilege rules; assigning me some actual work served to avoid challenges that this designation was simply a fiction. The tasks I performed included some memo preparation, assisting on drafting of briefs, assisting at depositions, review of discovery materials, and assisting lawyers in preparing for presentations.

15. During my observation, which typically was from 8 A.M. until 5 or 6 P.M., I kept notes on steno pads. Each evening I transcribed and expanded those notes using my word processor. After an initial detailed review and highlighting of those notes, I completed a systematic coding of those notes using qualitative analysis software (NVivo) which allowed me to group and review notes related to a given theme or issue.

I chose to do this research in a single firm rather than multiple firms because of the potential for conflicts.¹⁶ Originally, I was concerned that the firm did some commercial litigation in addition to the insurance defense litigation, and, as a result, if I were to observe at another firm with a similar book of business, there would be a chance that the second (or third) firm would be representing an adverse party in a case that I saw at EBH. In fact, I underestimated the problems that might have arisen if I had observed in multiple firms: a large number of cases I saw involved multiple insurers who had adverse interests. In some types of cases, the issue was essentially one of subrogation where an insurer was trying to recover payments made to its insured from another insurer. In other types of cases, there were multiple defendants; this was particularly true in construction defect cases where the general contractor who, after being sued by an owner, brought in subcontractors and materials suppliers, each of whom had its own insurer. In some types of cases, a single defendant might have had multiple insurers on the risk over a period of time, and there were issues regarding whose risk it was and/or how to share out the risk.¹⁷

One of the potential problems of observing in a single firm is that the firm's practice may have been atypical. To assess the generalizability of what I observed, at least its generalizability to insurance defense practice in the Twin Cities area, I conducted a series of interviews with insurance defense practitioners in other firms.¹⁸ I identified potential respondents in a variety of ways. I started by asking key people at EBH who their main competitors were. A second source was the membership roster of the Minnesota Defense Lawyers Association, which is posted on MDLA's website.¹⁹ The final source was suggestions from respondents (i.e., I asked each respondent if there were other firms I might want to contact). A total of seventeen interviews were completed with insurance defense practitioners other than EBH.²⁰

16. In an earlier study of contingency fee practice, I observed for a month in each of three different law firms. See KRITZER, RISKS, REPUTATIONS & REWARDS, *supra* note 1, at 20-21 (discussing author's method of observation in his previous study of contingency fee practice).

17. In fact, there was at least one case on which I observed some activities at EBH that I later heard about from a lawyer I interviewed.

18. One of the seventeen interviews was completed with a Wisconsin practitioner based in Milwaukee. I also conducted some less formal interviews of lawyers at EBH with whom I did not spend a significant amount of time.

19. Minnesota Defense Lawyers Association, http://www.mdla.org/members_alphalisting.html (last visited May 10, 2005).

20. I have also conducted an equal number of interviews with lawyers whose practices involve cases likely to raise *Daubert* issues.

I developed the questions I asked during the interviews after an initial review of my observational notes. All but two of the interviews were recorded and then transcribed. For the two interviews where the respondent declined to be recorded; I took extensive notes during the interview and then transcribed and expanded those notes within an hour or two of the interview. I coded the observational notes and the interview transcripts according to the same framework.

A. The Business Realities of Insurance Defense Practice

Insurance companies are large consumers of legal services. Given the quantity of such services they buy, these companies want what is akin to wholesale prices for those services unless they are confronting exceptional circumstances (i.e., the threat of a very large loss, probably eight figures or more). Because of this volume, insurance companies are able to secure hourly rates that are well below those that are paid by other commercial clients. Relatively few insurance defense lawyers in the Twin Cities are able to charge rates in excess of \$160-\$170 per hour.²¹ More typical rates are in the range of \$110 to \$120 per hour for associates and \$140-\$150 per hour for the most senior partners; at some firms, the rates charged by associates start out as low as \$90 per hour. To put these rates in perspective, the going rate for auto mechanics in the Twin Cities at the time of my research was about \$80 per hour,²² and for plumbers it was as much as \$150 per hour.

Insurance companies are able to get these wholesale rates because they often have limited loyalty to their outside lawyers. Insurance defense lawyers can raise their rates only cautiously because insurance companies can easily move the work, either to competing firms or to in-house/captive offices.²³ For much commercial work there is a cost to changing lawyers, in that the current lawyer will have a lot of working knowledge of the client's affairs that will

21. Only one firm reported that they were able to charge over \$200 per hour for partners, and that firm had taken the stance that they would only do insurance defense work if the client was willing to pay the rate they demanded. Not surprisingly, the firm was doing less and less such work, and the work it did was not the "run-of-the-mill" insurance type case.

22. This is the nominal rate for mechanics; the time that is charged is based on the "book" time, and good mechanics can consistently beat the book time which means that their real rate is something more than \$80 per hour (probably more in the range of at least \$100 to \$120 per hour). Moreover, this figure is for labor only, and does not include the markup on parts; my guess is that a good mechanic probably generates close to \$150 per hour net of the wholesale cost of the parts he or she installs.

23. See Cox, *supra* note 7, at A17 (describing the recent trend by insurance companies to keep work in-house in order to cut costs); Mack, *supra* note 9, at C38 (explaining the controversy of utilizing in-house lawyers instead of outside counsel).

take time to replicate in the new firm. The nature of insurance defense work, however, is such that there is little if any such cost involved. Insurance companies have in place detailed litigation policies that can be handed to the new firm, and in many cases the authority of local claims staff is so constrained that the personal relations that might exist between outside counsel and those staff persons, particularly when combined with litigation policies, has little impact on the handling of cases.

I do not suggest that loyalty is completely absent in relationships between law firms and insurers.²⁴ The degree of loyalty will vary from insurer to insurer, and some insurers may genuinely treat outside counsel as nothing more than a commodity. However, even in the presence of significant loyalty between an insurer and a law firm, the commodity nature of the market for these services sharply constrains the fees that can be charged to the insurers, and forces the law firms to put up with demands that they find both costly and annoying (e.g., reducing bills they view as entirely reasonable, bearing costs that would normally be the client's responsibility, etc.).

B. Alternative Fee Arrangements and Their Implications

The purchasing power of the insurance companies is such that threats to leave or move work in-house can lead law firms to consider "deals" with the insurers that shift risks from the insurer to the lawyer. As one lawyer described the situation to me, "[I]nsurance companies became resistant to paying by the hour [because] they didn't trust the counting of hours and wanted some protection against inflated prices arising due to the slowness of the lawyers."²⁵

24. In fact, at least one lawyer I spoke with felt that loyalty between insurance companies and their outside lawyers had increased: "[D]espite many examples of a lack of loyalty, my view is that loyalty has improved over time, not worsened. Most clients do recognize the substantial benefits of long term relationships with their lawyers and do not take lightly the decision to switch horses."

25. As this quote makes clear, the billing arrangement inevitably impacts the principal-agent relationship. See Douglas Cumming, *Settlement Disputes: Evidence from a Legal Practice Perspective*, 11 EUR. J. OF L. AND ECON. 249, 253-58 (2001) (analyzing the effects of four different fee arrangements for the possibility of a conflict of interest between a plaintiff and plaintiff's attorney when deciding whether to settle a case); Bruce L. Hay, *Contingent Fees, Principal-Agent Problems, and the Settlement of Litigation*, 23 WM. MITCHELL L. REV. 43, 44 (1997) (examining how to calculate a contingent fee that is optimal to the client, given that the attorney can choose to go to trial or settle); Geoffrey P. Miller, *Some Agency Problems in Settlement*, 16 J. LEGAL STUD. 189, 193-95 (1987) (explaining how the conflicts of interest between the plaintiff and the attorney can affect litigation under different types of fee arrangements); Mark Spiegel, *Lawyering & Client Decision-making: Informed Consent and the Legal Profession*, 128 U. PA. L. REV. 41, 122 (1979) (describing how legal-services lawyers tend to spend more time on non-fee paying clients who are aggressive, even if that client is not the most deserving). The goal of

The result is a variety of alternative fee arrangements.²⁶ Most of the insurance defense lawyers I spoke with indicated that the issue of alternative methods of billing had come up with their insurance company clients, although only about one-third acknowledged currently doing any work on an alternative fee basis. About an equal number of firms reported either that they had done some such work in the past, had considered offering alternative fee arrangements, or had successfully resisted adopting such arrangements when asked to consider them by one or more insurance company clients. Of those lawyers who reported that their firms in the past had alternative billing arrangements but no longer use them, some reported that the decision to drop the alternative arrangement came from the insurance company and some reported that it was a firm decision.

The simplest alternative billing arrangement is some sort of flat fee: the firm receives a fixed amount (plus expenses) for handling a case. Such arrangements make sense when cases are fairly predictable and routine. Thus, the most common type of case involving flat fees was a PIP case where the firm represented the insurer in a dispute with the insured over no-fault benefits. Under Minnesota law, most of these cases are resolved through arbitration if they cannot be settled. Much of the preparation for the arbitration is done by the paralegal, and the lawyers I observed could handle them with a few hours of arbitration preparation, plus time spent trying to negotiate a settlement. The arbitration hearings themselves were very quick (typically an hour or less). Given that most of these cases involve disputes over what medical treatment should be covered by the insurer, a significant part of the lawyer's time goes into setting up

different fee arrangements is to structure the incentives in that relationship with the purpose of trying to align the lawyer's interest with the fee payer's interest. Every fee arrangement inevitably produces a mixture of positive and perverse incentives. See Johnson, *supra* note 4, at 569-602 (exploring how the different methods of compensating lawyers produce differing economic incentives, which may not be in the best interests of clients); Herbert M. Kritzer, *Lawyer's Fees and the Holy Grail: Where Should Clients Search for Value?* 77 JUDICATURE 187, 188-89 (1993-94) [hereinafter, Kritzer, *The Holy Grail*] (stating that different fee arrangements create different incentives for lawyers, with positive as well as negative implications). One irony in the desire of insurance companies to move away from the billable hour is that they may have been the primary force in creating this billing arrangement for insurance defense work. One of Tom Baker's respondents observed, "We didn't bill by hours when I started. We billed by task. We didn't keep time The insurance company said, 'Hey, we don't want to pay you \$50 for a motion. You tell us how long it took you to do the motion and we'll pay you whatever your hourly rate is as long as it is reasonable.' And we didn't like it but they were the clients. [But] we went along with it and it turned out that we liked it. Because we didn't know how much time we were spending on half of this stuff. We found out. We were shocked. Even today I'm shocked to find out it's 5 o'clock in the afternoon. I thought it was like 2 o'clock. Where did the day go?"

26. A senior partner at one law firm told me that the firm had entered into its first alternative fee arrangement in the mid 1980s.

independent medical exams (IMEs) and preparing medical records to be provided to the physician conducting the IME. In sum, the time required for these cases is quite predictable, so lawyers can handle such cases on a fixed fee basis. Moreover, even if the firm does not make as much on each file as it might under an hourly fee, such fixed fee arrangements can increase the volume of work and serve as "loss-leaders" for other, more profitable work.

The fixed fee arrangement, however, creates some other problems. Given that the full fee is payable even if the case settles after it is referred to the lawyer but before arbitration, insurance adjusters may be reluctant to refer cases that they think will settle. One effect of this reluctance is that adjusters sometimes delay referring cases, and this can result in a case being poorly postured when the lawyer finally receives it. One lawyer I spoke to emphasized this as a recurring problem. He said that his firm was negotiating with one of its insurance company clients to modify the arrangement so that adjusters could consult with the firm on an hourly fee basis prior to referring the case, with any fees generated being credited against the fixed fee if the case were to be turned over to the lawyer. Another lawyer told me that his firm avoided this problem by having an understanding with insurers concerning files referred on a flat fee basis: if the lawyer felt the case could be handled very quickly, the firm would handle it on an hourly basis rather than charge the normal flat fee.

I was told of other attempts to use flat fee arrangements in traditional tort cases or in UM/UIM cases. Most of these arrangements seem to be short-lived, with neither the insurer nor the firm particularly satisfied with the results. According to the lawyers, the insurers tend to resent paying flat fees and then having cases settle quickly; one result is that the mix of cases referred to lawyers, which had been the assumed mix when the deal was struck, tend to change with fewer of the "quick" cases, i.e., the "slam dunks," being referred. This result is not surprising. Suppose an adjuster has \$10,000 on the table and the plaintiff is demanding \$20,000. If the fixed fee that will be payable if the case goes into suit is \$5,000, the adjuster will find it advantageous to try to settle the case for any amount \$15,000 or less. Another lawyer in a firm which had briefly done auto liability cases on a fixed fee basis reported that they had found the firm lost money under the arrangement because the claims representatives would not settle once a case was referred to the firm; according to the lawyer, the claims representatives' view was that "it doesn't cost us anything to take the case to trial, so why settle?" That is, the insurer did not have to worry about the cost of defense, and, as

a result, the law firm found that they were trying more cases than ever before.²⁷ While the arrangement was entered into in good faith with the management of the insurance company, the problem arose with the lower level staff who processed cases on a day-in, day-out basis.

Alternative billing arrangements are not limited to flat fees. Other fee arrangements I saw or was told about include:

Flat fee with optional opt out for a specified percentage of cases (i.e., the firm can designate up to xx% of cases that it handle on an hourly fee rather than a flat fee basis).

Mixed flat fee/hourly fee, in which the case is handled on a flat fee up until some specified stage of the case (e.g., the start of depositions or the start of trial), and then shifts to hourly.

Time-capped flat fee, in which a case is handled on a flat fee with a cap on the amount of billable time covered by the flat fee, such that if the cap is exceeded, the fee shifts to hourly for time beyond the cap.

Simple phase billing, in which an agreed upon amount is paid for each stage of a case (opening and answering, initial motions, depositions, pretrials, etc.); usually these arrangements shift to hourly once trial starts.

Multi-track phase billing, in which cases are identified as simple, medium, and complex, with different phase billing amounts for simple and medium, and straight hourly billing for complex cases.

Mixed hourly and "unit" billing, in which some activities are done on an hourly basis and some on a "unit" or per diem basis (i.e., a specific amount for a deposition, a specific amount for reach day of trial).

Open-file billing, in which the firm receives a set amount for each month a file is open, typically with some minimum to account for the flurry of activity involved in opening a file (e.g., \$250 per month with a three month minimum).²⁸

From the viewpoint of the law firm, the firm provides an additional service to the insurer by accepting some of the risk posed by unpredictable legal expenses.²⁹ However, the market position of the insurers is such that they often, if not usually, can get this additional service essentially at little or no cost from the firm.

27. Another lawyer, who told me that her firm had tried a "flat fee up until trial arrangement" for such cases, reported that her firm found that the adjusters had less inclination to settle early, and that many more cases progressed closer to trial.

28. A lawyer I interviewed at one of the firms with this kind of arrangement told me that the firm arrived at the month fee by analyzing the average monthly billing per case for a particular client and then setting a fee commensurate with the historical average.

29. The firms can limit the risk by including provisions, such as the number of trials per year, in their agreements with insurers (with trials above the agreed upon figure handled under a traditional hourly fee arrangement).

One major dilemma that these arrangements present is that, as with any billing or fee arrangement,³⁰ the incentives of the payer and the payee of the fee depend on the arrangement. Behavior is at least modified by the incentive structure, even if there is an agreement that cases will continue to be referred as before and that lawyers will continue to handle cases as before. I discussed *supra* some of these incentives with regard to the flat fee. It is easy to imagine the incentive-related effects that go with other arrangements (e.g., for open-file billing, there is an incentive to keep a file open at least until costs have been covered).

This is a particular problem when the client is not the insurance company paying the lawyer's bill but the insured whose policy requires the insurer to cover the cost of defense. One lawyer specifically commented, "I think that they [the insurer] were uncomfortable with the obligations made in their policies to their insureds; uncomfortable in that a flat fee arrangement might curb what a lawyer should be doing for an insured, a premium payer." While in most cases, claims are well within policy limits, and hence the insured simply wants to have the insurance company deal with the case and be involved only when necessary,³¹ alternative billing arrangements can be extremely problematic if there is any risk of the case going to trial and resulting in a verdict that exceeds insurance coverage. Thus, if the incentive structure discourages the defense lawyer from undertaking the same level of pretrial preparation that lawyer would undertake if being paid on an hourly fee, then the lawyer may be subject to claims of malpractice from the insured, and possibly to disciplinary action from the regulatory body responsible for the legal profession. One lawyer described this issue very well:

30. See Johnson, *supra* note 4, at 567 (hypothesizing that the fee-for-service, contingent-fee, and third-party payment methods each create different configurations of economic incentives); Herbert M. Kritzer, *Lawyer Fees And Lawyer Behavior in Litigation: What Does the Empirical Literature Really Say?*, 80 TEX. L. REV. 1943, 1966 (2002) (describing how the mechanism for computing creates contrasting incentives); Kritzer, *The Holy Grail*, *supra* note 25, at 4 190 (detailing how allocation of risk differs depending on the fee arrangement and how this risk affects lawyer's or client's behavior).

31. One lawyer described to me his typical relationship with the actual client. When the lawyer receives the file from the insurer, he writes to the client (the insured) to introduce himself and to alert the client that the case is in suit. The lawyer may have a telephone conversation with the client to get the client's side of what happened, although if the insurer's file contains a statement from the client, the lawyer may rely on that during the preliminary stages. The lawyer typically will not actually meet the client until it is time for the client's deposition at which time he will have the client come in an hour or two before the deposition for preparation. Unless the case actually goes to trial, the only other contact the lawyer will have with the client will be when he sends the client a letter informing the client that the matter has been resolved.

To me, there is an inherent conflict; an immediate and apparent conflict on the flat fee basis. You can imagine this scenario: Insured has a \$50,000 limit, and you've agreed to a \$5,000 flat fee. You're now at \$4,995; you propose to take some depositions, and some other things. The insurer is all for it because now you are on your own nickel. Let's say the case comes back with a verdict of \$125,000. The insured, your client, to whom you owe due diligence, fealty, and loyalty, now says:

"What happened?"

"We got a bad result."

"How come you didn't do any discovery after May 16?"

"I didn't think it was necessary."

"What billing rate did you have?"

"I had a flat fee."

"When did you hit the flat fee cap?"

"May 14."

Thus what it creates is an immediate conflict, because the age old conundrum for insurance lawyers has been the proscription against, in the rules of ethics, being paid by someone other than your client. The American Bar Association and the insurance industry created some rules of agreement back in the late 1930s, canons of understanding between the insurance carriers and the profession. This was allowed because it was the only way you could do it and get the benefit of the agreement by the insurance company to pay for the defense lawyer. But that problem becomes more acute as you start altering the billing arrangements.

Another lawyer I interviewed told me of a case where he was sued by a defendant for failing to provide a vigorous defense:

Several years ago, I defended a client [an insured] who, while drunk, drove the wrong way down a divided expressway and crashed head on into oncoming car. The driver of the other car suffered serious injuries requiring lifetime medical care. My client had a \$100,000 limit policy, but plaintiff refused to settle for the policy limit because she wanted a judgment reflecting the actual amount damages even if it was uncollectible. The case went to trial, and the jury returned an award for multiple millions.

A couple of years later, my client turned around and sued me for failing to provide a vigorous representation. He claimed that I should have argued that the design of the expressway entrance was defective—if the entrance had been properly designed, it would not have been possible to get on the highway going the wrong way, and thus the government was at fault for defectively designing the expressway. During discovery, the former client's lawyer found something in my file that suggested I had handled the case on a flat fee basis; the lawyer advanced the argument that this was evidence that I had failed to provide zealous representation. Fortunately, as it turned out, I had in fact told insurer that the case was too big and complex to handle on fixed base and it was actually handled on hourly basis.

One obvious solution to this kind of problem would be to limit the use of alternative fee arrangements to matters where the lawyer

represents only the insurance company, as is the case in no fault claims and UM/UIM claims, or to claims that clearly fall well below any policy limits.³²

The lawyers at Etling, Burke & Howe appeared to feel that how they handled a case was influenced, at least somewhat, by the fee arrangement under which they were working. Under arrangements where they do not bill the client for their time, there is an incentive to increase efficiency. Thus, if there is a choice between using a formal discovery process to obtain needed information and trying to get that information without the time and expense of a formal process, under alternative billing arrangements the lawyer may be more inclined to use an informal process. Under some of the arrangements there is an incentive to move files along as quickly as practical given the issues in the case. One EBH lawyer who often worked under alternative fee arrangements commented to me that he has had plaintiffs' lawyers say things like, "[T]hanks for getting this done so quickly."

Another lawyer whom I accompanied to a judicial settlement conference commented as we walked to the courthouse that he had no incentive to keep the case going because it was a flat fee case (he also commented that the plaintiff's lawyer probably wanted to get it settled because that lawyer's investment in the case already well exceeded any fee the lawyer could expect to get). However, I do not want to suggest that the alternate fee arrangements lead defense lawyers to roll over and play dead in the negotiation process. Given the continuing nature of the relationship with the insurance company clients, the lawyers have an inherent interest in getting "good deals" for their clients. In addition to concerns about how they are perceived by their repeat clients, litigators tend to be competitive. One lawyer I spoke with told me that in a case he was trying to settle, he had settlement authority of \$10,000 and had received a demand for that amount; nonetheless, the lawyer said he would haggle with the opposing lawyer and see if he could get the other side to accept a lower amount in settlement. Thus, while the fee arrangement may affect the inclination of the defense lawyer to hold out for a marginally better deal, the effects are to be found at the margins.

32. Thinking about the lawyer who reported that his firm had found itself trying many more cases under the flat fee arrangement because the insurance representatives had less incentive to settle, *supra* note 27, one also could argue that even if there were absolutely no risk of a verdict exceeding coverage, the insured has to endure the time and psychological costs of trial, which would otherwise be avoided through settlement. Of course, there is also the situation of the insured who feels strongly that she or he has no liability or responsibility for what happened and wants to be vindicated through trial, but under the traditional fee system does not get the opportunity because the insurance company makes a business decision that it is best to settle the case.

Another kind of incentive effect of various fee arrangements concerns *who* within a firm should do various tasks. Under an hourly fee arrangement, the obvious incentive is to have as much work done by “timekeepers” (i.e., staff who track and bill for their time) as possible, provided that the client is willing to pay for the work. Typically, the insurer’s litigation guidelines specify some tasks that they will not pay for on the assumption that the work should be handled by clerical staff (e.g., scheduling depositions, arranging for a court reporter, sending forms requesting medical records, etc.). Even within such guidelines, however, there is a lot of discretion reflecting how tasks might be characterized. For example, what is involved in requesting medical records? If it is simply filling out a form requesting all records between two dates, attaching a release from the plaintiff, and mailing it to the medical provider, it makes sense to label it a clerical task. However, if what is involved is reviewing medical records received to date, identifying gaps in the medical records or issues that require additional investigation (e.g., possible pre-existing conditions), and preparing a request that specifies in some detail the records being requested, this is more than a clerical task. Thus, while the goal under alternative fee arrangements is to push work down to the lowest level person who can do it efficiently, the goal under an hourly fee is to push tasks upward in the fee hierarchy. This must be done with some sensitivity, both to formal guidelines and to the continuing relationship and the desire for future business; a lawyer does not want the insurer to develop a view that the lawyer is “overstaffing” a case, either in the sense of spending too much time on the case or in the sense of having tasks done by more expensive personnel than is necessary.

While an hourly fee creates an incentive to push work up to timekeeping and higher priced staff, under a non-time-based arrangement the incentive is the opposite: to have the work done by the least expensive personnel that can do an adequate job. The firm wants to keep costs as low as possible because any difference between costs and fee is either profit or loss; the lower the costs, the higher the profit (or the lower the loss). Thus, even if an insurer being billed on an hourly basis would pay to have a paralegal complete a task (e.g., preparing a treatment chronology), if the task could be done by a secretary paid \$20-\$25 per hour rather than a paralegal paid \$30-\$35 per hour,³³ and if the time were not being directly billed to the insurer,

33. The cost of secretarial time may not be less than that of a paralegal. A senior, experienced secretary may well be paid more than a relatively junior paralegal; in fact, the average salary of paralegals at EBH is only about 10 percent more than the average salary of

it would be advantageous to have it done by the secretary. Similarly, if there were an investigatory task that could be done either by the lawyer or by the paralegal (or a law clerk or an investigator), the incentive as to who should do the work would depend on the billing arrangement.

In some ways these seem like straightforward choices, assuming that there are significant cost differentials for different types of staff. The difficulty arises when a firm does work on a variety of fee arrangements. If company X pays by the hour while company Y pays on an "open-file" basis, the firm would like to have work distributed differently depending on whether the file is from company X or company Y. However, from a management perspective, this work distribution is extremely difficult to bring about. At Etling, Burke & Howe there was a drive to increase the ratio of timekeepers to secretaries as a way of reducing overhead. However, this only reduces overhead under the hourly arrangement where secretarial staff is a pure cost and produces no income; under alternative arrangements secretarial staff can be a profit center if the secretary is able to do work that under an hourly arrangement would be assigned to a more costly timekeeper.³⁴

C. Marketing: Getting and Keeping Business

As with any business, insurance defense firms prosper only as long as they have a continuing flow of work that is reasonably predictable. Traditionally, firms did many things to maintain a good flow of work from their insurance company clients. One element of this was to be very cognizant of the insurers' expectations vis-a-vis costs. While the natural incentive under an hourly fee is to bill as much time as possible in a given case, this is not true if one is dependent on current sources (and payers) for future cases; under that circumstance, the lawyer has to take care that the bills do not seem out of proportion with what other firms are charging or the adjusters' expectations. I saw repeated examples at EBH of lawyers making efforts to reduce expenses in a way that benefited their insurance company clients, and often that involved putting off to the last minute billable activities in anticipation of a hoped for settlement.

legal secretaries at the firm, and many experienced secretaries are paid more than relatively junior paralegals.

34. From a firm management perspective, it is not easy to distribute work in the optimally efficient manner. Doing so requires tracking the time and costs of all elements involved in handling cases, including the time that secretaries devote to specific cases.

Historically, the adjuster with whom the lawyer interacts has played an important role in the dance of expectations, and lawyers and firms have worked hard to maintain good working relationships. Law firms often entertain the adjusters with whom they work through happy hours, meals, tickets for sporting events, golf outings, hunting and fishing trips, and the like.³⁵ Social aspects are important to keep the relationships well-oiled. However, many insurance companies have moved to limit the role of the front-line adjusters in these relationships. This has happened in a variety of ways. Insurers have centralized claims offices so there are no local personnel (making social events difficult) or have greatly limited the authority of local offices.³⁶ Many insurers have begun enforcing existing but long ignored policies that restrict adjusters' participation in these activities. At least some firms have tried to work around these policies by wrapping meals or other "goodies" into seminars on recent developments that are relevant to the adjusters' work.

35. One other issue that has developed relates to gender. Many of the traditional marketing activities are geared more toward traditionally male interests than to female interests (sporting events, golf, hunting, fishing, etc.). This made sense in a time when most adjusters were male. See ROSS, SETTLED OUT OF COURT, *supra* note 2, at 28. However, the adjusters with whom the lawyers work are increasingly women. One lawyer estimated the percentage of women adjusters to be as high as 90 percent, and no one I asked gave a figure less than 50 percent. Some firms have adjusted their entertainment activities to include theater tickets and even have designed events so there was a choice between playing golf and spending time at a spa. At least one female attorney with whom I spoke expressed discomfort over social situations in which she found herself taking a male adjuster (or a group of male adjusters) to dinner or out for drinks; waitstaff would always present the bill to the male. Another woman attorney reported that in discussions about marketing activities in her firm, she presented statistics to her male partners which showed that over ninety percent of hunters are men.

36. Limited authority at the local level is by no means a new development. See ROSS, SETTLED OUT OF COURT, *supra* note 2, at 172-74. However, other changes may have further reduced the discretion of adjusters, whether local, regional, or national. Specifically, many insurers now employ a computer-based system for assessing claim value; the most widely used such system is known as Colossus, which was developed by Computer Sciences Corporation. See Colossus Brochure, <http://www.csc-fs.com/downloads/pcbrosch/colossusbrosch56404500.pdf> (last visited May 24, 2006) (describing Colossus as a system for "assisting adjusters in the evaluation of bodily injury claims"). Colossus has been controversial among the plaintiffs' bar. See Aaron DeShaw, *Colossus: What Every Trial Lawyer Needs to Know*, <http://www.watl.org/Verdict%20Articles/Colossus.pdf> (last visited May 24, 2006) ("The purpose of Colossus is to remove all individuality of a claim and simply break the claim down into factors which will be evaluated identically regardless of the insurer, the adjustor, or the claimant."). Excerpts of this article also have appeared in a number of different plaintiffs' bar publications. See <http://www.trialguides.com> (last visited May 24, 2006) (follow "Additional articles & reviews . . ." hyperlink at the bottom of the page); see also Candace Heckman, *Does Insurance Company 'Low-ball' Pain and Suffering? Industry's Use of Colossus, a Service to Judge the Worth of Claims, Comes Under Fire*, SEATTLE POST-INTELLIGENCER, May 15, 2003, at A1, available at http://seattlepi.nwsource.com/local/122105_colossus15xx.html (telling the story of a woman seriously injured in an automobile accident whose settlement was computed by Colossus and was grossly under-compensatory).

Even with such limits in place, it is clear that defense lawyers continue to value relationships with adjusters with whom they work on a regular basis. The lawyers I observed at Etling, Burke & Howe routinely spent a bit of time during most telephone conversations with adjusters engaging in some informal social chat about family, activities, sports teams, and the like. While in most cases this amounted to only a minute or two at the beginning of a call, on occasion it went on for some time. After one fairly lengthy bit of social chat I overheard with an adjuster, the lawyer commented that this adjuster tended to go on and on, and to maintain the relationship the lawyer felt it necessary to engage in the long conversations even though he could not bill the time. Lawyers at EBH also continue to engage in more traditional activities to nurture client relationships, such as taking adjusters to lunch, distributing tickets to sporting events, and purchasing small gifts for adjusters around Christmas or at other opportune moments. An example of the latter involved an adjuster who was making her first trip to London; the lawyer went to a local book store to purchase a couple of travel books on London as a gift for the adjuster (an expense that would be billed to the firm's marketing account).

Most of the other lawyers I interviewed reported that they or their firm engaged in these same types of marketing activities, although the lawyers also reported that the amount and nature of such activities have changed over time.³⁷ Some lawyers said that there was more emphasis on one-on-one activities. Others suggested that certain types of entertaining have become less common. Some of these changes may reflect specific concerns on the law firm side. For example, one lawyer commented that his firm had substantially reduced the emphasis on alcohol because of an increased concern about liability issues. While at one time the two-or-three martini lunch might have been an aspect of the firm's entertaining of adjusters, that is no longer the case; nor does the firm sponsor "happy hour" gatherings with adjusters.

D. Bill Auditing and Litigation Guidelines

Insurance companies have sought to develop systematic methods of monitoring the billing practices of the outside lawyers they employ. One aspect of this monitoring is the controversial use of outside auditing firms where the bills submitted by the law firm are

37. One lawyer reported that at one time "you were supposed to wine and dine so many hours a month, it's not part of our firm's practice, and I don't think it's part of any firm's practice, at least not openly."

reviewed and frequently reduced (no one reported to me an instance in which the audit increased the payment). Lawyers in many states have attacked such auditing practices as violating attorney-client relationships and the lawyers' ethical responsibility to the client.³⁸ Outside auditors have an incentive to cut the lawyers' bills as a justification for the fees they are paid by the insurers; if they do not find cuts greater than their own fees, insurers may see the auditors' services as not worth their cost, although if the lawyers limit their billing in anticipation of the audits, the savings might be realized even in the absence of specific cuts made by the auditors.

Even if outside auditors are not used, insurers may require lawyers to submit bills through an on-line system, either one provided by an outside vendor or one created and run by the insurer itself. One lawyer complained to me that a major insurance company client had started using an outside vendor but required that the submitter of the bill pay the vendor's fee. That is, every time the law firm submitted a bill for a case, it had to pay the outside vendor a fee of \$20. This created a disincentive to submit bills for small amounts of time because the billing fee of \$20 could take a nontrivial chunk out of the amount being billed: when aggregated across a large number of cases, \$20 fees quickly add up to a sizeable amount. One side result is to encourage firms to carry small amounts of outstanding time across billing periods in order to avoid repetitive billing fees. This effectively allows the insurers to secure an interest-free loan from the law firm; while any one such "loan" is small, the total amount of such interest-free loans outstanding at a give time many be quite significant when the client is a large insurer with many files out at law firms.

Another way that insurance companies have sought to control outside counsel has been to define what counts as billable time. Insurers do this by establishing formal guidelines that specify procedures that defense counsel must follow and identify a list of things that the insurer will not pay for or will pay only at a reduced rate:

38. See Lisa Brennan, *Outside Fee Audits Draw Bar Dissent*, NAT'L L.J., Aug. 3, 1998, at A6 (noting that seven states' bars have issued ethical opinions telling lawyers to get clients' express written consent before sending bills to auditing firms); Janet Conley, *Fight over Auditing Coming to an End*, NAT'L L.J., Apr. 23, 2001, at A1 (reporting that some of the country's biggest insurance carriers have stopped sending their lawyers' bills to third-party auditors, due to defense lawyers' successful challenge of the practice on the basis of attorney client confidentiality); Darryl Van Duch, *Test Case for Insurers' Billing Rules*, NAT'L L.J., Jan. 25, 1999, at A1 (describing a suit filed in Montana against national insurance companies by defense lawyers who argued that the insurers' billing rules create a conflict of interest between the independent counsel and the insurance companies).

Clients have gotten more frugal, and they demand more explanation for what you're doing. That's the biggest change. They'll pay for less. For example, they'll say, we'll pay you half time to travel. I don't care that you have to drive to somewhere way up north because we ask you to take the case. You can't fly there; you have to drive. But they're only going to pay you half time for that. Or clients won't pay for voice mail, even though you have to pick up the file and you have to figure out why you're calling, and dial, and you make notes; its usually six minutes or more there anyway. And it seems to get more stringent as the years go by.

In addition to specifying what can be billed, the typical set of guidelines require the lawyer to provide a written report periodically to the insurer and to obtain approval for key steps in the litigation process (e.g., obtaining independent medical examinations, hiring experts, scheduling depositions, and the like). Some insurers require the lawyer to prepare a litigation budget for each file the insurer refers to the lawyer.

The lawyers I spent time with and interviewed saw these guidelines as a necessary evil and found ways to work within them such that conforming to the guidelines became part of the lawyers' routines. No lawyer I spoke to reported that they encountered significant resistance to proposed litigation plans (i.e., taking depositions, doing medical exams, etc.); occasionally an adjuster might suggest holding off on an activity (e.g., a medical exam or a deposition) in the hopes that the case might settle without incurring that expense. The more frequent problem that lawyers mentioned was simply getting the adjuster to respond to the request to proceed with some activity; lawyers attributed this to the heavy case load most adjusters carried and to the trust they felt existed between the adjusters and themselves. The solution that most lawyers arrived at was to tell the adjuster that they planned to proceed as outlined unless they heard otherwise from the adjuster. In the words of one lawyer:

For the most part, at least these days, I'm working with insurers with whom I've got a lot of trust, and I write up a report, and say, "This is what I think we should do, and if you disagree call me," and I don't get any calls.

One lawyer told me that a particular adjuster told him to put a memo in his (the lawyer's) file indicating that he had received verbal approval to proceed so that if a question came up during an audit, they were covered. While getting adjusters to respond was often an issue, lawyers typically reported that some adjusters were quick to respond, either because it was just the adjuster's style or because the lawyer and adjuster had not had a lot of prior experience working together. One lawyer reported that one of the companies he worked with had a form that the adjuster was supposed to sign and return approving the plan proposed by the lawyer. Still, even when an adjuster wanted to discuss some aspect of what the lawyer was

proposing, or wanted some additional justification, lawyers reported that the adjuster almost always approved the course of action the lawyer had proposed.

While one might expect lawyers to complain about being required to prepare budgets, I heard few objections. Some lawyers told me that they dealt with the budget issue by updating the budget regularly as the case progressed. One lawyer commented that it was sometimes a problem to increase a budget as a case progressed, not because of the adjuster but because of the adjuster's superiors; the lawyer found that he often had to write elaborate letters justifying the increase in the budget. Other lawyers told me that they simply gave the adjuster a "high side" budget to reduce the likelihood that they would have to increase it to avoid these kinds of problems. Perhaps the most interesting comment on budgets was from a young lawyer who told me that he was very suspicious and hesitant about budgets initially but had come to realize that being required to prepare budgets forced him to think through cases more thoroughly when they initially came in. Of course, sometimes the insurer's demand for a budget seems a bit absurd:

I settled one case right off the bat. Before I did the budget. I submitted the bill last month, and they wrote back, "We can't pay this because you haven't submitted the budget." Well, its kind of ridiculous, so I have to sit down and for 20 minutes go through what the budget would be in a case that's closed, and probably didn't cost them more than \$300, \$400 in attorneys fees, and the budget is going to say \$5,000.

One lawyer pointed out how the budget can be extremely useful for the insurer from a business perspective other than as a means of controlling the relationship between the lawyer and the insurer:

If I tell them that my litigation budget on this file is \$10,000, and they could settle it for five [thousand dollars], it is a pretty easy decision for them. So when I'm recommending settlement in my initial evaluation in this range, they say, "Yes, it makes sense from a defense side. Lets go in and do that." So I do think that they're worthwhile.

Billing guidelines (i.e., what can and cannot be billed) raise fewer problems than one might expect. One specific area that did seem problematic was the policy of some, perhaps many, insurers that they would not pay for internal meetings (i.e., meetings where two or more lawyers met to discuss a case). This creates some problems when a senior lawyer assigns a junior to work on a case, and they need to meet to discuss the case. It can also create problems when a case raises different kinds of issues which are handled by different lawyers, and the lawyers need to meet to coordinate their activities. I did not sense that this was a major problem but rather that it was more of a nuisance; I suspect that the time was still billed, but was not described as a meeting.

The other problem that the billing guidelines create, when combined with auditing by the insurers, is the need to adequately describe activities so that whoever reviewed the bills would not question whether it was a billable item. Part of this involves the need to identify an appropriate code for the specific activity involved and another part involves the need to provide a narrative description of the activity. One lawyer I interviewed told me about a particularly extreme example: The lawyer called the representative of the insurance company to find out what billing code to use in connection with some work he had done; this work saved the insurer \$40,000 by providing a basis upon which to deny coverage. The representative he talked to asked what exactly he had done. The lawyer explained that he had spent an hour thinking through the client's situation and had come up with the idea which the insurer subsequently used in a letter it sent to the insured denying coverage. The contact told the lawyer that there was no billing code for "thinking."

A more common example is requesting medical records. Simple requests to medical providers to send medical records are deemed to be clerical tasks that should be completed by clerical staff who are not timekeepers (i.e., it is not a billable task). However, preparing a request for medical records can be billable if it is more than clerical. For example, a paralegal can bill his time for this task if the billing notation says something like, "reviewed medical records received to date; identified possible prior treatment that might be related to claimed condition; prepared specific request for medical records for relevant treatment and time period." This work is seen as involving judgment rather than simply performing a clerical activity. Law firms have to train staff, both junior lawyers and paralegals, to use the appropriate descriptions and catch phrases that will reduce the likelihood that a billed item will be questioned.³⁹ It is important to note that lawyers did not necessarily see the documentation/description requirements as a bad thing; one lawyer commented, "Part of [the auditing process] was really good for us, because it made us describe what we did, and the more we describe what we do, the easier it is for people to pay that bill." Another lawyer commented that "it

39. The training is not only an issue for new staff; there is also the issue of teaching old dogs new tricks. One young lawyer who was a shareholder in a small, relatively new insurance defense firm commented that at her previous (larger) firm, many of the older lawyers had substantial difficulty adjusting to the demands of the insurers for documenting exactly what they were doing. Where previously they might simply have recorded "prepare for deposition," they now had to detail what this preparation involved, or the insurer would refuse to pay for the time.

now seems natural to put down the detail of what you are doing in the time records.”

While the lawyers have accommodated the demands of their insurance company clients in terms of billing, prior approvals, and general oversight, they do have mixed feelings about these developments. When I asked one lawyer about the major changes he had seen over the last ten years, he replied:

Oh man . . . much more oversight by the insurance companies. Much more concern with the bottom line. Much more control, or attempt to control the case, by the insurance companies, rather than to rely on my judgment. I feel like I'm being second-guessed a lot more. And its getting to the point where it's almost an adversarial relationship. Adversarial isn't the right word. But its like the companies who are hiring us to do the best job for their insureds don't trust us enough to do the best job. They have to second-guess what were doing. We're not going to pay for this because we don't think it was necessary. But we aren't going to pay for this because we don't think it took you as long as it did.⁴⁰

While these kinds of changes are attributed to cost consciousness on the part of the insurance companies, they may also reflect consolidation within the insurance industry, and the problems that such consolidation create for management and control:

The insurers have become hierarchical. There's less control local. And, we saw, perhaps beginning about 10 years ago and capping about five years ago, a consolidation within the industry. Companies were merging, and so they necessarily had to become more hierarchical. And so the relationship with the local adjuster has been de-emphasized. And the adjusters themselves in these companies are probably feeling it as well. More need to document what they're doing. Less decision-making that they can exert. And depending on the client-base, that could be more so as far as how they handle the case.⁴¹

One might ask whether any firms or lawyers had such negative experiences with one or more insurance companies that they decided to decline future business from those companies because the work was not worth the hassle. Only two or three lawyers reported having “fired” a client insurer for these kinds of reasons. At one firm I was told that there were insurers they would not work for, but this was

40. One of Tom Baker's respondents expressed much the same view, “I can look back 33 years and if I look back 33 years to 1966 we pretty well had the freedom to handle, and I did some litigation in 1966 . . . We had the freedom to handle a case the way we wanted to. We would report to the company and we knew the people at the company pretty well, or the senior partner knew them personally. So we had pretty much freedom to handle that case the way we chose.”

41. A number of lawyers commented on the declining role/decreased authority of local claims people (see *supra*, note 36, for a discussion of the possible role of Colossus). The consolidation probably has also affected personal relationships between senior partners and senior insurance company executives. One lawyer commented, “The biggest changes were just the nuance of the relationship between a more personal relationship where the firm, the rainmaker in the firm, had a personal relationship with the claim manager or the vice president of the company.”

because the firm would not agree to the rates that the insurer was demanding. A senior partner at another firm told me:

Firms like ours do not get into bidding wars for absurd fee agreements, and we often walk away from business opportunities we regard as unprofitable. We have fired a number of clients over the years because of pricing issues.

There were also firms that I was told had abandoned routine insurance defense work, but this too was more because of the fees insurers were willing to pay as opposed to issues such as billing or litigation guidelines. In fact, even large corporate clients often (perhaps usually) have guidelines for billing and litigation activities that their law firms must abide by, although they may be less manic over details than the insurance companies.

1. The Tyranny of Time

Despite the growth of alternative billing methods, time and timekeeping are central to insurance defense practice. Every lawyer I spoke with reported that the expectation at their firm was that lawyers would bill at least 1800 hours per year; in some firms this expectation was formalized while at others it was an informally accepted goal. Lawyers reported having billed between just under 1800 hours to over 2200 hours during 2004. The time billing expectation creates two problems: putting in the time and recording it in billing records.

The lawyers I worked with made many remarks about needing to keep pushing to get enough hours billed; they would remark that they were "getting behind"⁴² and needed to find ways to make up time. This often meant working at home in the evening, coming in on week ends, or starting the work day as early as 6:00 am. It also was reflected in comments complaining about having to spend time on activities that the lawyers did not feel they could bill. Some of this time was spent on overhead activities, such as preparing for seminars, which were part of the firm's marketing activities, reviewing billing records, attending internal firm meetings, or preparing personal business plans for the coming year. Some of it was time spent on cases that the lawyer simply felt could not be billed to the client.⁴³ An

42. At least one lawyer I spent time with specifically commented that my presence was "slowing me down;" I suspect that some of the other lawyers felt this way as well even if they did not verbalize their concerns. This was an issue that I was very sensitive to, and I tried to refrain from asking questions except during natural breaks (i.e., trips to get coffee). Even so, my presence frequently prompted lawyers to talk about what they were doing or to ask me questions about how I would evaluate something.

43. In some situations it was the firm and not the lawyer who felt the lawyer could not bill all of the time. The management at EBH looked closely at both the hours billed and the revenue

example of the latter involved a lawyer who had a very peripheral role in a case but was the only person available when a call came in from a client about the status of a court filing in the case. The lawyer spent over an hour trying to track down what had happened because no one else (no lawyer, no paralegal, and no secretary) was in the office or reachable who could quickly provide the information. The lawyer commented to me as he worked on this task that he was going to have to “eat most of this time.”

A key issue for everyone in this system is recording the time spent working on client matters. One of the more senior lawyers I spoke with talked at length about the problems of getting lawyers who are supposed to record time to do it accurately and to get it all down even when they are expected to bill a certain amount of time. He related his own problems tracking his time:

At the end of the day, I review the time I have recorded, and it often seems an hour or more short. And I can't figure out where the missing time went.

This is a problem even for lawyers who tend to spend concentrated periods of time on a single file rather than jumping among up to a dozen files in the course of a day.

Lawyers have a variety of strategies to deal with this problem. Some lawyers simply keep the billing/time-record software open in a window on their computers and try to immediately record every bit of time on every case as it happens. One lawyer I spent time with uses a computer program called Time Stamp, which resembles a chess clock. This program allows him to click among files; at the end of the day he can look at the “clock” and record his time during the day. One problem he encounters is being sure to open a clock for a file if an unexpected telephone call comes in; another is being sure to “hit the button” to switch among files. At the end of the day, he still has to reconstruct what he has done on each file that he recorded time.

Even with a good strategy to track time, there are issues of what to record and what to let slide by, as well as how to record time. That is, who defines what an hour is? The standard minimum billing unit is a tenth of an hour (six minutes). It was common for lawyers to record that minimum for any activity even if the activity, sending a quick email or a telephone call, required only a minute or two. But there is still the question of how to count the time spent playing telephone tag (i.e., do you record one tenth of an hour if you try to call

generated by each lawyer. This can be a particular problem when there are alternative fee arrangements. A lawyer under pressure to bill 1800 hours may “flog” files that are billed on a nonhourly basis because the lawyer does not have to be concerned about the insurer auditing his or her time. However, this is a very significant concern for the firm which wants lawyers to generate revenue equal to (or, preferably, greater than) their hourly rate for 1800 hours.

an adjuster or opposing counsel or expert and end up leaving a voice mail message?) or reading an email that does not require a reply (is this worth a tenth of an hour?). Imagine the following sequence on the "Smith file": at 9 a.m. lawyer Jones gets a call from the adjuster asking about the status of the case, and Jones tells the adjuster that he is waiting to hear back from the plaintiffs' lawyer on a date for the plaintiffs' deposition. The call lasts two minutes. At 10:30 the plaintiff's lawyer calls to say that he can make the plaintiff available on a specific date; Jones checks his calendar and agrees to that date; the call lasts two minutes. At 1 p.m., Jones's secretary brings in the mail, and in it Jones finds a long awaited medical record for the Smith file, and spends eight minutes looking at it. He does nothing else on the Smith file that day. How much time should Jones record for the file? Should he aggregate the time and record two tenths of an hour, or should he treat each bit of time as a separate billable item and record four tenths? Would it be different if the tasks were done consecutively so that the lawyer spent a total of twelve minutes during a single time stretch? Should time be broken out by task or by client?

From the viewpoint of a lawyer who needs to accumulate 1800 billable hours in the course of a year, billing for distinct tasks increases the amount of time that might be billed in the course of a day. It may be possible to actually bill eight hours during a period of eight hours in the office if there are a lot of tenths that actually only involved a minute or two. In the course of an hour, a lawyer might try to return a dozen phone calls, completing only three, each of which lasts fifteen minutes. For each of the three completed calls he might bill three tenths of an hour and for each of the nine voice mail messages left, he might bill a tenth. The total would be eighteen tenths of an hour billed for a sixty minute period.

As I spent time with the lawyers at Etling, Burke & Howe it became clear that tracking and billing time is a learned skill. This was most evident as I watched one lawyer work with a paralegal who had been promoted from a position as a secretary. In the earlier position as a secretary, the employee had not needed to track time. As a paralegal, she was now a timekeeper and the firm expected paralegals working full time to bill 1600 hours per year or roughly thirty-two hours per week.⁴⁴ The new paralegal was having trouble even coming close to this target in the time she recorded. Part of the problem was that she was not sure what she could and could not bill for; some of

44. One issue EBH was struggling with was new overtime regulations which meant that paralegals who worked more than 40 hours in a week had to be paid at time and a half. The firm could not pass on overtime costs to clients, so paralegals had to meet their billing targets within the 40 hour per week limitation.

the problem was simply keeping track of activities in the course of the day. The lawyer supervising the paralegal was meeting with her every day or two to go over what she had billed and discussing what she had not billed that she should have.

2. Handling Cases/Working with Adjusters

The activities involved in handling insurance defense cases vary depending upon whether the case is personal injury (tort or UM/UIM), no-fault, workers' compensation, or property damage. Typically, lawyers have to assess cases in terms of liability, causation, and damages (or, in the alternative, the insurance company's exposure). Initial activities on a case involve opening the file (checking for conflicts and getting a file number for billing purposes) by completing some internal forms, preparing and serving and/or filing answers to complaints,⁴⁵ notifying the insured that the lawyer has been retained, beginning to collect relevant documents such as medical records and police reports, and preparing an initial assessment for the insurer.

The next phase of the work involves more formalized investigatory activities such as taking the plaintiffs' (or claimants') deposition, scheduling medical examinations, retaining experts to investigate and opine on causation issues (in products-related cases), and assessing damages more systematically. In personal injury cases there may be substantial delay between the time a file is received by the defense lawyer and the completion of this phase if the plaintiff's medical condition has not stabilized. A key issue during this phase is selecting physicians to conduct independent medical examinations, along with choosing other experts relevant to the case. Lawyers draw heavily upon their accumulated experience and connections when selecting experts. The lawyer may contact an expert used in the past whom the lawyer knows does not quite "fit" the instant file and ask that expert for suggestions. In products-related cases, the lawyer may ask the client to suggest a reputable expert.

Once the file is "mature," the case is ripe for settlement. In some situations there may be ongoing settlement negotiations as the file develops, but those negotiations may not involve the defense lawyer; that is, there may be negotiations between the plaintiffs' lawyer and the insurance adjuster even as the defense lawyer works

45. I say "serving and/or filing" because under the rules of civil procedure in the Minnesota state court, complaints and answers are not filed with the court until some action by the court is required; pleadings are simply served on the relevant parties. Lawyers in Minnesota speak in terms of a case being "in suit," which means that a complaint has been served.

on the case.⁴⁶ Sometimes the adjuster will tell the defense lawyer to hold back on developing the file because the adjuster hopes to reach a settlement without incurring substantial litigation expense (this may arise if a case is filed to protect against a statute of limitations problem or if the adjuster had held off making good offers to see how serious the plaintiff's lawyer was).

Typically the defense lawyer does not receive any settlement authority until the file is well-developed (i.e., IME's have been completed, depositions of the plaintiff and defendant have been completed, and the defense lawyer's experts have provided at least an informal report). This does not mean that early settlement discussions never happen, but there does not appear to be pressure from the adjusters to move quickly to settlement except when the settlement discussions continue between the adjuster and the plaintiff's lawyer, although there may be cases in which the lawyer's initial assessment of the case leads the adjuster to seek a settlement before the lawyer does much work on the case. When the lawyer does receive settlement authority, that authority is likely to be at the low end of the lawyer's evaluation of the case.⁴⁷ That is, if the lawyer tells the adjuster that

46. One lawyer reported that often in the week before trial he will let the adjuster handle the negotiations with the plaintiff's lawyer so he can focus on preparing for trial.

47. One of Tom Baker's respondents was very adamant about the relatively limited role of defense lawyers in the settlement process: "If you do anything in your article, would you please enlighten all the people in law school, 98%, not 98%, 50% of the plaintiffs attorneys, that the days of our having anything to do with settling the cases are long gone, long gone. . . . All the new kids think we can just pick up the phone and tell the people to settle cases. When I first started out, that's the way it was. My boss used to pick up the phone and scream and yell, 'You idiot.' As a matter of fact I'll go you one further. I at one time had authority to settle for 2 different insurance companies. I had the authority to settle any case at all under \$100,000. I did. I never did it. I'd always call and verify but I could. Those days are long gone. And with most of the companies they don't even want our input because they don't want to see afterwards if there was one of those bad faith things. 'Your own lawyer recommended you.' So they don't even ask you. You just report, go down to the pre-trial, tell us what the demand was, tell us what the judge said, blah, blah, blah, this that and the other thing."

Another of Baker's respondents observed, "More and more [settlement activity] is going in-house. Just like counsel is going in-house more and more. I mean, a lot of these firms basically just tell the lawyers, 'Don't get involved in any negotiations, you just push the papers through, we'll take care of all the negotiations.'"

A third commented, "In the old days, even 20 years ago, we would tell the insurance company what the exposure in the case was and that means what they could expect for a reasonably fair verdict if they got hit. And then what a reasonable settlement value was. And I would say 95% of the time they went along. Then you went into settlement discussions and you conduct the discussions. They weren't even there. You would report to them on the phone what you thought and what the judge said and you'd give them a recommendation and they'd go along with it 98% of the time. If the case could be settled, it was. If it wasn't, it wasn't. Today sometimes they don't even ask us what the exposure is or what a reasonable settlement value is. But there usually are settlement discussions and we usually get back to them. Very often they ask. They are more pro-

the exposure if the case goes to trial is \$30,000, and that a good settlement would be perhaps \$15,000, the lawyer's initial authority in the case is likely to be in the range of \$3,000 to \$5,000. As the settlement negotiations progress, the lawyer usually has to go back to the adjuster for increases in authority. For example, in the judicial mediation I attended, the offer on the table was \$50,000 and the plaintiff's demand was \$60,000; the defense lawyer's authority was \$52,000. The judge asked the plaintiff's lawyer if \$55,000 would settle the case, and the lawyer replied in the affirmative. The judge then asked the defense lawyer to find out if the adjuster would go to \$55,000; the lawyer left the room, called the adjuster, and got approval for \$55,000, thus settling the case.

In the most extreme situation, the adjuster essentially authorizes each specific offer that the defense lawyer extends to the plaintiff. One lawyer told me about a case that got to the eve of trial:

Prior to suit, the plaintiff's demand was \$50,000 and the adjuster's offer was \$5,000; after the case went into suit and the plaintiff's doctor had been deposed, the adjuster authorized the lawyer to offer \$10,000. The plaintiff reduced his demand to \$40,000 but no further offers were made until a week before trial when the adjuster authorized the defense lawyer to offer \$20,000. The plaintiff's lawyer responded that he had no authority to accept anything less than \$40,000, but would "look at" an offer of \$35,000; the defense lawyer reported to the adjuster who said, "let them stew." The defense lawyer contacted the plaintiff's lawyer and asked for a firm demand under \$40,000.⁴⁸

Two days before trial, the defense lawyer reported to the adjuster that she had heard nothing further from the plaintiff's lawyer and told the adjuster to expect a trial result between \$15,000 and \$50,000. When the defense lawyer came in the day before trial, she found a voicemail from the evening before from the adjuster in which the adjuster said they were rethinking. The defense lawyer called the adjuster who said his supervisor had said to go ahead and up the offer; the defense lawyer told the adjuster that she thought that "it's going to take 40." The adjuster instructed the defense lawyer to offer \$35,000, which the lawyer proceeded to do.

Two hours later the plaintiff's lawyer called and said they wouldn't go below 40. The defense lawyer called the adjuster; she told the adjuster, "The plaintiff knows you want to settle, and they won't take less than \$40,000." The adjuster authorized the lawyer to offer the \$40,000, and the case settled for that amount.

In some situations the lawyer may have substantial authority to negotiate a settlement within a broad range. This seems to be particularly true at a mediation. In fact, it is often the case that the

active today, especially in the larger cases than they used to be. That's my feeling. I don't think I'm in control as I used to be."

48. This example illustrates the risk aversion of at least some adjusters. I was struck by the fact that the lawyers were often more inclined to go ahead to trial than were the adjusters with whom they worked. This was by no means a universal pattern, but there were several cases I saw at EBH where the adjusters were very anxious to get a case settled and avoid the risks of trial.

lawyer first obtains settlement authority on the eve of mediation, and that there have been no settlement discussions between the defense lawyer and the plaintiff's lawyer before the mediation. Regardless of when the defense lawyer first obtains settlement authority, the lawyer will make a first offer that is very low within that authority, but may be able to settle the case within the authority he or she has at the outset. I sat in on a mediation where the lawyer came in with \$100,000 in authority. The sequence of demands and offers went as follows:

Round	Plaintiff's Offer	Defendant's Offer
1	\$315,000	\$20,000
2	\$285,000	\$25,000
3	\$200,000	\$50,000
4	\$180,000	\$57,500
5	\$165,000	\$62,500
6	\$160,000	\$65,000
7	\$140,000	\$75,000
8	\$120,000	\$75,000
	(but says he would accept \$110,000)	(but says he would settle at \$100,000, though refuses to settle at that amount)

When the offer stood at \$65,000, the defense lawyer contacted the adjuster, who shortly was going to be leaving her office, and asked to have his authority increased to \$125,000 in the event that he needed more than \$100,000 to settle the case; the adjuster agreed to the increase. The lawyer told the adjuster that he hoped he would not need to use the additional authority. About ninety minutes later, the case settled for \$100,000.

While in the above case the lawyer worked essentially within his authority, it is not unusual for an adjuster to actually attend a mediation. In this situation, the defense lawyer and the adjuster jointly assess offers. Even when the adjuster is not present, the lawyer may go back to the adjuster to discuss each move rather than working within the authority granted previously by the adjuster. Whether there is anything systematic that explains how much discretion lawyers receive from the adjusters in the settlement process is unclear. Certainly some of it has to do with the constraints under which the adjuster operates (i.e., company policy regarding granting settlement authority to outside counsel). One might be tempted to say that it is a function of the lawyer's experience and hence the degree of trust that the adjuster has in the lawyer's judgment; however, I saw

the same lawyer work both within a context of extensive leeway (having substantial settlement authority in a case) and within a context of substantial constraint (having to obtain specific authorization for each move).

If mediation and settlement negotiations fail to resolve a case, the lawyer must prepare for trial. This involves a detailed review of materials in hand, the preparation of exhibits, the preparation of a "trial book" (i.e., a notebook outlining the case the lawyer will make at trial, containing key documents, bits of transcripts, medical reports, etc.), taking testimonial depositions of medical and other experts (including treating physicians), taking testimonial depositions of other witnesses who will not be able to appear in person at trial, and some intensive contact with witnesses the lawyer will call in person at trial. The lawyers I spent time with delayed much of this preparation for as long as they could. Importantly, this was not mere procrastination. Rather, as mentioned previously, it was a more calculated decision to avoid incurring costs that the insurer would have to pay. The goal was to keep insurers happy by limiting costs, if at all possible. The result was that the day or two before trial was very intense because so much had been put off. In the simplest cases, the lawyer might even wait until the night before trial to really work intensively on it, particularly if there were ongoing settlement discussions during the day. For the lawyers, a trial starting on a Monday was almost ideal in terms of cost controls because little negotiation would occur over the weekend; if the case did not settle on Friday, the lawyer would have two days to get ready for the Monday trial.

One final point regarding the lawyers' relationships with the insurance companies who retain them: those insurers sometimes ask the lawyers to do things that the lawyers have significant doubts about.⁴⁹ For example, one lawyer I spent time with refused, under the instructions of the insurer, to turn over some materials that the insurer claimed was privileged. The lawyer told me that the insurer always resisted requests for these types of materials even though once the plaintiff's lawyer brought a motion to compel, there was no doubt that the materials would have to be surrendered. From the insurer's perspective this was a matter of principle and they would continue to

49. These examples are based on observations at EBH. I tried to devise questions that I could use in interviews to access the generalizability of these patterns, but almost none of the lawyers I spoke with would acknowledge these types of happenings. It is possible that this is unique to EBH, but I very much doubt that is the case. I suspect that many of the other lawyers had similar experiences but either my questions were inadequate to the task, or lawyers simply will not acknowledge these kinds of experiences. The only way to find out about them is to be present when they occur.

insist that counsel resist the requests even when advised that they would lose any motion to compel. In another small case involving a dispute over the necessity of medical treatment an insured had obtained and was claiming under no-fault Personal Injury Protection ("PIP") coverage, the insurer was insisting that the lawyer demand that the claimant appear in person at the PIP arbitration hearing even though the insurer could agree to allow the claimant to appear by telephone (he now lived out-of-state), and the expense of travel to attend the hearing would greatly exceed the amount in dispute.⁵⁰ The lawyer expressed serious qualms about demanding that the claimant appear in person; she saw the insurer's demand in this regard as unreasonable,⁵¹ albeit within the insurer's rights under Minnesota's no-fault statute.

Another lawyer at EBH expressed frustration to me after a no-fault arbitration hearing about handling cases where the insurer had no good defense. The lawyer believed that the insurer had made a business decision to fight such cases as a means of deterring certain classes of claims even though the insurer should have known that the claimant who persisted with the claim would prevail. A different lawyer described a case he was working on as a "virtual sure loser"; in the lawyer's view the type of case involved could be won only when the claimant would present so poorly that the claimant would have a total lack of credibility.

Sometimes insurers make demands that the lawyer can readily refuse on clear ethical grounds. For example, one lawyer told me about a telephone conversation that she had recently had with an adjuster whose supervisor had just decreed that the company would not pay on the file unless the defense counsel called the claimant's treating physician to see what the physician had to say about the case. The lawyer was able to essentially laugh off this demand by explaining that it would be unethical to call the treating physician of a represented claimant. Furthermore, while the claimant had signed a release for medical records, the claimant had not signed a release authorizing the physician to speak with anyone other than his own lawyer, and under the Health Information Protection Act ("HIPA") it

50. Not only would the travel exceed the amount being claimed, the claimant's share of the arbitrator's fee was almost equal to the amount in dispute (although the arbitrator could make an award that placed the entire burden of his/her fee on the insurer). The cost to the insurer of forcing the issue to arbitration was more than 10 times the amount at issue.

51. The lawyer also observed that these types of demands may serve to "drive a wedge" between the insurance company and the arbitrators. The implication is that in the long run the insurer may be less able to get positive decisions from arbitrators who see this behavior.

is illegal for a physician to discuss a patient's medical situation unless specifically authorized to do so.

3. Working with Other Parties

Insurance defense lawyers spend significant time interacting with lawyers representing the plaintiff and lawyers retained by insurance companies to represent codefendants. Just as is the case for contingency fee practitioners,⁵² defense lawyers value cooperative relationships. This does not mean they expect the other lawyers to be less than vigorous advocates for their clients; it does mean that they value honest dealing and willingness to accommodate reasonable requests in the course of the litigation. As was true for plaintiffs' lawyers,⁵³ defense lawyers reported that they found some opposing lawyers reasonably easy to work with and others to be more difficult. Interestingly, in the case of defense lawyers, these other lawyers could be either lawyers representing the plaintiff or lawyers representing other defendants. I encountered a surprising number of comments about the difficulties that the opposing plaintiffs' lawyers were probably having with their clients (e.g., that the client had unrealistic expectations about the value of her case, or that the client was being difficult in scheduling an IME).

A very significant portion of the interaction the lawyers had with lawyers representing other parties involved lawyers representing other insurance companies. In other words, a significant proportion of tort and workers compensation litigation consists of insurance companies fighting among themselves. As briefly mentioned when I discussed my decision to observe a single firm, this fighting among insurers happens in two ways.

First, a good bit of litigation involves matters of subrogation in which one insurer has paid out on a policy and is now trying to recoup its payment from the insurer of an alleged tortfeasor. The most obvious example of such litigation involves significant property loss cases. Consider the case of a business that has suffered a significant fire loss; the business's insurer pays off on its policy, both for the physical loss and the lost business revenue. The investigation of the fire suggests that the source of the fire was around an area where a number of pieces of electrical equipment were plugged in, and while not definitive, the fire inspector concludes that there was probably a

52. See KRITZER, RISKS, REPUTATIONS & REWARDS, *supra* note 1, 234-41 (reporting that contingency fee lawyers see cooperativeness as an approach that promotes efficiency and good results for clients).

53. *Id.*

short-circuit in the outlet, and the circuit breaker that was supposed to cut off failed to do so. Further investigation indicates that the circuit breaker was recently installed, and it may not have been installed correctly. The business's insurer files suit, in the name of the business owner, against the electrician who installed the circuit. The lawyer hired by the electrician's insurer then brings in the manufacturer of the circuit breaker as a codefendant; the insurer for the manufacturer retains another lawyer. You now have a case involving three insurance companies, one trying to collect from a second, and the second pointing a finger at the third. While nominally the parties are the business, the electrician, and the manufacturer, in reality this is a fight among the three insurers as to which of the insurers should be responsible for paying for the loss caused by the fire.

The second situation involving fights among insurers was partly included in the above example: the finger-pointing among defendants or insurers. I saw two fairly common situations where this arises in fairly extreme ways. The first involves workers' compensation cases. Consider the following situation:

A workers' compensation claim is filed. The claimed injury is an aggregation of a prior injury, and the aggregation is something that would have probably developed over time (rather than being the result of a clearly identifiable incident such as an accident on the job). The condition of the claimant is such that she requires significant medical treatment and will be off from work for several months. The prior injury occurred ten years ago at a previous employer, Company X, who at the time was covered by Insurer A. Six years ago, the claimant left Company X and went to work for Company Y doing the same type of work. Two years ago, the claimant was hired by her current employer, Company Z. These were all small construction companies, and each frequently changed insurers in order to get the best insurance rates; over the ten year period at issue the employers and insurers were:

Year	Employer	Insurer
1	X	A
2	X	A
3	X	B
4	X	B
5	Y	C
6	Y	D
7	Y	D
8	Y	E
9	Z	F
10	Z	G ⁵⁴

The insurers for Company Z might claim that the current condition is not an aggravation but simply a normal progression of the original injury, and hence it should be the responsibility of Insurer A. Insurer A might argue that the current condition has

54. One could make the situation even more complex by presuming that employer Z was represented in year 10 by insurer D who had previously insured employer Y for two years.

nothing at all to do with the original injury but was in fact a result of the claimant's recreational activities; in the alternative, Insurer A might argue that given the cumulative nature of the injury, all seven insurers should share in the payment with the shares proportional to their time on the risk. The insurers for Company Y (C, D, and E) might claim that the injury was due to a specific incident at Company Z; Insurer F might agree with that position and point specifically to an incident in Year 10, thus arguing that Insurer G should bear the full cost of the new claim.

I asked two different workers' compensation specialists what percentage of their files involved multiple insurers trying to resolve responsibility and/or shares. Their estimates differed substantially, with one giving an estimate of 10 percent, and one estimating the figure to be twenty-five to thirty-five percent (omitting asbestos cases which always involve multiple insurers).

The other setting where this type of finger-pointing routinely occurs involves construction defect cases. There are a large number of cases in Minnesota where homeowners are claiming that construction defects have led to moisture intrusion, which causes significant damage and can make houses uninhabitable if there is significant mold growth. In these cases the homeowner typically sues the general contractor, who brings in subcontractors (stucco, framer, roofer, window installer) and materials suppliers (window manufacturers). Many of these parties have multiple insurers over time, and the law has been unclear as to whether liability (and thus coverage) depends upon the date the work was performed, when the damage was discovered, when the damage occurred, or some combination.⁵⁵ The result is that these construction defect cases involve anywhere from three to ten insurers. In some cases, the insurers for a single party may agree on a joint defense and on how to share the payment of any damages; in other cases there is no such agreement and every insurer may retain its own defense counsel.

Finger-pointing among insurers can also arise in traditional personal injury cases. A good example would be a construction accident where a new type of scaffolding being used collapses. The scaffolding might be manufactured by a company in England, for example. A U.S. vendor is responsible for selling, providing manuals and safety materials, and training purchasers. The scaffolding may be rented from an equipment supplier that contracts with a company that actually erects the scaffolding at the building site. Part of the

55. There appears to be some case law in Minnesota that favors the theory that damage from moisture intrusion is deemed to be a "continuing event" and thus that all insurers on the risk from the date the owner took possession from the builder are liable, and the damages should be split proportional to the time each insurer was on the risk. See *Wooddale Builders, Inc. v. Md. Cas. Co.*, 695 N.W.2d 399, 404 (Minn. Ct. App. 2005) (noting how to allocate damages for continuous occurrences). However, the lawyers I spoke with seemed to see the coverage issue as more ambiguous than this suggests.

scaffolding system might include a hoist that can handle some specified weight limit. The scaffolding collapses when a workman employed by the insulation contractor is working on it, and at the same time the roofing contractor is hoisting a batch of roofing shingles. It is not hard to imagine the finger-pointing that would go on:

The general contractor has overall responsibility for the site and the work, so it gets sued.

The insulation contractor can't be sued because it was the employer of the injured worker, but its workers' compensation carrier files a subrogation claim.

The roofing contractor is sued alleging that its workers overloaded the hoist.

The company that erected the scaffold is brought in under the allegation that the scaffolding was not properly erected.

The company that owns the scaffolding is sued under the allegation that it failed to insure that the company it hired to erect the scaffolding knew what it was doing.

The U.S. vendor of the scaffolding is sued for failing to adequately warn the company that bought it about the hoist's limitations, and for failing to provide proper training.

The foreign manufacturer is sued for manufacturing and selling a product that was faultily designed.

There is no question that something happened that should not have. While there may be a dispute about appropriate damages (assume that the injury is such that the worker will no longer be able to work in construction, and will be unable to engage in active recreational activities that had been an important part of his life), this case would be more an issue of resolving who should pay what portion than it would be a matter of the plaintiff demonstrating that he was entitled to significant compensation.

The transaction costs associated with these cases are very high because of the number of parties and lawyers involved. One could make an argument that a significant portion of the costs associated with tort litigation arise not from demands by injured parties but by fights among insurers over who should pay and/or how to apportion the payment among multiple insurers. How much might be saved in transaction costs born by insurers and their insureds if there was some system whereby insurers did not fight over these issues and there was some simple rule determining which company should bear the loss? In fact there is a history of such agreements, called "knock-

for-knock” agreements,⁵⁶ in some settings where insurers essentially waive subrogation rights on the grounds that over a large number of cases things will balance out, and it is best to avoid the transaction costs of fighting over responsibility in individual cases. The problem here is akin to a prisoners’ dilemma: if all casualty insurers were to abide by a knock-for-knock type policy, most insurers would gain;⁵⁷ however, as soon as one insurer seeks to invoke its subrogation rights, other insurers will feel compelled to do so as well. The breakdown is particularly likely in the case of a very large loss, which would look bad on the insurer’s books and place the company management in an awkward situation with shareholders and potential investors.

4. Responding to Commodification

The idea that insurance defense practice has evolved into a “commodity” area of legal practice has been expressed before. In a 1997 *National Law Journal* article, law firm consultant Harvey Goldstein described insurance defense as a “commodity practice,” which he compared to wills and trusts work.⁵⁸ The nature of the practice and the nature of the market for such work allows insurance companies to “nickel and dim[e] the firms to death.”⁵⁹ A good example of this “nickel and diming” is the requirement discussed above that firms use an online system for submitting bills, and then require that the firms pay a fee to the system vendor each time they submit a bill.

Insurance companies have long been able to demand good rates from their lawyers simply because of the amount of legal services that they buy. However, the emphasis on the bottom line, combined with trends such as company consolidation and the growth of in-house (or captive firm) legal staffs led to a major shakeout in insurance defense practice starting in the early 1990s.⁶⁰ Some of the larger firms in the Twin Cities that were known as insurance defense firms have essentially abandoned that area and shifted their focus to other areas.⁶¹ As part of my interviewing process, I asked respondents to

56. See HERBERT JACOB ET AL., *COURTS, LAW, AND POLITICS IN COMPARATIVE PERSPECTIVE* 129 (1996) (describing the “knock for knock” practice).

57. This does not necessarily resolve the subrogation issue that can arise when there are insurers who specialize in different lines of insurance (e.g., casualty versus health versus workers’ compensation).

58. Gail Diane Cox, *Insurance Defense in a Shakeout*, NAT’L L.J., Jan. 13, 1997, at A1.

59. *Id.*

60. See Taylor, *supra* note 8, at A26 (describing how cost-cutting has changed the insurance defense practice).

61. This is by no means unique to the Twin Cities area. Several of Tom Baker’s respondents commented about getting out of insurance defense work or limiting that work in particular ways:

name insurance defense firms that I should be sure to contact. The name of one firm came up repeatedly, but my efforts to schedule an interview at the firm ran into problems (I was turned down by several lawyers I contacted). I finally contacted the managing partner of the firm, who agreed to meet with me; however, when in the course of our telephone conversation I mentioned that many people had suggested his firm as one that I should contact, the managing partner expressed chagrin that other practitioners were describing the firm as an insurance defense firm. He explained that the firm had shifted its focus to other areas and that insurance defense work was a very small part of the firm's current book of business.

The strategy of some of the smaller firms that did insurance defense was to develop expertise in specific, more specialized areas in which cases involved higher stakes. One area that many firms seek out is medical malpractice defense, particularly for large, self-insured medical providers. Another area involves specialized motor vehicle accident cases such as claims against trucking companies, claims against taxi companies, or claims against companies that provide specialized transportation services (e.g., medical transport, employee transport, etc.). As discussed above, a third area that is booming in the Twin Cities (as of the time of my research) are construction defect cases involving moisture intrusion. This area at times seems like it is, at least temporarily, a full-employment program for insurance defense lawyers because each case involves a number of parties and often multiple insurers for many of the parties. As part of my interviews with insurance defense practitioners, I asked each to tell me about the most recent case they had settled; the most common type of case that was described was a construction defect case.

For the larger firms that want to continue in the insurance defense area, one possible business model is to develop a diversified defense practice that includes a combination of more routine insurance defense (both liability and workers' compensation) and more complex cases involving medical and professional negligence, products

"We still do for some carriers the slip and fall, rear end collision, that kind of work. But that's a dramatically slower part of our practice than it once was. Considering the amount we have to pay to start an associate is not cost effective for the firm to do insurance defense work in those situations where we have to go to special discount built in. We can't. And the discounts are fairly substantial . . . And the auditing business. So it's a double whammy in that regard. When I first started I would say that half of our litigation department was in insurance defense work. And I would say that much, much, much smaller, it is a much smaller percent. Transitioning to commercial litigation from tort litigation. Litigation is what we're the strongest in. So we needed to have a better balance in our firm between tort litigation and commercial litigation. But it was a no brainer with the factor of, that if you ask an insurance company to pay you \$300 an hour, they're going to have some second thoughts."

liability, major construction defects (beyond the moisture intrusion cases) plus areas not involving insurance defense such as intellectual property litigation or other kinds of commercial litigation. The rationale is that a larger firm can use the routine work to help cover firm overhead in areas such as accounting and billing systems, human resources, technology support, and the like. While the routine work may not generate significant profits that accrue to the partners, it can be done on a break-even basis. The routine work serves as a training area for younger attorneys,⁶² and provides a pool of staff resources that can be mobilized for larger, more profitable cases, which require a team of lawyers and for which higher hourly rates can be charged. Given that many of the insurers that have large numbers of small matters also have commercial lines of insurance that produce some large claims, the relationships that a firm develops and maintains handling routine work can lead the insurer to refer larger files to the firm. In a sense, the goal here is to develop a portfolio of cases some of which come to the firm in a steady and predictable way and thus provide a stable cash flow, plus a set of less predictable cases that are more episodic, but which can be billed out at higher rates because of the complexity and stakes involved. This is not unlike the portfolio of cases I have previously described for contingency fee practitioners.⁶³

Finally, in my interviews I sensed at least some frustration about the declining importance of relationships between lawyers and local adjusters, particularly among lawyers with substantial experience. They remember a time when their relationships with local claims personnel were central to their work. These local people not only steered work to them but also could provide support if questions arose about bills and litigation strategy. Local claims people have become much less important, both losing decision-making authority and being displaced by centralized billing and audit systems; in some cases they have simply disappeared as insurers have consolidated claims operations at regional, or even national, offices. At a personal level, lawyers may feel that their work is not appreciated; they are just a cog in the claims machine—a cog that can be easily replaced if a

62. One of Tom Baker's respondents, when asked about whether the development of staff counsel had impacted him and his firm, commented, "Not at all, because I'm handling major cases . . . I need to bring in some of the smaller cases to train the younger lawyers and there was a period of time with the in-house counsel we were not getting the smaller cases and that impacted on my ability to train them. Now we're getting a sufficient number of the smaller cases that I can train them."

63. See KRITZER, RISKS, REPUTATIONS & REWARDS, *supra* note 1, at 10-11 (noting aspects of contingency fee practitioners' portfolio management).

cheaper one comes along. One lawyer expressed this very clearly when asked what has changed in his practice over the last ten years:

I could talk a long time about this. It's one of the great disappointments I have in my practice. Two main areas: loyalty and gratitude. It's not that we don't get the gratitude from the insureds, the small guy. We continue to get that, and it's one of the great things about doing this work. . . The gratitude issue that is a problem for me is the adjusters, the supervisors—and this blends into the loyalty issue—they don't care. It doesn't matter. You might spend all night, all week trying the case. . . In the first ten years I practiced, there were a dozen occasions, I might get a letter from a corporate executive of the [insurance] company thanking me for the job I had done. . . That hasn't happened in 10 years; I haven't seen it.

Nor has there been the loyalty we used to have. It seems to be more a matter of numbers, of budgets. . . I understand that it's a business; I understand that it's corporate, [but] there are a lot of personal elements involved here. I have some clients that I have worked with for twenty years. Those guys are generally appreciative, but the heat that they're under from their companies now versus ten years ago, it's night and day. . . We could do the best job possible for a company today; get the best verdict possible, and that would mean *nothing* in terms of loyalty for the next case. If another firm came along and offered them five dollars less per hour, that's where they'd go.

Not all of the attorneys I spoke with saw the loyalty issue in this way. Many had established and maintained longstanding relationships with one or more insurers, even when the firm did not offer (or would not agree to) rock-bottom rates. Moreover, while the lawyers quoted above refer to insurers changing firms as solely a function of rate competition, other factors may be involved such as dissatisfaction with the work done by a firm. At EBH, one lawyer told me of a client they had lost, not due to rates but due to company consolidation (i.e., the claims manager which came from Company A which had merged with EBH's client, Company B, had worked with another firm), coming back to EBH after becoming dissatisfied with the work of the other firm.

Another lawyer told me how the loyalty that existed between the firm and one of its major insurance company clients had positioned the firm to develop creative alternative fee arrangements that persuaded the insurance company to keep their substantial business with the firm rather than moving to a staff counsel operation:

We had represented XXXX for around 35 years at the time this issue arose. A lot of people at XXXX went to bat for us and helped convince the very few people who wanted to create a staff counsel office not to make the switch. Some of the people we worked with us called us in the early stages of XXXX's planning, and that's how we got wind of their plan in the first place. I remember well the tension in the air at the meeting where I presented our proposal to the company, a proposal our friends at the company helped us formulate to meet anticipated objections. The people who liked us simply overpowered the one person at that meeting who was determined to create the new office; they were well prepared at that meeting and they provided enormous assistance in warding off this attempted change in counsel.

The lawyer went on to explain that while under the new fee arrangement the firm's revenue per hour from this company had dropped slightly, the firm had captured much more of the company's work so that their total revenue from the company was now several times what it had been previously.

One difficulty in reaching strong conclusions on the loyalty theme is that I do not have solid information on how practices have changed over time; I only have the perceptions of long-time practitioners. Moreover, perceptions about the impact of some changes in the insurance industry can cut both ways. For example, has the shift from control of allocation of files to law firms from the local claims staff to regional or national claims offices increased or decreased loyalty to firms? I observed one lawyer at EBH speaking with a claims adjuster with whom he had worked for a number of years who was moving to another company; at the conclusion of the call, the lawyer commented on his belief that this move might enable the firm to get some work from the adjuster's new employer. On the other hand, a senior partner at EBH commented that:

The control of the business by centralized authority rather than individual adjuster, as it used to be, improves loyalty. When I started practicing, cases often went to the lawyer who gave the adjuster the best perks. We used to talk about taking an adjuster to lunch "to pick up a file." With centralization came a reduction in the number of law firms who could do the work, less discretion by individual adjusters, and greater loyalty. Now when an adjuster leaves the company, we still keep the business, and when a new adjuster shows up, he's required to use us even though he has strong personal ties elsewhere.

The two perceptions are not entirely inconsistent because the lawyer I observed might have been dealing with an adjuster who did not work at a company with highly centralized policies, and the adjuster's new employer might not have centralized policies either. The difficult question to answer is not whether there has been some change, but how much change there has actually been.

III. CONCLUSION

Insurance defense has never been the most lucrative field of practice for American lawyers. However, the absence of high fees and the resultant high income was offset by stability and predictability. Lawyers and law firms established relationships with specific insurance companies, and barring major changes (mergers of insurance companies or droppings of lines of insurance by the companies), lawyers and firms could rely upon a steady stream of business over a period of many years. Unlike contingency fee practitioners who always had to worry about where the next client

would come from, insurance defense lawyers knew that more files would be arriving next week.

The working environment for insurance defense practice has changed radically over the last two decades. Insurers are much more conscious of costs and are *constantly* looking for ways to reduce their expenditures on defense counsel. That may mean moving work in-house, it may mean seeking alternatives to hourly fees, it may mean putting work out to bid, and it may mean changing firms if a better price can be obtained. Today, insurance defense practitioners live in a highly competitive world where they must be prepared to lose a major source of work at any time. They also must be prepared to live with being “nickled and dimed” again and again and again by the insurers who send work to them.

These kinds of changes are not unique to the field of insurance defense. They are generally consistent with the changes that have been occurring within what has been called the corporate hemisphere of the bar.⁶⁴ The corporate world has become much more cost conscious vis-a-vis the legal services it buys. Corporations have built up in house counsel operations both as a means of direct cost saving (i.e., in house lawyers can do the work cheaper than outside counsel) and as a means of intelligently monitoring the work of outside counsel both for cost and quality.⁶⁵ What distinguishes insurance defense work from other legal services provided to corporations by law firms is the relatively low rates that insurers are able to obtain from the firms to which they refer work. The reason that other types of corporate work have not become “commodity” in nature is probably that the corporation is likely to incur some significant costs in shifting work from one firm to another because the current firm has acquired significant knowledge specific to the corporate client. The more routine, commodity nature of insurance defense work means that insurers do not incur these costs in changing legal service providers.

64. See HEINZ & LAUMANN, *supra* note 10, at 319-85 (describing the hemispheres of the legal profession); JOHN P. HEINZ ET AL., *URBAN LAWYERS: THE NEW SOCIAL STRUCTURE OF THE BAR* 29-37 (2005) (same).

65. See Robert L. Nelson & Laura Beth Nielsen, *Cops, Counsel, and Entrepreneurs: Constructing the Role of Inside Counsel in Large Corporations*, 34 *LAW & SOC'Y REV.* 457, 458-59 (2000) (explaining the changing and increased role of inside counsel); Robert Eli Rosen, “We’re All Consultants Now”: *How Change in Client Organizational Strategies Influences Change in the Organization of Corporate Legal Services*, 44 *ARIZ. L. REV.* 637, 670-71 (2002) (same).