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Recent Developments in Ethics for In-House Counsel

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In April, 2011, the author published an article in the CCI newsletter entitled "Recurring Ethical Issues for In-House counsel." That article is attached as an appendix. This paper focuses on recent Texas ethics opinions, and how they might affect in-house counsel.

I. BILLING, ENGAGEMENT LETTER, AND FEE ISSUES.

Given the recent economy, it is not surprising that many of the opinions issued recently by the Supreme Court of Texas Professional Ethics Committee deal with fees and other issues regarding engagement.

A. A firm generally cannot make a profit on costs unless the client agrees. State Bar Ethics Committee Opinion 594 (February 2010).

1. Opinion 594, consistent with ABA Opinion 93-379, states generally that a firm cannot mark-up and make a profit on costs.

2. The Opinion deals with a situation where a contingency fee lawyer negotiated a pre-existing medical bill down from $5,000 to $500, but still took the full $5,000 "off the top" as per his engagement letter. Not surprisingly, this was found to be unethical because the client did not consent, after full disclosure, to pay $5,000 for a $500 cost.

3. The opinion leaves open the loophole that if the client agrees after full disclosure, then the firm could make a profit on third-party costs. The ABA opinion makes clear, however, that general overhead should be included in fees and those amounts cannot be marked up. (There was once a great article in the ABA Journal calling criticizing this practice and referring it to as "Skaddenomics.")

4. As a client, this means you need to carefully review engagement letters. If the outside lawyer puts in the engagement letter that it will be marking up third-party costs and you sign the letter, then this would be "agreed to" under the opinion and perfectly acceptable. You should consider deleting any such language out of an engagement letter you sign.

B. The engagement letter controls over a court award of fees. State Bar Ethics Committee Opinion 588 (September, 2009).

1. The Opinion deals with a situation where the engagement letter provided the lawyer got one third of the total recovery. The court awarded damages and fees in the same amounts, thus the fees awarded were half of the total recovery. The lawyer inquired as to whether it was "unethical" for him to honor his contingent fee agreement, as if he only kept a third of the total recovery then a portion of the court-awarded fees would be given to the client.

2. The Opinion holds the lawyer to his contract, and he is only allowed to keep the third for which he contracted, and notes that awards of fees are typically to the client in the first instance, and it is the client who is paying the lawyer, not the other way around.

3. You know this is not the answer the lawyer was seeking when he asked, but he gets points for creativity for trying to frame it as an ethical issue!

4. Although not addressed in the Opinion, the corollary of this is also usually true—if the third of the total recovery was more than the fees awarded, the lawyer would get to keep the full third.

5. An exception might occur if the court made specific findings that certain fees were not reasonable—there would certainly be an argument by the client that if the fees were not reasonable, it would be unethical for the lawyer to charge the client for them.

6. Thus for example, if your outside counsel prevails on a motion for fees but the court awards less than you have been billed on the grounds that they fees were not "reasonable," you might want to address the issue with outside counsel.

C. Fees cannot be shared with a suspended lawyer. State Bar Ethics Committee 592 (January, 2010)

1. Under this Opinion, a fee splitting arrangement that is entered into with a suspended lawyer (unknown to the other lawyer) is not enforceable as a matter of ethics.

2. Query what might happen if the suspended lawyer never returned to practice, and sued for his share? The contract may well be void as against public policy, but the Opinion does not address that issue.

3. As in-house counsel, you certainly should not participate in compensating a lawyer that is suspended from the practice of law, as this would be a violation of Rule 5.05(b) (assisting in the unauthorized practice of law).

D. Arbitration Agreements in engagement letters are generally binding. State Bar Ethics Committee 586 (October, 2008) and 580 (March, 2008)

1. Opinion No. 586 provides that arbitration clauses in engagement letters are generally binding as a question of ethics.

2. The opinion notes, however, that the law is unclear on whether an arbitration clause in an engagement letter would be binding regarding a malpractice claim where the client did not have separate representation under the Texas Arbitration Act.

3. As a matter of ethics, the arbitration clause is only valid if the client understood its significance, as required by Rule 1.03(b). (As a practical matter, this is likely the lawyer's burden if the client claims it did not understand. If the client is a layman, this burden is quite high; if the client is in-house counsel, it will likely be met by the outside lawyer).

4. This will get the lawyer away from a jury, but the engagement letter cannot go farther and, for example, waive punitive damages as that would violate Rule 1.08(g).

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