Considerations in OUTSOURCING LEGAL WORK

"OUTSOURCING" is sending work traditionally handled inside a company or firm to an outside contractor for performance. A company or firm may have any number of reasons for outsourcing, but the most common are: (1) convenience, e.g., the outsourcing contractor is able to perform on a schedule that meets the company's needs; (2) financial, e.g., the outsourcing contractor is able to perform the volume of work at better rates, or saves money for expenses;[1] or (3) problem solving, e.g., the outsourcing contractor is able to accommodate special needs that would otherwise require an infrastructure commitment if the company performed the service itself.

BY MARCIA L. PROCTOR

Law firms are familiar with certain kinds of outsourcing. For example, a law firm or a law department of a business may "outsource" investigative services, temporary secretarial services, or litigation support services. Law firms have also "outsourced" legal services through co-counsel arrangements, local counsel arrangements for out-of-state matters, and temporary lawyer service agencies.

The most recent outsourcing wave is to send work traditionally performed by United States law firms to other countries. The Internet makes it possible for parts of a project to be assembled from multiple countries and multiple time zones, with little disruption. This extraterritorial outsourcing has elements in common with other independent contractor/vendor arrangements, and adds a layer of unique issues. Whether a lawyer is inside counsel for a company looking to save money, or outside counsel considering leveraging services, the lawyer remains responsible for fully counseling the client regarding the pros and cons of outsourcing legal work,[2] and if the client wishes to pursue outsourcing, the lawyer must proceed competently and may even retain imputed responsibility for the outsourced work.[3] If the contract lawyer is not licensed to practice law in the United States, U.S. ethics rules may not apply to that person, but would still apply to the lawyer who outsourced the work.

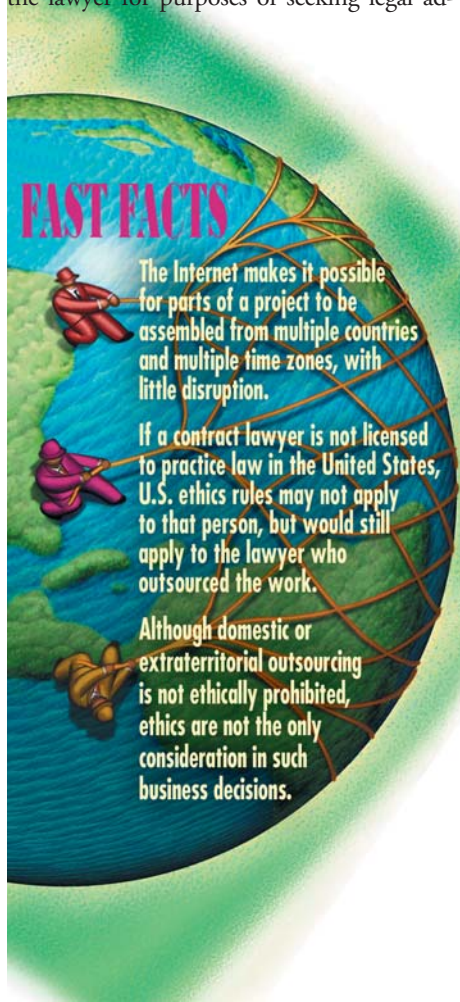
ABA Formal Opinion 88-356 provides a valuable overview of the types of ethics concerns that arise in contracting legal work, when the contract lawyer is bound by U.S. ethics rules. In addressing the implications of "temporary lawyers," the ABA opinion concluded that ethics rules were implicated as follows: (1) avoiding conflicts of interest; (2) maintaining confidentiality of information relating to the representation of clients; (3) disclosing to clients the arrangement between the lawyer and the firm in some circumstances; and (4) maintaining professional independence of the lawyer performing the work, from the non-law company to which the fee is paid. Those guidelines will not be repeated here.

For extraterritorial outsourcing, the hiring firm must know whether the individuals who perform the work are "lawyers" or "nonlawyers" for purposes of determining the hiring firm's ethics duties. If the contract individuals are "nonlawyers," MRPC 5.3 is relevant. The hiring firm must *"make reasonable efforts"* to ensure that the conduct of the contract individuals is *"compatible"* with ethics rules, and the hiring firm may be responsible for contractor conduct that violates ethics rules if the hiring firm orders, has knowledge of, or ratifies the conduct. If the contract individuals are "lawyers," then MRPC 5.1(c) is relevant. Again, the hiring firm may be responsible if it orders, has knowledge of, or ratifies contractor conduct that violates the rules. In order to fulfill these duties, the outsourcing contract itself should incorporate the ethics duties pertinent to the work contracted.

A lawyer's ethics duties for confidentiality go beyond the business concept of protecting proprietary information and preserving customer data. Under MRPC 1.6(a) and (b), a lawyer must protect both confidences (privileged information) and secrets (other information gained in the professional relationship and embarrassing or detrimental to the client).

In the United States, "privilege" protects any communication between the client and the lawyer for purposes of seeking legal advice. In other countries, privilege may be only a matter of contract,[4] of company policy,[5] or may exist only with outside counsel.[6] If the hiring firm intends to protect its client information under United States laws, that should be specified in the outsourcing contract. To avoid inadvertent or involuntary disclosure of confidences or secrets, both the outsourcing firm and the persons who work on the particular client matter should be trained to understand the difference between American concepts of "privilege" and mere "confidentiality."

The ethics rule also requires protection of client "secrets." In some cultures, it may be common to display the amount of money one has, to brag about important business ventures, or share work information with coworkers and family. These cultures may not appreciate or realize that revealing information about a matter can be embarrassing or detrimental.



Disclosure of Outsourcing

Outsourcing arrangements made by inside counsel are disclosed to the organizational client through its internal contracting and accounting procedures. Disclosure is not an issue.

Outsourcing by private law firms is not as apparent to the client. Although ethics authorities do not require disclosure of the details of the outsourcing arrangement, ABA Formal Opinion 88-356 concluded that the fact of outsourcing should be disclosed:

- when the temporary lawyer performs without the close supervision of a firm lawyer, "because the client, by retaining the firm, cannot reasonably be deemed to have consented to the involvement of an independent lawyer."
- when the temporary lawyer's fee is directly billed to the client as a disbursement, instead of the lawyer firm paying the compensation.
- when the arrangement between the firm and the temporary lawyer involves a direct division of the actual fee paid by the client.[7]

ABA Formal Opinion 00-420 also would require disclosure of outsourcing if the law firm surcharges the client for the work of the outsourced firm and bills the services to the

client as a disbursement. As long as the total fee is reasonable, the contracting firm would not have to disclose a surcharge on the contracting lawyer's work if billed as legal services.

Fee Arrangement

Some extraterritorial outsourcing firms may be overseas law firms, while some, like agencies handling temporary lawyers, may be operated by nonlawyers. ABA Formal Opinion 88-356 concluded that an arrangement whereby a law firm pays to a temporary lawyer compensation in a fixed dollar amount or at an hourly rate, and pays a placement agency a fee based upon a percentage of the lawyer's compensation, does not involve the sharing of legal fees by a lawyer with a nonlawyer in violation of Rule 5.4, distinguishing the payments as follows:

> *"The temporary lawyer is paid by the law firm for the services the lawyer performs under supervision of the firm for a client of the firm. The placement agency is compensated for locating, recruiting, screening and providing the temporary lawyer for the law firm just as agencies are compensated for placing with law firms nonlawyer personnel (whether temporary or permanent)."*

The Opinion also reasoned that there is no direct payment of a "legal fee" from the client to the temporary lawyer or to the placement agency, both of which are billed by and paid to the law firm.

ABA Formal Opinion 93-379 addressed billing expenses and disbursements in the context of goods or services of nonlawyers. The Opinion concluded that lawyers should disclose to their clients the basis for the fee and any other charges to the client, including:

- Fees for legal services should be inclusive of general office overhead in the absence of disclosure, in advance of the engagement to the contrary.
- 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 incurs additional expenses beyond the actual cost of the disbursement item.
- If a lawyer receives a discounted rate from a third-party provider, it would be improper if he or she did not pass along the benefit of the discount to the client.
- 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, absent client consent.

ABA Formal Opinion 00-420 adopts those standards for contracted lawyer services, but distinguishes billing a contract lawyer as legal services from billing the contract lawyer as a disbursement:

> *"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."*

Independent Judgment

When outsourcing legal services to a nonlaw company, the outsourcing contract should specify that the nonlawyers will not interfere with the independent professional judgment of the contract lawyers. Sometimes the outsourcing firm may prescribe or limit the amount of time the lawyer spends, control format, or otherwise affect either access to information that may be useful in performing the work or the content of the work product before it is released to the contracting firm. ABA Formal Opinion 88-356 even suggests that "the law firm must make certain that the compensation received by the temporary lawyer, whether paid directly by the firm to the lawyer or paid by the placement agency to the lawyer from sums which the firm pays the agency, is adequate to satisfy the firm that it may expect the work to be performed competently for the firm's clients."

Independent professional judgment should also be protected when determining

whether to outsource legal work. "Independent professional judgment" does not just mean lawyer independence from other clients and the lawyer's own interests. It also means professional independence from *this* client, i.e., providing advice regarding the implications of the client's own business judgment regarding the rendering of legal services.[8] When a lawyer makes a decision based upon the client's business needs instead of legal needs, independent professional judgment can be compromised.

Other Factors

Extraterritorial outsourcing of legal work requires additional due diligence concerning the candidate outsourcing company and the lawyers performing the actual work. Is the contract company on solid financial footing? Will it be in business in five years? Who are its main competitors and what distinguishes them? Who are its main customers? Where do their contract lawyers come from? The hiring firm should have a backup plan in place in the event the contracted firm defaults on its obligations because of financial problems, lack of experience or capability, or is acquired by a competitor of the contract firm.

The hiring firm should also have an understanding of the lawyering laws of the country in which the work will be performed. Whereas the license of a temporary lawyer may be verified in the United States, it is more difficult to do so in other countries. First, the legal training to become a lawyer will differ from country to country. The American Bar Association and the State of Michigan do not always consider the legal education from other countries to be comparable to U.S. legal training for purposes of licensure.[9] Even if the legal training would otherwise be comparable, licensing rules may differ.[10] To ensure the quality of work performed, as well as to apply ethics rules according to whether the outsourcing worker is a "lawyer" or "nonlawyer," the U.S. lawyer contemplating outsourcing must know something about the lawyering requirements of the jurisdiction where the work will be performed, and the credentials of the people who will actually perform the contracted work.

The hiring firm should have an understanding of the culture and business practices in the jurisdiction in which the work is being performed. In some countries, bribing public officials and paying for preferential treatment is accepted, while United States laws may forbid such activities.[11] The outsourcing firm needs to diligently monitor work quality and personnel identity.

A hiring firm should also consider remedies in the event of breach. In the United States, the risk of losing a client, malpractice judgments, or disciplinary action may be sufficient deterrents, but are of little concern to an extraterritorial contractor. The hiring firm might consider contract terms, such as alternate dispute resolution, liquidated damages, escrow funds, or indemnification. Specific provision should be made for notice of work interruption, etc., and for the return of work product and source material.

> *"Businesses enter into outsourcing arrangements expecting the service provider to perform the outsourced services in certain ways. The downside of outsourcing arises in those situations where the service provider does not perform as anticipated by the business. The ultimate downside of outsourcing occurs where the service provider experiences financial difficulties and goes bankrupt. The service provider's bankruptcy instantly crystallizes the inherent risks present with outsourcing—once the bankruptcy filing has occurred, it becomes obvious that these risks may be difficult (if not impossible) to manage effectively."*[12]

Conclusion

Although outsourcing—domestic or extraterritorial—is not ethically prohibited, ethics are not the only considerations in such business decisions. An inside counsel who outsources nonlegal work that used to be provided by the inside law department or by outside counsel, runs the risk that the outsourcing will eventually be controlled by the purchasing department or another part of the organization—inside counsel will no longer be the gatekeeper of legal services.[13] The interface between the nonlegal functions and the law department's problem-spotting and problem prevention roles will be hindered. An outside counsel who outsources to leverage services to clients may find that leverage negotiated away as clients look to have the savings passed on to them. Any outsourcing can put a strain on a lawyer's ability to supervise, and the time used to review the outsourced work may affect the lawyer's job satisfaction. The lawyer's role becomes narrower, but the lawyer's responsibility becomes broader.

Many of the issues raised in this article can be addressed by contract. To evaluate the quality of the outsourcing contractor, a contract may require submission of a test sample work product, condition payment upon a successful background check of the company, etc. Ethics standards should be spelled out in the contract. If the outsourcing contractor uses nonlawyers, the U.S. lawyer could consider noncompete agreements to protect against confidentiality and conflict of interest concerns.[14] ◆

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Footnotes

1. Griffin, Keith, *Firms' Misgivings Persist About Use of Temporary Lawyers,* The Connecticut Law Tribune, 1/21/05.
2. MRPC 1.2, 1.4.
3. MRPC 1.1, 5.3.
4. Lex Mundi International Study of Attorney-Client Privilege, 2002, p 27, summary by Facio & Canas law firm.
5. Lex Mundi International Study of Attorney-Client Privilege, 2002, p 36, summary by Ali Budiardjo, Nugroho, Reksodiputro.
6. Lex Mundi International Study of Attorney-Client Privilege, 2002, p 28, summary by Prochazka Randl Kubr law firm.
7. See MRPC 1.5(e).
8. Rosen, Robert Eli, *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, 648–649 (Fall/Winter 2002).
9. E.g., Michigan Supreme Court Rules for the Board of Law Examiners 2B.
10. Canadian lawyers are separately authorized as barristers and solicitors.
11. E.g., Foreign Corrupt Practices Act, 15 USC 78dd-1, et seq. In general, the FCPA prohibits corrupt payments to foreign officials for the purpose of obtaining or keeping business.
12. Spiotto, Ann H. and James E., The Ultimate Downside of Outsourcing: Bankruptcy of the Service Provider, 11 Am Bankr Inst L Rev 47 (Spring 2003).
13. Rosen, Robert Eli, *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, 666 (Fall/Winter 2002).
14. MRPC 5.6(a) addresses "offering or making" noncompetes for lawyers in employment relationships.