Who is Paying for the Tuna Sandwiches?

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With our neighbours to the South about to fall off the fiscal cliff, large sophisticated clients are starting to push back on the legal fees that they are prepared to pay their lawyers. One area in particular that has become a focus in recent days is disbursements. For example, an article in the Wall Street Journal on October 21, 2012 reported that a recent survey of in-house legal departments found that 80% of clients object to the charges submitted by outside counsel for legal research, while 69% say that they should not have to pay for it at all.

So that leads to the question. Should you be charging those costs back to your clients? And what about courier fees, file fees, fax charges and the cost of electronic legal research? What ethical constraints must you be alert to?

The Code of Professional Conduct sets forth principles to guide how you may charge your clients for disbursements. Rule 2.06 (1) provides that:

> A lawyer must not charge or accept a fee or disbursement unless it is fair and reasonable and has been disclosed in a timely fashion.

The commentary to that rule provides that:

> A fee will not be fair and reasonable if it cannot be justified in the circumstances, or is so disproportionate to the services rendered as to introduce the element of fraud or dishonesty, or undue profit.

While that commentary is directed at fees the same principles would apply to disbursements, as is evident from the remainder of the commentary:

> The fiduciary relationship between lawyer and client requires full disclosure in all financial dealings between them and prohibits the acceptance by the lawyer of any hidden fees. No fee, extra fees, reward, costs, commission, interest, rebate, agency or forwarding allowance, or other compensation related to professional employment may be taken by the lawyer from anyone other than the client without full disclosure to and the consent of the client.

An ethics opinion issued a number of years ago by the American Bar Association on billing for disbursements, reiterates that view:

> *". . . it is impermissible for a lawyer to create an additional source of profit for the law firm beyond that which is contained in the provision of professional services themselves. The lawyer's stock in trade is the sale of legal services, not photocopy paper, tuna fish sandwiches, computer time or messenger services".*

So how does this all apply to the real world of running a law firm? Typically disbursements that are out of pocket expenses paid to third party service providers are not a pressing concern for clients. The more difficult issue is the extent to which lawyers may pass on the cost of in-house services to their clients. One of those costs that has increasingly become integral to the way that we practice law is the cost of legal research. Lawyers generally prescribe to services such as Quicklaw or eCarswell by paying a flat rate fee per month in exchange for unlimited access to the service. How then can you bill your client for using those services?

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Who is Paying for the Tuna Sandwiches?

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- Should you charge the client the effective rate? (In other words what it would have cost the client without the benefit of the flat fee arrangement e.g. based on time and charges for the computer useage); or

- Should you charge the flat fee proportionate rate? (The client's proportionate share of the use of the service for that month based on a proportion of the flat fee, keeping in mind that if there is very little usage of a product in a particular month, the "proportionate" rate charged to the client could potentially be much higher than what the effective rate would have been); or

- Should you charge the client anything at all? Has the subscription to the service become part of your overhead, as it was when your primary research site was in your office library? You didn't charge for depreciation on the D.L.R.s, so is it appropriate to charge for the cost of Quicklaw or eCarswell?

- And a final question: What if the very same cases that you found on Quicklaw were available for free on CanLII? Is it reasonable for you to charge your client when you could have accessed the identical information for free?

What many courts are saying and what legal commentators are observing is that online charges will not be awarded on a fee assessment because they are increasingly being viewed as part of a firm's overhead, just the same as the office rent, liability insurance and the cost of paper. It is simply part of the cost of doing business. In Phillip v. Whitecourt General Hospital, 2005 ABQB 174, Justice Watson said at para 105:

> *Nowadays, law firms simply have to have computers. They have to function on computers, just like they have to have heat in the offices. There may have been a time when Bob Cratchit had to get his own coal or something, but nowadays the law firms have to just sort of absorb all those sorts of things.*

There is clearly an evolution occurring when it comes to how lawyers may recoup expenditures that are necessarily incurred in the course of providing services to clients. The requirement in the Code of Professional Conduct that charges for fees and disbursements must be fair and reasonable and disclosed in a timely fashion leads to the following conclusions:

1. A lawyer can charge a client for the time spent performing research at the lawyer's hourly rate providing that it is fair and reasonable and has been disclosed in a timely fashion in compliance with Rule 2.06 (1) of the Code. So look at your hourly rates and ensure that they do in fact adequately reflect the value of your services.

2. A lawyer should not profit from disbursement charges to clients. Whether it be long distance charges, fax or photocopying charges or file fees, they ought not to be your firm's profit centre.

3. Absent agreement from your client, the cost of those services ought to be limited to a reasonable calculation of direct costs as well as a reasonable allocation of related overhead. For example, without such an agreement, photocopy costs ought to be no more than the direct cost of the service (i.e the actual cost of making a copy plus a reasonable allocation of the overhead cost of providing the service e.g. the photocopy machine operator).

4. If you pay a flat rate fee for unlimited access to a legal research service, it may be difficult to establish that charging a client the effective rate, or the proportional rate of useage is a reasonable cost. You should consider whether a more reasonable charge would be a fixed access fee in addition to any specific expenditure for searches conducted on behalf of the client.

5. Any charge for research should be reflected in the work that is found on the file. If you are subsequently challenged there is no better proof than a paper trail establishing the work that has been done.

6. If an administrative charge forms part of the amount charged as a disbursement, disclosure of such charges should be made to the clients in advance.

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Who is Paying for the Tuna Sandwiches?

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7. It is not appropriate to "up-charge" a client for services provided at a reduced rate. For example if the lawyer pays a discounted rate of $50 per hour to a third party provider, it would be inappropriate to charge the client $100 per hour. Absent disclosure to the client that would amount to a hidden fee.

The key is communication with your client. You must continue to openly disclose and discuss with clients all items that will be charged as disbursements and how those amounts will be calculated. The Commentary to Rule 2.06 (1) says that you should provide to your client in writing as much information regarding fees and disbursements as is reasonable and practical in the circumstances. The best protection that you can have with respect to either a fee complaint or a fee assessment is a well prepared client. If a client knows that you will be charging them for a file opening fee, the cost of every courier, long distance telephone call or fax transmission, they are unlikely to subsequently complain about the reasonableness of your account. If a client knows up front that a matter will require extensive legal research, or that you are going to have to hire a researcher to perform that research, the cost of that research will not come as a surprise. Providing that you have addressed these issues up front, then your client is able to make an informed decision as to whether or not they are prepared to pay for the disbursements and costs that will be charged to them. And while the Code of Professional Conduct does not require you to enter into a written retainer agreement, it would certainly be prudent for you to do so, and to address all of these issues in that agreement.

Who Pays for the Tuna Sandwiches? Part 2

Darcia Senft, Director - Policy and Ethics

Several years ago, our CEO, Kris Dangerfield, wrote an article called "Who pays for the Tuna Sandwiches?" It relates to billing practices of firms and provides guidance about certain office expenses and whether it is appropriate to pass these costs on to firm clients as individual disbursements when sending out a statement of account. It would be prudent to review the article from time to time to ensure that your firm's billing practices are consistent with guidance that the Law Society provides. The article may be accessed here.

Some of the issues addressed in the article continue to arise and raise concerns about the appropriateness of certain billing practices. It has come to our attention that some firms routinely charge clients both a "file opening fee" and a "file maintenance fee" (or firms charge a higher fee upon opening a file and indicate that it is intended to cover both file opening costs and file maintenance costs). It appears that firms are charging a file maintenance fee to help cover the firm's anticipated storage costs after a file is closed.

Is it fair and reasonable to charge clients for a service that has not been provided and is, ultimately, for the firm's benefit?

Closed files are considered to be the property of the firm. Although there is a rule that requires lawyers to retain accounting records for a period of ten years [See Rule 5-54(1)], there is no rule that sets out how long a client file must be stored. The Law Society has suggested that lawyers may wish to retain closed client files for a period of time in case a client later makes an allegation of negligence or professional misconduct. Keeping the file for this purpose is for the benefit of the firm and not the client.

The reasonableness of such a fee is brought into question when you consider a range of circumstances.

- In situations where clients are taking their business elsewhere, the anticipated "service" of storing a closed file will not be provided. Under those circumstances, if these clients have already paid a "file maintenance fee", is the fee reasonable and should the client be reimbursed?

- When a lawyer leaves a firm and receives the necessary authorization to transfer a client's open file to a new firm, there is no obligation on the part of the former firm to retain any part of that file. If a firm chooses to make a copy of the entire current file (or any portion of the file), it is a choice made by the firm, for the firm's own benefit – not the client's. How could a firm reasonably justify passing on the costs of storing its own copy of a file to the former client?

- With increasing amounts of legal work being conducted online (including the practice of scanning letters and documents and saving them into a computer "file folder"), firms may decide to keep an electronic client file for a reasonable period of time and appropriately dispose of the "original" or paper client file (assuming it was properly culled upon closing). The cost of electronically saving a client file for a reasonable period of time is less-expensive than paying for warehouse storage.

Who Pays for the Tuna Sandwiches? Part 2

In some cases, firms may charge a file opening fee as well as a blanket "administration fee." It is unclear what a general administration fee is intended to cover. Is this an effort to pass on a portion of the costs of running a firm, such as rental payments or staff salaries, to individual clients? Other firms charge an "imaging" fee, which may be an effort to cover some costs associated with the firm's electronic document management system (such as scanning documents), which is just another form of "file maintenance." Is it appropriate to charge individual clients these kinds of fees in an effort to recoup some of the cost of doing business?

Perhaps if this anticipated law firm expense is explained to a client at the initial meeting and confirmed in a retainer agreement in such a way that the client is able to make a fully informed decision about whether to consent to such a charge at the outset, a firm may be able to justify its practice. However, you ought to carefully consider what are appropriate costs to pass along to a client.

In light of all of the considerations identified about billing issues and concerns, please review your firm's billing practices while keeping in mind the professional ethical obligation of lawyers to not charge or accept a fee or disbursement unless it is fair and reasonable and has been disclosed in a timely fashion.