

November 29, 2000

**AMERICAN BAR ASSOCIATION STANDING COMMITTEE ON ETHICS AND
PROFESSIONAL RESPONSIBILITY**

Formal Opinion 00-420
Surcharge to Client for Use of a Contract Lawyer

November 29, 2000

When costs associated with legal services of a contract lawyer are billed to the client as fees for legal services, the amount that may be charged for such services is governed by the requirement of Model Rule 1.5(a) that a lawyer's fee shall be reasonable. A surcharge to the costs may be added by the billing lawyer if the total charge represents a reasonable fee for services provided to the client. When legal services of a contract lawyer are billed to the client as an expense or cost, in the absence of any understanding to the contrary with the client, the client may be charged only the cost directly associated with the services, including expenses incurred by the billing lawyer to obtain and provide the benefit of the contract lawyer's services.

Introduction

This opinion addresses whether under the ABA Model Rules of Professional Conduct, a lawyer who retains the services of a contract lawyer (hereinafter "retaining lawyer") may add a surcharge when billing a client for the cost of services provided by a contract lawyer.¹ A "surcharge" is made when the retaining lawyer charges the client more for the services of the contract lawyer than the cost incurred by the retaining lawyer for obtaining those services, either directly or through the contract lawyer's agency or employer; in other words, a surcharge is profit.

The term "contract lawyer" is used in this opinion to mean any lawyer retained by a lawyer or law firm who is not employed permanently for general assignment by the lawyer or law firm engaged by the client. The relationship between a retaining lawyer and a contract lawyer can arise

¹ In many instances, the fee and cost structure for a legal engagement is the subject of an agreement between a client and a lawyer. This agreement, or a disclosure concerning fees and costs, may be required by the rules in some circumstances discussed here. Whether or not an agreement exists between the lawyer and her client as to how the costs of a contract lawyer will be billed, those costs must be reasonable. Most of the conclusions reached in this opinion are based upon the presumption that no such specific agreement exists.

This opinion does not address whether and in what circumstances disclosure to the client of a relationship of the retaining lawyer with a contract lawyer is required. Although the Committee finds no requirement under the rules for disclosing the identity of specific personnel assigned to a client's matter absent client inquiry, the Committee recognizes that client expectations and the overall client-lawyer relationship may make such disclosure desirable.

November 29, 2000

in a variety of ways.² Contract lawyers may be engaged to work on one or more specific matters. They may be employed either by the firm directly or assigned by an independent organization. In either case, the contract lawyer functions as a part of the legal services delivery group and reports to a retaining lawyer. Other contract lawyers are retained as specialists or special counsel to perform a specific service in a specific matter. A lawyer may be required to engage a specialist to assure competent representation, or obtain the services of a lawyer in another jurisdiction to provide required opinions or other assistance to the retaining lawyer. The work of the contract lawyer may be performed on the premises of the retaining lawyer or elsewhere and the degree of supervision will vary, as will the contract lawyer's participation in the general practice activities of the retaining lawyer or law firm.

Services of a contract lawyer may be billed to the client either as fees for legal services or as costs or expenses incurred by the retaining lawyer. Whether the cost attributable to a contract lawyer is billed as an expense or included in legal services fees is not addressed by the Model Rules and does not seem to be a matter of ethics. When a contract lawyer's services are billed with the retaining lawyer's as fees for legal services, however, the client's reasonable expectation is that the retaining lawyer has supervised the work of the contract lawyer or adopted that work as her own.

Billing Contract Lawyer Services as an Expense

In ABA Formal Opinion 93-379 (Billing for Professional Fees, Disbursements and Other Expenses), the Committee stated that lawyers should disclose to their clients the basis for the fee and any other charges to the client. That opinion provides the following as guidance:³ fees for legal services should be inclusive of general office overhead in the absence of disclosure in advance of the engagement to the contrary;⁴ in the absence of disclosure, it is improper to assess a surcharge on disbursements over and above the actual payment of funds to third persons made by the lawyer on the client's behalf, unless the lawyer herself incurs additional expenses beyond the actual cost of the disbursement item;⁵ if a lawyer receives a discounted rate from a third party provider, it would be improper if she did not pass along the benefit of the discount to her client rather than charge the

² In ABA Formal Opinion 88-356 (Temporary Lawyers), *in* FORMAL AND INFORMAL ETHICS OPINIONS 1983-1998 35 (ABA 2000), the term "temporary lawyer" was used in examining the ethical obligations of law firms and temporary lawyers in general. The term was defined as meaning "a lawyer engaged by a firm for a limited period, either directly or through a lawyer placement agency." *Id.* at 35, n.1. This term would exclude lawyers who work part-time or full-time for an extended period for one firm exclusively, although without contemplation of permanent employment, as well as those who have an "of counsel" relationship or are associated as independent counsel on a particular case. It is the intent of this opinion to include any lawyer on temporary assignment for or associated on a non-permanent basis with a lawyer or law firm. As noted by Deborah L. Arron and Deborah Guyol, *Ethical Considerations Raised by the Use of Contract Attorneys*, *in* LAW PRACTICE MANAGEMENT, SOLO PRACTICE ISSUE, vol. 23, no. 1 (ABA, January/February 1997) (hereinafter "Arron and Guyol"), whether the temporary arrangement is short- or long-term makes little difference in applying ethical precepts.

³ See FORMAL AND INFORMAL ETHICS OPINIONS 1983-1998 at 216. The principles in Opinion 93-379 were based liberally upon the desirability of promoting the lawyer-client relationship rather than on any specific requirement contained in the Model Rules.

⁴ *Id.* at 223.

⁵ *Id.* See also State Bar of Michigan Committee on Ethics Opinion Number RI-241 (August 10, 1995).

November 29, 2000

client the full rate and reserve profit to herself when billing as a disbursement;⁶ in billing clients for fees and costs in connection with legal services, it is impermissible for a lawyer to create an additional source of profit for the law firm beyond that which is involved in the provision of professional services themselves (unless the client has agreed or consents otherwise).⁷

The analysis of billing expenses and disbursements in Opinion 93-379 is made in the context of goods or services of non-lawyers: expert witnesses, court stenographers, airfare, taxicabs, meals, hotel rooms, and internal expenses allocable to a client's matter for such things as photocopy paper, computer time, and messenger services. Thus, Opinion 93-379 does not speak directly to the subject of this opinion, contract lawyers, in the context of disbursements or expenses. We conclude in this opinion that the principles of Opinion 93-379 equally are applicable to surcharges for legal services provided by contract lawyers when billed to the client as a cost or expense.

Billing Contract Lawyer Services as Legal Services

Paragraph (a) of Rule 1.5 (Fees)⁸ provides the overarching requirement that a lawyer's fee shall be reasonable and sets forth a list of factors to be considered in determining the reasonableness of a fee. The rule specifically does not address the individual components that, taken together, determine the actual amount of any legal fee, such as costs associated with delivering the legal services, or the part of a fee that might constitute the lawyer's profit. Certainly, the absence of a specific reference to a lawyer's profit in Rule 1.5 cannot reasonably be read to prohibit a lawyer from including a profit factor in her fees. It is implicit in Formal Opinion 93-379 that profit from providing legal services is expected and appropriate, as long as the total fee is reasonable.

Disclosure to a client of the basis or rate of a legal fee is required in Rule 1.5(b) and in Rule 1.5(c) applicable to contingent fees. Rule 1.5(b) provides that "when the lawyer has not regularly

⁶ *Id.* at 223.

⁷ *Id.* at 224.

⁸ Rule 1.5(a) provides:

(a) A lawyer's fee shall be reasonable. The factors to be considered in determining the reasonableness of a fee include the following:

(1) the time and labor required, the novelty and difficulty of the questions involved, and the skill requisite to perform the legal service properly;

(2) the likelihood, if apparent to the client, that the acceptance of the particular employment will preclude other employment by the lawyer;

(3) the fee customarily charged in the locality for similar legal services;

(4) the amount involved and the results obtained;

(5) the time limitations imposed by the client or by the circumstances;

(6) the nature and length of the professional relationship with the client;

(7) the experience, reputation, and ability of the lawyer or lawyers performing the services; and

(8) whether the fee is fixed or contingent.

November 29, 2000

represented the client, the basis or rate of the fee shall be communicated to the client, preferably in writing, before or within a reasonable time after commencing representation."⁹ Although Rule 1.5(b) requires communication with the client concerning fee basis and rate only when the client has not been represented regularly, the Committee believes that the spirit of this rule best is served by communication whenever the fee basis or rate structure for services provided to a regularly represented client changes.¹⁰

Some of the ethical issues affecting a retaining lawyer in her relationship with a temporary lawyer were addressed in ABA Formal Opinion 88-356.¹¹ The opinion discussed at length issues of fee sharing and disclosures required under Rule 1.5(e),¹² but the subject of surcharges on fees paid for services of contract lawyers was not subjected to analysis in the context of billing practices.¹³ In discussing payments made to a temporary lawyer placement agency, including the temporary, lawyer's compensation, Opinion 88-356 stated:

A legal fee is paid by a client to a lawyer. Here the law firm bills the client and *is paid a legal fee* for services to the client. The fee paid by the client to the firm ordinarily would include the total paid the lawyer and the agency, and *also may include charges for overhead and profit*.¹⁴

⁹ DR2-106 contained substantially the same factors listed in Rule 1.5(a) to determine reasonableness, but did not require that the basis of the fee be communicated to the client "preferably in writing" as does Rule 1.5(b). It is apparent that the reasonableness of a fee may be influenced by what services are provided by the retaining lawyer in relation to what is effectively "subcontracted" and billed as an expense. For example, if a lawyer representing a client in a contingent fee matter contracted out all work except for the trial itself and passed along contract lawyers' work as expenses over and above the contingent fee, the reasonableness of the resulting cost of legal services to the client would be subject to examination, even assuming compliance with Rule 1.5(c). Courts generally will not enforce contingent fee contracts that result in fees not reflecting the reasonable value of services. See ROBERT L. ROSSI, ATTORNEY'S FEES § 5.15 (2d ed. 1995). The same analysis pertains to any fee arrangement.

¹⁰ Both Rule 1.5(b) and DR2-106 require communication with the client when not regularly represented by the lawyer. In the RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 50 (2000) ("the Restatement"), a lawyer is required to communicate the fee basis to the client before or within a reasonable time after beginning to represent the client *in a matter*, unless the lawyer previously has represented the client on the same basis or at the same rate as would be proposed. Thus, the standard expressed in the Restatement would require communication of any different fee basis as to successive matters for the same client.

¹¹ See *supra* text accompanying note 2.

¹² Rule 1.5(c) provides:

(c) A division of a fee between lawyers who are not in the same firm may be made only if:

(1) the division is in proportion to the services performed by each lawyer or, by written agreement with the client, each lawyer assumes joint responsibility for the representation;

(2) the client is advised of and does not object to the participation of all the lawyers involved; and

(3) the total fee is reasonable.

¹³ FORMAL AND INFORMAL ETHICS OPINIONS 1983-1998 at 44-47.

¹⁴ *Id.* at 46 (emphasis supplied).

November 29, 2000

Neither Rule 1.5(e) nor Rule 1.5(b) would require disclosure to the client of the share of the fees each lawyer receives when fees for services are being divided, or of the relationship between the costs of a lawyer assigned to work on a matter and the billing rate for that lawyer.

Opinion 88-356 may be read to imply that where charges incurred by the retaining lawyer for temporary lawyers are billed to the client as an expense or disbursement, the client must be advised of the *compensation* arrangement between the retaining lawyer and the contract lawyer or the contract lawyer's agency.¹⁵ There is no provision in the rules that requires disclosure of how disbursements are calculated,¹⁶ or that distinguishes different duties of disclosure of the involvement of contract lawyers predicated on how their services will be charged to the client. Opinion 88-356 should be regarded as supporting the conclusion that the role of contract lawyers retained to work on a client's matter(s) should be disclosed to the client (when not otherwise required by Rules 1.5(b), 1.5(c), or 1.5(e)) based on the relationship of the contract lawyers with the firm, particularly when the work of the contract lawyer will not be supervised within the justifiable expectations of the client. The bases for disclosure, independent of Rule 1.5, are found in Rule 1.2(a) (Scope of Representation), requiring discussion with the client concerning the means by which the representation is pursued; Rule 1.4 (Communication), a general requirement for communication concerning the representation; and Rule 7.5(d) (Firm Names and Letterheads), which prohibits misrepresenting a relationship among lawyers.

The matter of surcharges on legal fees has been considered in several jurisdictions. Recent ethics opinions in Virginia, Colorado, and the District of Columbia¹⁷ have approved the right of a retaining lawyer to charge the client more for the services of a contract lawyer than is paid to the contract lawyer when those costs are billed to the client as legal services, subject only to the obligation of Rule 1.5(a) to charge a reasonable fee. There is no duty to disclose the surcharge when the work of the contract lawyer is supervised or, absent supervision, when the work of the contract lawyer is adopted as the work of the retaining lawyer.

¹⁵ Many state and local bars have taken the position that the use of a contract or temporary lawyer always must be disclosed to the client, *e.g.*, Los Angeles County Bar Association Formal Opinion 473 (1993); Ohio Bd. of Commissioners on Grievances and Discipline Opinion No. 90-23, 1990 WL 640499 (December 14, 1990); New Hampshire Opinion 1989-90/9 (Feb. 25, 1990); Association of the Bar of the City of New York Committee on Professional and Judicial Ethics Formal Opinion 1989-2 (May 10, 1989); *see also* *Oliver v. Board of Governors, Ky. Bar Ass'n*, 779 S.W.2d 212, 216 (Ky. 1989) (cited in Arron and Guyon at 34, *supra* note 2 and accompanying text). Arron and Guyon conclude that a conservative reading of the requirements of Rule 1.5(c) suggests that disclosure is necessary whenever a contract lawyer's work is paid for by the client, regardless of whether it is paid as a disbursement or included in legal services. Illinois State Bar Advisory Opinion 98-02 (September 1998) apparently construes Formal Opinion 88-356 as meaning that disclosure is required when a contract lawyer is not working under close supervision or payment is charged as a disbursement.

¹⁶ *See* FORMAL AND INFORMAL ETHICS OPINIONS 1983-1998 at 222-23. Although Opinion 93-379 does not attach any significance to the word "disbursement," the Committee suggests that use of that term denotes what has been spent by the billing lawyer, as distinguished from an expense incurred by the billing lawyer. "Expense" may be a more comprehensive term that would include charges for additional costs directly associated with a particular disbursement.

¹⁷ Virginia Legal Ethics Opinion 1735 (October 20, 1999); Colorado Bar Association Ethics Committee Formal Opinion 105 (May 22, 1999); Virginia Legal Ethics Opinion 1712 (July 22, 1998); District of Columbia Bar Legal Ethics Committee Opinion 284 (Sept. 15, 1990).

November 29, 2000

Each of these recent opinions also expressly or impliedly observes that it is improper to add surcharges on payments made to a contract lawyer when billed to the client as disbursements unless there is an agreement with the client or disclosure about a markup in advance of the billing. Virginia Opinion 1712 suggests that rather than bill a placement agency's fee as a disbursement with a disclosed markup, the firm simply should bill for services in an amount reflecting the marked-up charge.¹⁸

Conclusion

Subject to the Rule 1.5(a) mandate that "a lawyers fee shall be reasonable," a lawyer may, under the Model Rules, add a surcharge on amounts paid to a contract lawyer when services provided by the contract lawyer are billed as legal services. This is true whether the use and role of the contract lawyer are or are not disclosed to the client. The addition of a surcharge above cost does not require disclosure to the client in this circumstance, even when communication about fees is required under Rule 1.5(b). If the costs associated with contracting counsel's services are billed as an expense, they should not be greater than the actual cost incurred, plus those costs that are associated directly with the provision of services, unless there has been a specific agreement with the client otherwise.

This opinion is based on the Model Rules of Professional Conduct and, to the extent indicated, the predecessor Model Code of Professional Responsibility of the American Bar Association. The laws, court rules, regulations, codes of professional responsibility, and opinions promulgated in the individual jurisdictions are controlling.

AMERICAN BAR ASSOCIATION STANDING COMMITTEE ON ETHICS AND PROFESSIONAL RESPONSIBILITY. 541 North Fairbanks Court, 14th Floor, Chicago, Illinois 60611-3314 Telephone (312)886-5300 CHAIR: Donald B. Hilliker, Chicago, IL • Loretta C. Argrett, Washington, DC • Jackson M. Bruce, Jr., Milwaukee, WI • William B. Dunn, Detroit, MI • James W. Durham, Philadelphia, PA • Mark I. Harrison, Phoenix, AZ • Daniel W. Hildebrand, Madison, WI • William H. Jeffress, Jr., Washington, DC • Bruce Alan Mann, San Francisco, CA [through 2000] • M. Peter Moser, Ballimore, MD • CENTER FOR PROFESSIONAL RESPONSIBILITY: George A. Kuhlman, Ethics Counsel; Eileen B. Libby, Associate Ethics Counsel

¹⁸ In *Mahaney, Geghan & Roosa v. Nelson J. Baker*, No. CR 970138281 (Conn. Super. August 9, 1999), the court determined that a lawyer who employed the services of contract lawyers for special assistance in a litigation matter, disclosing their involvement to the client, could not charge the client the hourly rate agreed upon by the client and the billing lawyer for the case when the retaining lawyer paid for services provided at a lesser hourly rate. The charges were not billed as disbursements, but as services. The court based its conclusion on the fact that the retaining lawyer and the contract lawyers formally were not affiliated in practice. The court's discussion does not disclose the entire terms of the fee contract. In the report of the case, no reference is made to rules of professional conduct. In the Committee's view, the formality of affiliation of lawyers does not govern the right to add a surcharge to services under the Model Rules.