Michael C. Ross

Ethics Issues Arising Between the Law Firm and Its Client

By Michael C. Ross

Jim Roethe, former General Counsel at Bank of America and litigation partner with Pillsbury, Winthrop, Shaw Pitman, and I recently taped a CLE program entitled "Professional Relationship and Ethics." We discussed some ethical issues that may arise between the client and the law firm in billing, staffing, litigation discovery, lawyers' financial interests and back-dating documents. Below is a brief summary of our discussion.

Billing Rates

Many law firms have different hourly rates for different clients, and different rates for the same client depending upon whether the client is being reimbursed by a third party for the bill. Although there is nothing inherently unethical about these different rates, ABA Model Rule 1.5 prohibits "unreasonable" fees, and outside counsel should be sure that clients understand the basis for the rate.

Different hourly rates are often based upon the volume of work done for a client and the nature of the relationship. New clients and clients with little volume will likely understand why they are paying a higher hourly rate than long-standing clients that have made volume commitments to the firm. The firm should, however, exercise care in describing the rate. Labels in an engagement letter like "standard" or "discount" may be ambiguous; describing a rate as "most favorable" may later prove false.

"Padding" and Overestimates

Most large law firms have express expectations for the number of billable hours attorneys will work each year. Lawyers' progression and bonuses are, in varying degrees, dependent upon meeting or exceeding those expectations. This creates pressure on attorneys to meet or exceed expectations and temptations to "pad" or overestimate time spent working for a client. There is also pressure on billing attorneys to bill as much of the logged time as possible.

Most matters are still billed by the hour, and there is an inherent (at least short-term) conflict of interest between the firm and the client. It is, therefore, incumbent upon law firms to counterbalance the pressures described above with strong emphasis upon the importance of ethical values. The firms should train their attorneys to ensure that hours are logged accurately and that hours billed are reasonable.

Non-Billable Time

Some clients refuse to pay for certain time spent by attorneys. One of the most common examples is attorney conferences, despite the fact that they may be very efficient and effective. Nonetheless, if the law firm agrees to the client's condition, the firm's alternatives are limited. The firm can use alternatives, explain to the client the difficulties, and try to persuade the client to change its condition. If the non-billable time is spent, the firm can show that time on the bill and write it off or seek an exception to the condition. The firm should not, however, encourage its attorneys to find creative ways to describe the time spent that makes it appear that non-billable time is something else.

Over-staffing

Law firms' billing mainly by the hour also raises the specter of overstaffing. In view of the firms' short-term interest in being paid as much as possible for each matter, some attorneys may have a tendency, possibly unconscious, to employ other attorneys freely on matters. The solution, as with billing, is timely, clear communications between the firm and its client. In the engagement letter, budget and periodic reviews, clients should make their desires clear, and law firms should keep clients well-informed of staffing decisions and changes.

Departing Attorneys

A potentially difficult issue arises when an attorney decides to leave the firm. A common

example is the associate who decides to leave early in the next calendar year but stay around to collect a bonus for the current year. In order to avoid having the departure decision reduce the amount of the bonus, the attorney does not tell the firm of his or her decision. The problem occurs when that attorney is asked to take on a project that will last longer than he or she will be with the firm. If the attorney accepts the assignment and leaves the firm as planned and before completion of the project, the client's interests are likely to suffer. Although the firm can, after the fact, discount the bill to offset inefficiencies caused by the staffing change, there may be nothing to be done about adverse effects on the quality of the work. Accordingly, it behooves the departing attorney to advise the assigning attorney of the departure plans so that he or she can decide whether to find another attorney or seek the client's prior consent to the staffing decision.

Alcohol and Drug Abuse

Another difficult situation arises if an attorney is suffering from alcohol or drug abuse or another condition that is likely to impair the attorney's ability to render competent and diligent service (required by ABA Model Rules 1.1 and 1.3, respectively). In some cases, the attorney is engaged in or has completed rehabilitation and is still working. If the law firm advises the client of the situation (presumably with the affected attorney's consent), the client may insist on alternative staffing and discounts for work done to date by the affected attorney. If the firm does not disclose the situation to the client, it is taking a significant risk of future claims by the client. In hindsight, anything that goes wrong will be attributed to the attorney's condition.

Litigation Discovery

Perhaps more than ever, there seems to be a great deal of pressure on companies and their outside counsel in litigation to win at all costs. ABA Model Rule 3.1 (Meritorious Clams and Contentions), 3.2 (Expediting Litigation), 3.3 (Candor Toward the Tribunal), and 3.4 (Fairness to Opposing Party and Counsel) offer countervailing ethical values.

Technological advances and developments in the case law have made discovery of electronic documents burdensome on litigants and their counsel. Difficult questions arise about where and how to search for responsive electronic documents. Clients bear responsibilities for knowledge of internal systems and organization charts. Outside counsel bears responsibilities for litigation strategy and adherence to legal and ethical standards. It is important that there be a clear understanding of the allocation of responsibilities between client and law firm, and clear communications regarding specific discovery response decisions. The alternative could be as severe as the trial results in the highly publicized case involving Ron Perelman and Morgan Stanley.

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Document Retention

The now notrious cases involving Arthur Anderson in its representation of Enron, and Frank Quatrone taught some lessons regarding communications about a company's document retention policy. Litigation and government investigations are subject not only to ethical rules but also criminal laws prohibiting obstruction of justice. When an investigation or lawsuit is imminent, "reminders" about the company's document retention policies are highly likely to be viewed by opposing counsel, prosecutors, judges and juries as suggestions to destroy documents that would be damaging to the company's case.

Outside Counsel Financial Conflict of Interest

Publicity regarding the Boies firm's role in the Adelphia case has raised the issue of the propriety of undisclosed investments by outside attorneys and their family members in companies that provide legal support services to the firm's client. After the fact disclosure of the investment seems to lead to complaints about the cost and quality of the work done by the support firm.

This case could lead law firms to try to learn and keep track of investments by the firm's attorneys and their families, an enormous undertaking for large firms. As a practical matter, however, there is an actual conflict only if the attorney involved in the decision to hire the support firm knows (or reasonably should have known) of the financial interest, and the financial interest is material to the investor. Accordingly, clients will not want firms to go to the expense of establishing and maintaining a database of investments by their attorneys and their families because the cost would be reflected in higher rates.

Back-dating Documents

Recent cases in the press raise the issue of when back-dating documents can lead counsel into unethical

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and, perhaps, illegal conduct. The prosecution of Computer Associates involved alleged changes in the dates of purchase agreements that misrepresented statements of financial results. The investigation of Mercury Interactive involves alleged changes in the dates of grants of options to management in order to reduce the exercise price of the options.

Outside and inside counsel must understand the circumstances surrounding the dating of transactional documents. Often a transaction is dated "as of" a certain date and signed at a later date, with the date of signing clearly reflected on the document. In other cases, the date of a transaction is changed solely to create the desired financial result. Accordingly, counsel must inquire into the circumstances and consider the effects of the dating upon affected constituencies, such as, investors, the SEC, and the IRS. As some attorneys have found out the hard way, documenting a back-dated transaction for a client can lead to complicity in fraud. ◆

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