Chapter 2

Use Care in Setting and Collecting Legal Fees

A. AGREE TO FEES PRIOR TO REPRESENTATION

As previously stated, agreeing to legal fees prior to a representation is critical. Discussing money and fees with clients is always awkward. The inclination may be to avoid a detailed discussion of the cost of representation and to merely send bills to the client instead. However, a client experiencing "sticker shock" when receiving legal bills is a client who is more likely to object to the quality of services received, even where the representation results in a good outcome. In addition, attorneys will have less flexibility to change the fee after the representation has begun. Attorneys should also avoid changing the fee mid-representation, especially when that change can be seen as favoring the attorney; courts will scrutinize that mid-representation agreement very carefully.

Prior to beginning the representation, the lawyer should ensure that the client understands billing rates and other issues relevant to the cost of representation. See Appendix C, Standard Intake Form. Lowballing an estimate may please the client in the beginning but will only serve to frustrate the client later. As such, a fee agreement should be in writing.

Fees must always be reasonable. Many states' rules of conduct for attorneys mirror Rule 1.5 of the ABA Model Rules of Professional Conduct:

> (a) A lawyer shall not make an agreement for, charge, or collect an unreasonable fee or an unreasonable

amount for expenses. 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.

(b) The scope of the representation and the basis or rate of the fee and expenses for which the client will be responsible shall be communicated to the client, preferably in writing, before or within a reasonable time after commencing the representation, except when the lawyer will charge a regularly represented client on the same basis or rate. Any changes in the basis or rate of the fee or expenses shall also be communicated to the client.

(c) A fee may be contingent on the outcome of the matter for which the service is rendered, except in a matter in which a contingent fee is prohibited by paragraph (d) or other law. A contingent fee agreement shall be in a writing signed by the client and shall state the method by which the fee is to be determined, including the percentage or percentages that shall accrue to the lawyer in the event of settlement, trial or appeal; litigation and other expenses to be deducted from the recovery; and whether such expenses are to be deducted before or after the contingent fee is calculated. The agreement must clearly notify the client of any expenses for which the client will be liable whether or not the client is the prevailing party. Upon conclusion of a contingent fee matter, the lawyer shall provide the client with a written statement stating the outcome of the matter and, if there is a recovery, showing the remittance to the client and the method of its determination.

(d) A lawyer shall not enter into an arrangement for, charge, or collect:

  (1) any fee in a domestic relations matter, the payment or amount of which is contingent upon the securing of a divorce or upon the amount of alimony or support, or property settlement in lieu thereof; or

  (2) a contingent fee for representing a defendant in a criminal case.

(e) 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 each lawyer assumes joint responsibility for the representation;

  (2) the client agrees to the arrangement, including the share each lawyer will receive, and the agreement is confirmed in writing; and

  (3) the total fee is reasonable.

B. USE CAUTION IN ALTERNATIVE FEE ARRANGEMENTS

One new approach to the issue of attorney's fees is the implementation of an alternative fee arrangement ("AFA"). Alternative fee arrangements are fee agreements or billing arrangements customized to fit the goals and needs of a client and matter based on discussion between a client and its counsel, as opposed to the standard hourly fee arrangement. AFAs are becoming very popular because they can be tailored to the specific representation and circumstances. They also are good for improved communication with clients, because all the costs are exposed at the beginning of the representation. Clients want more predictability and control in an economy where every penny counts. Attorneys want more options to monetize the value added by their professional services.

The most important starting point for considering an alternative fee arrangement is to make sure that everyone is talking about the same thing. For example, when asked for their preferred AFA, most clients say a discounted hourly rate. On the other hand, most attorneys hear "alternative fee arrangement" and think "fixed fee."

Yet, both clients and attorneys agree that alternative fee agreements can lead to more effective and efficient handling of matters by counsel, improved communication between counsel and client, and a better understanding by counsel of the client's goals and objectives. This alignment of interests between counsel and the client often is seen by clients as the primary reason to engage in alternative fee discussions.

However, when attorney fees move beyond standard hourly rates, the ethics rules can get complicated (and controversial). In addition to ethics issues, the economic realities of alternative fee arrangements vary significantly based on the culture, size, location, type and history of a law firm.

Today, there are a myriad of alternative fee arrangements available in the legal marketplace. Billing guidelines that significantly limit the activities or costs for which attorneys can even bill may now constitute the most common alternative fee arrangement. In addition, there are fixed or flat fees (on either the entire matter, discrete tasks, or multiple matters). Some other alternative fee arrangements include the following:

- Success fees: a result-oriented arrangement that contemplates additional fees in the event of a successful or pre-defined result;
- Contingency fees: fees are paid only if a certain result is achieved where client and counsel negotiate in advance the potential range of results and associated fees;
- Value billing: a pre-set fee based on the "value" of the service as opposed to its quantitative measure such as the number of hours or amount of work;
- Blended rates: fees based on rates that are blended for all timekeepers or one hourly rate for partners and one for associates;
- Retrospective billing: fees adjusted at the end of the year based on the volume of assigned matters and fees billed;
- Collar fees: periodic payments for a predetermined time period whereupon the fees are reviewed against a budgeted amount and adjustments are made if fees are more or less than the predetermined fee range;
- Fixed profit billing: fees calculated by guaranteeing a level of profit after deducting fixed costs or expenses; and
- Project billing: fees based on a fixed amount for the completion of a project as opposed to a task.

Attorneys should be aware of the potential ethical issues related to AFAs. Attorney fees, regardless of form, must be reasonable. In addition, alternative fee arrangements cannot alter or operate to change the fundamental attorney-client relationship, even if the client agrees. Typically, this means that alternative fee arrangements cannot ethically limit an attorney's independent professional judgment; create a conflict of interest between the client's interests and any other interest (including the attorney's);

or impair the client's absolute right to terminate the attorney-client relationship.

The consequences of an improper billing arrangement can extend well beyond just a fee forfeiture. Some jurisdictions have censured or suspended attorneys who have not followed these rules. For example, in *In re Mance*, 980 A.2d 1196 (D.C. App. 2009), the District of Columbia Court of Appeals publicly censured an attorney for a non-refundable "flat fee" for a criminal representation ($15,000 with an initial installment of $7,500 paid up-front). In another instance, the Colorado Supreme Court suspended an attorney for a $20,000 non-refundable "advance fee" for a civil case in *In the Matter of Larry D. Sather*, 3 P.3d 403 (Colo. 2000). As a result, one of the most important provisions in an ethical and enforceable alternative fee arrangement provides that the client is entitled to terminate the agreement without penalty at any time for any reason. Agreements should track this language.

Courts insist that a quantum meruit approach protects attorneys from clients who exercise the unfettered right to terminate a representation before the attorney earns the full fee. Under this approach, a discharged attorney can recover the fair and reasonable value of all services rendered prior to the termination.

The absolute right of a client to terminate an attorney's representation has far-reaching implications for advance fees and certain retainer fees. Basically, an attorney must return all unearned fees when a representation is ended. Under various bar rules, and the holdings of numerous courts, pre-paid attorney fees, even if characterized as a "retainer" or prepaid "advance fee," remain the property of the client until earned. It is the issue of when a fee is earned that can cause complications. Many attorneys have attempted to address these challenges by including provisions that deem all attorney fees paid as earned at the outset of the representation. Courts have not been receptive to this approach. Basically, courts insist that attorneys earn fees by actually performing services, notwithstanding provisions in a fee contract to the contrary.

In some situations, it is a distinction without a difference. For example, a flat (or fixed) fee for a routine will or a divorce can be less than the cost of one hour of attorney time. In those situations, the fee is effectively earned once the attorney starts work on the representation. But, in most situations, it is an important distinction. The best approach for attorneys would appear to be to modify fee agreements to specifically address the "value" of the representation as opposed to just the calculation of the fee. Attorneys may also need to put unearned fees in a separate trust account rather than the firm's operating account.

Value involves both a qualitative and quantitative component. Qualitative value can include the value of the attorney's commitment to continued availability as well as the willingness to lend the attorney's name and reputation to the representation. Quantitative value can include intermediate monetization of value based on milestones in the case or the completion of a part of the representation. In both cases, the assigned value must still be reasonable. But when attorney and client agree up front on these values, the result is more likely to be a valid, ethical, and enforceable fee agreement.

There are also business considerations that may impact whether an AFA is used. Indeed, attorneys may be burned by setting a client's fee at a certain amount and then working more than the equivalent of that amount at the attorney's hourly rate. Attorneys who feel like they've already "earned" their fee may ignore their duty or end up making mistakes that could cost them. Attorneys may not allow their financial interests to interfere with their obligations to their clients.

Like all billing arrangements, alternative fee arrangements should be reduced to writing. Due to the ethical implications of AFAs, they may be more appropriate for certain representations. Where an attorney has specific and certain knowledge of a client's needs, has experience in the type of matter being handled, and has the trust of the client (typically where the client is already an existing client), alternative fee arrangements may make more sense.

Collaboration and communication with the client are key to any AFA. It is important to thoroughly discuss any proposed alternative fee arrangement with the client to ensure that both the client and firm understand their respective obligations. The alternative fee agreement must also be reasonable. Overall, when properly entered into, alternative fee arrangements can be very beneficial to both parties leading to improved client relationships. They can provide more certainty to the client, promote enhanced communications regarding expected results, and better align mutual interests.

C. CONSIDER BEST PRACTICES IN COLLECTING FEES FROM CLIENTS

Once a fee arrangement has been reached – traditional or alternative – there is still the issue of collecting fees. After time entry, collecting outstanding fees is one of a lawyer's least favorite things to do, but it must be done. Fee collection is one of those areas where doing the fundamentals throughout the course of the year pays the biggest dividends. It is also one of the areas where the risk of a malpractice claim can be the greatest. As a result, there is a high premium on having solid systems in place for billing and collections. Here are the five fundamentals of effective billing and collection.

1. Negotiate the Fee Before the Attorney-Client Relationship Begins

As previously discussed, negotiating a fee before the attorney-client relationship begins is crucial. Lawyers have significant flexibility in negotiation before the work actually begins. After setting a reasonable fee that does not penalize the client for terminating the relationship, it is obviously easier to collect on the fees agreed to.

Of course, circumstances can change during a representation. If they do, a different fee may be warranted. If this happens, the safest course is to suggest that the client consult independent legal advice regarding whether to agree to the new fee arrangement. Lawyers should not give clients advice regarding new fee arrangements that they propose. Indeed, courts do not look kindly upon fee agreements that are renegotiated to the benefit of the lawyer and the injury of the client.

2. Document the Fee Arrangement

The majority of fee disputes hinge on what the agreed-upon fee actually was. The simplest and most effective method for avoiding these disputes is to agree in writing to the terms of the fee arrangement. This means not only that the lawyer should reduce the fee arrangement to writing, but also that the client should sign the document confirming the fee arrangement. Both the lawyer and the client should get a copy of the signed/countersigned document.

3. Send Bills Regularly

Many fee disputes arise from nothing more than "sticker shock" when a client sees for the first time all the different items and amounts that make up a bill for legal services or what the fee agreement reached by the attorney and client actually means in the context of a legal representation. Unfortunately, sometimes clients don't receive their first bill until the last three months of the year, with a request for payment before year-end. This can be frustrating to a client who had no grasp of what the representation was actually costing, which can negatively impact the law firm's bottom line.

Other times, clients do not see the amount of the fee (and incurred costs) until a settlement has been reached or, in a real estate or corporate transaction, until the closing. Regardless of the context, this is not a good thing. The better approach is for the client to see what the fees are, or will be, well in advance of the request for payment. For the hourly fee attorney, this means sending out bills regularly so that the client gets a sense of what the fees and costs are. Obviously, "regularly" differs based on the circumstances of each representation. The descriptions of attorney and other billable time spent on the matter should explain to the client what tasks were performed and why those tasks were relevant and necessary to the representation.

If there is little activity while a motion or appeal is pending and fees are low, then attorneys may only send out invoices every few months. On the other hand, if there is significant activity, then bills should be sent more frequently. Effective malpractice prevention requires that bills actually be sent at some regular interval regardless of how much activity there is.

For transactions, a pre-closing preview of the closing statement with the fees is helpful. For contingency fees, pre-settlement previews of the amount of the fees is appropriate. If the representation involves significant out-of-pocket expenses for which the client is responsible, interim bills are helpful. The key is to make sure the client understands what the fees are before the fees get locked in by a closing or settlement.

4. Follow Up on Unpaid Bills

Unpaid bills are problems waiting to happen. The sooner those problems are identified and resolved, the better. Unfortunately, many lawyers do a good job of documenting the fee and sending the bills but do a poor job on the follow-up. Rather than leave the follow-up to chance, the better approach is to actually enter a calendar control date for follow-up on outstanding bills.

If the bill has been paid, then a "thank you" would be appropriate. If the bill remains outstanding, then the attorney should reach out to the client. This contact enables the attorney to determine if the client has any issues preventing payment (or issues with the representation) or whether the failure to pay is a simple oversight or unintended delay.

The sooner the lawyer knows the answer to why the bills are not being paid in a timely manner, the better. If there are concerns or issues about the bills, then the lawyer should address them. If it is oversight, then contact with the client is helpful to the application of the rule of the squeaky wheel. If the failure to pay is an intended delay, then the lawyer and client can discuss what the limitations are and how they might be addressed.

Again, there is no magic time for follow-up. It will depend on the contours of the relationship with the client. Generally, most risk managers recommend 30-day follow-up on an unpaid bill. The most important step is to actually have a pre-set time for follow-up accompanied by a calendar entry with a reminder. As discussed below, once bills remain unpaid for a significant period of time, there are other considerations, including whether the attorney is prepared to pursue legal action against the client for unpaid bills.

5. Set Expectations

If the lawyer or law firm expects to get paid at least every six months, or by the end of a calendar or fiscal year, the lawyer or law firm should tell the client. If the fees will be paid directly from the settlement proceeds or at the closing, this should be discussed with the client. The most important prevention technique is to avoid surprises.

Simply put, most fee disputes can be averted by effective communication about the one thing most lawyers prefer not to talk about—getting paid.

In a representation, effective communication means communicating and agreeing on the fee before the representation begins; written confirmation of the fee with the client; regular communication about earned fees through regular or interim billing; and timely follow-up when bills have not been paid. And it means candid communication about what the lawyer's expectations (and limitations) are for payment. For lawyers who have followed these steps, fee collections may not be as daunting. However, these systems can be put in place at any time to avoid future headaches.

D. CAREFULLY CONSIDER WHEN TO SUE A CLIENT FOR UNPAID FEES

During tough economic times, the pressure to collect fees is intense. Clients who are already "slow pay" clients increasingly become "no pay" clients, creating even more pressure on attorneys and law firms that are already stretched thin. Attorneys' options for getting paid by unwilling or unable clients are becoming more and more limited. Collection efforts have moved from gentle reminders to written requests to formal demands for payment.

When such efforts are unsuccessful, attorneys and law firms are faced with the tough question of whether to bring a lawsuit to recover unpaid attorneys' fees and unreimbursed out-of-pocket expenses. Some attorneys and law firms have adopted a simple rule regarding suits for fees: never sue a client. While risk-free in theory, such rules ignore the economic realities of the modern-day law practice. Of course, the biggest risk of such a policy is that the attorney or law firm never gets paid, notwithstanding the expenses advanced and the time invested.

For attorneys and law firms that have planned ahead, there are ways to mitigate these risks with cash retainers, frequent billings, and early terminations of the attorney-client relationship when unpaid fees and expenses accumulate. Sometimes, however, even the best practices are unsuccessful, leaving attorneys and law firms with only one choice if they want to get paid: the filing of collection legal proceedings for unpaid fees and expenses.

Suits against clients for fees involve real risks. Out of every five suits for fees, two will result in a counterclaim for legal malpractice. While significant in terms of frequency, the risk of a counterclaim for legal malpractice should not be overstated. Although not legally sufficient, courts generally seem to be cognizant that such counterclaims are a common response to a suit for unpaid fees and unreimbursed expenses.

Nonetheless, a counterclaim for legal malpractice is still a claim for legal malpractice. This means it must be reported to the legal malpractice insurer and noted on all future applications for legal malpractice insurance that ask lawyers whether a claim has ever been made against them. Given the likelihood that a lawsuit against clients will result in a counterclaim for malpractice, some law firms report their own filing of a suit for fees to their legal malpractice insurer as a "circumstance that might give rise to a claim."

If a client brings a counterclaim for legal malpractice, most legal malpractice insurers readily provide a defense. But when that happens, the center of gravity for decision-making regarding resolution of the claim often shifts dramatically. Rarely do the interests of an attorney seeking to recover fees and those of a legal malpractice insurer defending a counterclaim for legal malpractice completely align.

As a result, the attorney's decision to withdraw from the representation and to bring a suit for fees is a matter of some consequence and should never be made lightly. The decision involves balancing the interests of getting paid against the costs and risks of attempting to do so. Here are some of the questions that attorneys and law firms should consider in making that decision.

1. Is the Amount Significant?

The first question is whether the amount of money at issue is really worth the risk. While seemingly obvious, this is a question sometimes missed by attorneys and law firms desperate for revenue and the reimbursement of incurred expenses. The fact is, it makes little financial sense to file a lawsuit to recover relatively small amounts while risking a counterclaim for legal malpractice. Even meritless legal malpractice claims are expensive. By the time an attorney adds the out-of-pocket expenses associated with filing a lawsuit to the value of the attorney time invested, the decision to sue over a small amount of outstanding fees just does not make a lot of sense.

While each attorney and law firm is different, it rarely makes sense to bring a suit for fees amounting to less than $2,500. For larger firms, where the operational costs are greater, the minimum number is much higher.

Beyond the minimum, there are formulas that some firms use to make the decision. Here is one: add the out-of-pocket expenses to the projected costs of attorney time in pursuing the suit and compare it with the amount at issue. With a 40 percent chance of a counterclaim, the ratio of reward to costs should be no less than 2:1. This assumes that an independent review yields no significant concerns of legal malpractice. Regardless, before deciding to bring an action for fees, do the math.

> Law firms considering whether to sue a client for unpaid fees should compare the reward (the amount of unpaid fees that might be collected) to the costs (the out-of-pocket expenses and cost of attorney time to be spent in the matter). Firms should only proceed if the ratio of potential rewards to projected costs is at least 2:1.

2. Is Any Judgment for Fees Collectible?

Consider why the client is behind in paying legal fees. Is it because the client has no funds or has gone bankrupt? An uncollectible judgment means no chance for reward. So why take the risk?

This is a good example of a situation where the best advice for an attorney is to stop thinking like a lawyer and start thinking like a business owner. Lawsuits against customers who have no assets involve all risk and no reward. A good business would not do it.

After doing the math, the next step for attorneys deciding whether to bring a suit for fees is to conduct an asset search on the potential defendant. There are myriad services that attorneys, like any business, can use in this regard. The important thing is actually doing the asset search.

There is always the possibility of future assets. In the plaintiffs' litigation context, a properly and timely asserted attorneys' lien can be effective. Beyond that, the question becomes how likely it is that the client will receive future assets from which the attorney or law firm could collect. If the chances are small, the incentive to file a suit for fees should be the same. There is no reason to throw good money after bad.

3. What's the Likelihood of Success?

Every attorney believes that she/he earned her/his fee. Therefore, attorneys are the worst people to ask about the chances of success in establishing the reasonableness of their fees or the value of their legal services. An independent review by another attorney within the firm who did not work on the file is best. This peer review or "fresh look" at the file should focus on what, if any, concerns, issues, defenses or claims might be raised by the defendant client. For further tips on how to ensure that such conversations are protected by attorney-client privilege, see Chapter Six.

Generally speaking, one question can tell an attorney or law firm everything they need to know in deciding whether to bring a suit for fees: Why did the client not pay the bill? If the answer is that the client has no money or assets, that implicates whether the judgment can even be collected, as discussed above. If the answer is because the client believes that the attorney committed legal malpractice, then it implicates the calculus for weighing the risks of a counterclaim against the rewards of a collectible recovery.

4. Is There an Acceptable Alternative?

Some states encourage attorneys and clients in a fee dispute to undergo arbitration. The advantage of fee arbitration is that it typically shifts the focus from whether the attorney collects to how much the attorney collects. On the other hand, the trade-off of engaging in arbitration and avoiding the risks of a counterclaim for legal malpractice is a forced discount on the amount of fees sought.

CAREFULLY CONSIDER WHEN TO SUE A CLIENT FOR UNPAID FEES

ABA Formal Ethics Opinion 02-425 (2002) examined retainer agreements that required the arbitration of fee disputes and malpractice claims and found that the requirement of such binding arbitration was permissible where (1) the client has been fully apprised of the advantages and disadvantages of binding arbitration and has been given sufficient information enabling them to make an informed decision about whether to agree to this provision and (2) the arbitration provision does not otherwise insulate the lawyer from liability or limit the liability to which the attorney would be exposed under common and/or statutory law.

Thus, an attorney can include an arbitration provision in an agreement with a client subject to the above requirements. *See Haynes v. Kuder*, 591 A.2d 1286 (D.C. 1991) (finding that terms of retainer agreement required legal malpractice plaintiff to go to arbitration with former lawyer and that lawyer did not fraudulently induce plaintiff to signing agreement because attorney made full disclosure to client of all ramifications of an agreement to arbitrate); Texas Ethics Op. No. 586 (Oct. 2008) (finding that arbitration provisions are permissible in engagement agreements with clients subject to the informed consent of the client and the non-limitation of any liability on the attorney's part).