LAWYERS AS CONTRACTORS—HOW MUCH CAN YOU CHARGE FOR THAT?

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CHAPTER 4
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**SPEAKING ENGAGEMENTS**

**State of Play: Being and Using a Contract Lawyer Within the Ethical Rules... If You Can Figure Them Out**, Texas Bar 3rd Annual Law Practice Management Course, Texas Bar CLE, November 5, 2009


**Setting Up and Maintaining Your Law Practice from Home**, Texas Bar Law Practice Management Section, Webcast, April 23, 2009

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I. INTRODUCTION

Outsourcing is a global trend, and as a lawyer you have probably outsourced some of your work at one time or another. If you have hired an attorney in another city to cover a hearing or an attorney to help with legal research, you have outsourced legal work. Outsourcing legal work to contract attorneys can provide an economic benefit for both a law firm and its clients. Today’s technology and economy allows attorneys to work remotely, and the legal profession has changed such that law firms no longer consist solely of partners and associates. Attorneys in a law firm can hold a variety of positions—partner, shareholder, member, senior counsel, associate, of counsel, part-time attorney, and contract attorney. When compensating attorneys in the firm, the law firm can pay attorneys an amount that still allows the firm to make a profit, and law firms do not usually have to disclose these financial arrangements to their clients. But the rules change when you engage outside, or non-firm, attorneys.

Law firms use outside attorneys when they need extra help without adding the expense of full-time staff. These attorneys are often hired to review documents, to appear as local counsel for an out-of-town hearing, to help out on a particular case or time of increased work, or to provide specialized knowledge in a particular area of law. According to the Professional Ethics Committee for the State Bar of Texas, compensation arrangements between law firms and contract attorneys must be disclosed and passed on to the client without an additional mark up if the contract attorney is not part of the law firm.1

This finding is contrary to both a 2000 ABA opinion2 and a 2008 ABA opinion3 relating to outsourcing legal work.4 The ABA has recognized that to make outside attorneys profitable to a firm, the firm must be able to charge the client more than the amount the firm paid to the contract attorney.5 By allowing a law firm to mark up this time, the law firm can recoup its costs of using the outside counsel—such as time spent researching, interviewing, and hiring the counsel, supervising the counsel, providing staff or other overhead support to the counsel, or providing office space or equipment to the counsel. As long as the fee charged to the client is reasonable, the ABA has no problem with the increased fee.6 Texas reached a different conclusion and approached the issue much differently than the ABA. This paper will discuss the differences between the Texas and ABA opinions and talk about what to consider when hiring contract attorneys.

II. TEXAS BAR OPINION 577

In March 2007, the Professional Ethics Committee for the State Bar of Texas looked at the question of whether a law firm may hire an outside lawyer and then charge more to the client for the work than the lawyer was paid.7 In other words, could the firm “mark up” the lawyer’s time?

The question the ethics committee addressed was:

May a law firm hire a lawyer who is not an associate, partner, or shareholder of the law firm to provide legal service for a client of the firm and then bill the client a higher fee for the work done by that lawyer than the amount paid to the lawyer by the firm?8

In answering this question, the Committee looked first at the Texas Disciplinary Rules number 7.01 dealing with practicing under a firm name and then turned its focus to Rule 1.04 dealing with the division of fees.9 The Committee concluded that a law firm may charge a client more for work done by lawyers that are “in” the firm than the lawyer is paid, but may not mark up the work done by non-firm lawyers.10

A. Practice under firm Name – 7.01(d)

Rule 7.01(d) prohibits lawyers from holding themselves out as members of a firm if they are not members of the same firm: “[a] lawyer shall not hold himself or herself out as being a partner, shareholder, or associate with one or more other lawyers unless they

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2 ABA Comm. on Ethics and Prof’l Responsibility, Formal Op. 00-420 (Nov. 29, 2000) (“ABA Opinion 00-420”).
4 It is also contrary to the standard in 48 other states. See Effectively Staffing Your Law Firm (Jennifer J. Rose ed., ABA 2009) at Chapter 6, n. 2 (Outsourcing Legal Research and Writing Projects by Lisa Solomon). Lisa Solomon is a legal research and writing attorney who works solely on a contract basis. See www.questionoflaw.net, last visited Sept. 13, 2009.
5 ABA Opinion 00-420 at ¶ 7.
6 Id.
7 See generally Opinion 577.
8 Opinion 577 at ¶ 1.
9 See TEX. DISCIPLINARY R. OF PROF.’L CONDUCT R. 7.01(d) and 1.04(f).
10 Opinion 577 at ¶ 13.
are in fact partners, shareholders, or associates.” Including attorneys on the client’s bill that are not members of the firm is prohibited by this rule unless the bill clearly states that the attorneys are not part of the firm.

B. Defining Non-Firm Lawyers

Next, the Committee turned its focus to Rule 1.04(f). Rule 1.04(f) prohibits attorneys from splitting fees with lawyers that are not “in” the same firm unless the fee splitting is disclosed and agreed to by the client. Although originally enacted to deal with referral fees and referring attorneys, the Committee applied this rule to contract attorneys and law firms that hire them.

In looking at Rule 1.04, the Committee decided that unless a contract attorney is “in” the firm, the law firm cannot profit from the contract attorney’s work—the firm must simply pass the cost of the contract attorney through to the client without a markup.

In order to determine whether a contract attorney is part of a law firm (a term not defined in the Rules), the Committee suggested several factors:

1. whether the attorney receives firm communications,
2. whether the attorney is included in firm events,
3. whether the attorney works at the firm or at another location,
4. whether the attorney has a history or long association with the firm,
5. whether the attorney identifies himself as a member of the firm,
6. whether the attorney is held out by the firm as being in the firm to clients and to the public, and
7. whether the attorney has access to the firm resources including computer data and applications, client files, and confidential information.

The Committee also provided examples of attorneys that could be considered “in” the firm: of counsel, senior attorneys, contract lawyers, and part-time lawyers.

C. Fee Splitting

After describing which attorneys can be considered “in” the firm, the Committee then turned its attention to billing a client for a non-firm lawyer’s time. The Committee’s primary focus related to splitting fees with non-firm lawyers.

Rule 1.04(f) requires attorneys that split fees to (1) split fees in proportion to the services performed or joint responsibility for the representation; (2) obtain written consent from the client to the terms of the fee division; and (3) charge a total fee that is not unconscionable. When law firms pay their “in” firm attorneys, fee splitting is not an issue. The financial arrangements within a firm are not disclosed to its clients, and they do not need to be. A firm can therefore charge the client more than the attorney is being paid, and the firm can split the fee with the lawyers in its firm.

But, according to the Committee, the requirements of Rule 1.04(f) come into play when the attorney is not “in” the firm. The Committee considers it fee splitting when a client is billed more for work performed by a non-firm attorney than the non-firm attorney is paid. In order to avoid violating Rule 7.01(d), the firm would have to state on the bill that the attorney was not a firm attorney and would have to comply with the requirements of Rule 1.04.

The Committee concluded that marking up the amount charged by a non-firm attorney without obtaining approval from the client is impermissible fee splitting. The Committee reasoned that a division of fees exists in this situation because “either the non-firm lawyer is sharing fees for his services with the law firm or the law firm is sharing a portion of its fees with the non-firm lawyer.”

But the Committee concluded that counsel for more than two law firms. Therefore if the contract attorney employed by the law firm works for more than two different firms, the attorney will not be able to be of counsel to all the firms.

The Committee included contract attorneys on the list of attorneys that could be considered “in” the firm. This implies that a contract attorney can be both in and out of the firm depending on the agreement between the firm and the contract attorney.

11 See TEX. DISCIPLINARY R. OF PROF.’L CONDUCT R. 1.04(f).
12 See Corey L. Marrs, Being a Contract Lawyer and How the Bar Does not Want You to Hire Me, News for the Bar (Litigation Section of the State Bar of Texas, Fall 2007).
13 Opinion 577 at ¶ 10.
14 Opinion 577 at ¶ 6.
15 Hiring contract lawyers as “of counsel” seems like a good way to avoid the issues of whether the attorney is “in” the firm. But Opinion 402 states that attorneys may not be of counsel for more than two law firms. Therefore if the contract attorney employed by the law firm works for more than two different firms, the attorney will not be able to be of counsel to all the firms.
16 The Committee included contract attorneys on the list of attorneys that could be considered “in” the firm. This implies that a contract attorney can be both in and out of the firm depending on the agreement between the firm and the contract attorney.
17 Opinion 577 at ¶ 6.
18 See TEX. DISCIPLINARY R. OF PROF.’L CONDUCT R. 1.04(f).
19 Opinion 577 at ¶ 7.
20 Id.
21 Opinion 577 at ¶ 10.
22 Opinion 577 at ¶ 11.
23 Opinion 577 at ¶ 10.
billing the time for a non-firm lawyer without a mark-up is not a division of fees.\textsuperscript{24} In that instance, “the law firm is billing, collecting, and paying over the fees charged by the non-firm lawyer for that lawyer’s services.”\textsuperscript{25}

III. ABA OPINION

While Texas focused primarily on fee splitting, the American Bar Association analyzed the use of contract attorneys differently. The question presented to the ABA in 2008 related to outsourcing legal work.\textsuperscript{26} The ABA had, in 2000, already concluded that a law firm may charge a client more for the work performed by a contract attorney than the contract attorney was paid as long as the fee charged to the client was reasonable.\textsuperscript{27} The ABA expanded on this opinion in 2008 when it addressed the issue of outsourcing legal work.

In Formal Opinion 08-451, decided on August 5, 2008, the ABA recognized that outsourcing work is a global trend in all businesses, including law. Outsourcing legal work allows law firms to provide quality service at reduced costs.\textsuperscript{28} According to the ABA, it also allows “for the provision of labor-intensive legal services by lawyers who do not otherwise maintain the needed human resources on an ongoing basis.”\textsuperscript{29} The ABA determined that as long as law firms and attorneys comply with all the ethical rules, there is no reason not to outsource legal work.

A. Supervising contract attorneys

First, the ABA noted that the Model Rules require a supervising attorney to make reasonable efforts to insure that the supervised attorneys conform to the Rules of Professional Conduct.\textsuperscript{30} These rules apply regardless of whether the supervised attorney is or is not a member of the firm.\textsuperscript{31} Although supervising contractors in the same city may be relatively easy, the task becomes more difficult when the contractors work at a remote location, such as in another city, state, or country.\textsuperscript{32}

To make sure that the legal work is performed by a competent attorney and to properly oversee the work, the ABA suggested that attorneys “consider conducting reference checks and investigating the background of the lawyer . . . providing the services” as well as any staffing agency used to procure the contractors.\textsuperscript{33} And, when dealing with a staffing agency, the attorney should “inquire into its hiring practices to evaluate the quality and character of the employees likely to have access to client information.”\textsuperscript{34} The ABA went even further and recommended that, depending on the sensitivity of the information being provided, the “lawyer should consider investigating the security of the provider’s premises, computer network, and perhaps even its recycling and refuse disposal procedures”, which may require a personal visit to the staffing agency’s facility to get a “firsthand sense of its operation and professionalism of the lawyers and nonlawyers it is procuring.”\textsuperscript{35}

B. Disclosing use of contract attorneys

Next, the ABA turned to whether a law firm must disclose the use of contract attorneys to its client. Although a client usually has the right to know who is representing it, if the contractor is closely supervised, the relationship does not need to be disclosed.\textsuperscript{36} The ABA considers an attorney to be closely supervised when the contractor would be disciplined or fired for misconduct.\textsuperscript{37}

In cases where the relationship is more attenuated, a firm cannot disclose confidential client information without client consent.\textsuperscript{38} Confidential information

\textsuperscript{24} Opinion 577 at ¶ 9.
\textsuperscript{25} Opinion 577 at ¶ 9.
\textsuperscript{26} ABA Opinion 08-451.
\textsuperscript{27} ABA Opinion 08-451 at ¶ 16; see also ABA Opinion 00-420.
\textsuperscript{28} ABA Opinion 08-451 at ¶ 3.
\textsuperscript{29} Id.
\textsuperscript{30} ABA 08-451 at ¶ 6.
\textsuperscript{31} Id.
\textsuperscript{32} Companies such as the Tusker Group in Austin employ attorneys in India for document reviews.

\textsuperscript{33} ABA 08-451 at ¶ 8.
\textsuperscript{34} Id.
\textsuperscript{35} Id. The ABA also noted that when hiring lawyers in foreign countries that “[c]onsideration should also be given to the legal landscape of the nation to which the services are being outsourced, particularly to the extent that personal property, including documents, may be susceptible to seizure in judicial or administrative proceedings notwithstanding claims of client confidentiality.” Id. at ¶ 10. Confidentiality should be considered when traveling internationally with confidential client information. The regulations at American borders—including interior borders at airports—now allow the search of laptops without reasonable suspicion. See United States v. Arnold, 523 F.3d 941 (9th Cir. 2008). The policies also allow officers to detain documents and electronics for “a reasonable period of time” so that the documents and electronics can be searched. See U.S. Customs and Border Protection Policy Regarding Border Search of Information, July 16, 2008. The search can take place at an off-site location. Id.
\textsuperscript{36} ABA 08-451 at ¶ 13
\textsuperscript{37} Id.
\textsuperscript{38} ABA 08-451 at ¶ 14.
cannot be shared because the implied consent to share information within a firm does not extend to people over whom the firm has no supervision and control.\textsuperscript{39} When confidential information must be disclosed to contractors, the law firm needs to obtain the client’s informed consent to use contractors. The firm will also need to perform a conflicts check and verify that the contractors do not do work for the client’s adversaries on the same or substantially the same matter.\textsuperscript{40}

Finally, like the Texas Committee, the ABA stated that the law firm cannot deceive the client and imply that the contractors are part of the law firm when they are not.\textsuperscript{41} No affirmative misrepresentations can be made to the client regarding the contractors’ status.

C. Fees

Next, the ABA looked at whether the fees charged to the client could be more than the fees paid to the contractors. The ABA concluded that the overarching requirement is that the fees charged be reasonable.\textsuperscript{42} In formal Opinion No. 00-420, the ABA had previously concluded that “a law firm that engaged a contract lawyer could add a surcharge to the cost paid by the billing lawyer provided the total charge represented a reasonable fee for the services provided to the client.”\textsuperscript{43}

In Formal Opinion 08-451, the ABA stated that its reasoning from its 2000 Opinion for why a law firm could mark up a contract attorney’s time was still valid: “the lawyer may bill the client only its actual cost plus a reasonable allocation of associated overhead, such as the amount the lawyer spent on any office space, support staff, equipment, and supplies for the individuals under contract.”\textsuperscript{44} The ABA concluded that the rationale for fees for outsourced legal services is no different for other outsourced legal services, except that the overhead costs associated with the provision of such services may be minimal or nonexistent if and to the extent that the outsourced work is performed off-site without the need of infrastructural support. If that is true, the outsourced services should be billed at cost, plus a reasonable allocation of the cost of supervising those services if not otherwise covered by the fees being charged for legal services.\textsuperscript{45}

If, however, a firm decides to bill the costs of using contractors as a disbursement rather than legal fees, the firm cannot mark up the cost of the services without a prior agreement from the client.\textsuperscript{46}

IV. TEXAS VS. THE ABA

The most glaring difference between the ABA opinion and the Texas opinion is the fee splitting analysis. Texas states that “a division of fees will exist when a law firm includes in its bills for work done by a non-firm lawyer and the amounts billed to the client for the non-firm lawyer’s work differ from the amounts billed by the non-firm lawyer to the law firm for such work.”\textsuperscript{47} This analysis ignores the reality of how contract attorneys are paid. Often contract attorneys are paid on the amount of time they bill the law firm—regardless of whether those costs are billed to or recovered from the client.\textsuperscript{48} When this occurs, the contract attorney is paid out of the net profits to the firm and not out of the gross fee paid by the client. The Texas requirement prohibits law firms from recovering time spent on finding, hiring, training, and supervising contract attorneys. All of this is part of the overhead associated with hiring contractors.\textsuperscript{49} Yet without being able to include a surcharge on the amount billed by the contractor, the firm will inevitably lose time and money hiring contractors. This does a disservice to a law firm’s clients.\textsuperscript{50}

The ABA, on the other hand, decided that the fee splitting rules do not prohibit a law firm from charging a client more than the contract attorney billed. The ABA concludes that a law firm “is not obligated to inform the client how much the firm is paying the contract lawyer; the restraint is the overarching requirement that the fee charged for the services not be unreasonable.”\textsuperscript{51} The ABA’s recognition that there are costs associated with outsourcing legal work is more in line with today’s economy.

\textsuperscript{39} Id.
\textsuperscript{40} ABA 08-451 at ¶ 15.
\textsuperscript{41} ABA 08-451 at ¶ 12.
\textsuperscript{42} ABA 08-451 at ¶ 16.
\textsuperscript{43} Id.
\textsuperscript{44} Id.
\textsuperscript{45} Id.
\textsuperscript{46} Id.
\textsuperscript{47} Opinion 577 at ¶ 10.
\textsuperscript{48} Corey L. Mars, Being a Contract Lawyer and How the Bar Does not Want You to Hire Me, News for the Bar (Litigation Section of the State Bar of Texas, Fall 2007).
\textsuperscript{49} Id.
\textsuperscript{50} See id. for a discussion of the ways in which hiring contract attorneys can save clients money and provide better services.
\textsuperscript{51} ABA 08-451 at ¶ 16.
V. WHAT TO CONSIDER WHEN HIRING CONTRACTORS

Looking at both the Texas opinion and the non-binding ABA opinion taken together provide the following helpful guidance for hiring outside attorneys:

1. **Do not deceive clients.**
   
   Make sure that the firm’s billing is not deceptive. If contract attorneys do not fit the Texas Committee’s opinion of which attorneys are “in” the firm, disclose this information. Also, if contract attorneys are not going to be closely supervised and their work is not going to be adopted by the supervising attorney, make sure this is disclosed.

2. **Supervise outside contractors.**
   
   A hiring attorney has an ethical obligation to supervise attorneys, whether or not the attorneys are part of the firm. When using outside attorneys, conduct reference checks, consider the security of confidential information, and run conflicts checks. Although the Texas opinion does not discuss supervising contractors, Texas attorneys are bound by the Disciplinary Rules of Professional Conduct.

3. **Safeguard confidential client information.**
   
   Unless the attorney works in your office, it can be difficult to safeguard confidential information against disclosure, even inadvertent disclosure. This can be managed in a number of ways. If confidential information is not necessary for the work being performed, the law firm may not need to give the contract attorney confidential information (i.e. a research project on an area of law). But, if the purpose of the contract attorney is to review documents for confidentiality, you should take additional steps to secure the documents, including disclosure to the client, consent from the client, and confidentiality agreements with the contractors.

4. **Fees must be reasonable.**
   
   Even though Texas does not permit a mark up on fees charged by contract attorneys without consent from and disclosure to the client, the overall fees charged must be reasonable.

5. **Understand the fee splitting rules.**
   
   Law firms seeking to hire contract attorneys need to be familiar with the rules related to fee splitting. In order to charge the client more than the contract attorney charges, the requirements of Rule 1.04(f) must be met.

6. **Know what your insurance covers.**
   
   Many insurance policies cover work performed by contract attorneys, but it is a good idea to have the contract attorney obtain a separate policy. Contract attorneys can purchase policies that cover work performed on non-contract matters at a relatively nominal rate.

7. **Be mindful of the unauthorized practice of law.**
   
   If the contract attorney is not licensed in Texas, the attorney can work for a Texas attorney, but he cannot practice law in Texas. This may not be an issue if the work done by the contract attorney is reviewed and adopted entirely by the supervising attorney, but be sure not to hold out the attorney as one who is licensed in Texas.

VI. CONCLUSION

The Texas Opinion’s analysis and conclusion regarding the use of contract attorneys is out of line with the current economic climate, the realities of law practice, the ABA, and forty-eight other states. Limiting the way Texas attorneys can bill for contract attorneys does a disservice to both lawyers and their clients. But as long as the Opinion 577 stands, Texas lawyers must be mindful of which attorneys are “in” the firm and how work performed by non-firm attorneys are billed to the client.