

**“ETHICAL CONSIDERATIONS IN ALTERNATIVE FEE
AGREEMENTS FOR THE DEFENSE LAWYER”**

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INTRODUCTION

Most lawyers defending product liability cases have been involved in some type of fee agreement with clients other than an hourly billing rate. Alternative fee agreements include flat fee, fixed fees, blended hourly rates, discounted rates, reverse contingency fee agreements as well as various forms of each of the above.

From the client's perspective fixed fees allow the client to control the costs, to create a budget, and to avoid the uncertainty of the hourly rate. From the defense lawyer's perspective fixed or flat fees and reverse contingency fee agreements encourage efficiency from the defense lawyer and the law firm. The bottom line for the defense lawyer is that she/he can increase their profits for handling legal work by being more efficient. The downside to fixed fees, flat fees or reverse contingency fees is that depending upon the amount of the fee paid by the client, there may be an incentive on the part of the lawyer to reduce the quality of the legal work to the client.

If the client remains satisfied with the defense counsel's representation through a jury verdict, the lawyer is unlikely to be questioned by the client or the state ethics board as to whether that particular lawyer or law firm fulfilled its ethical responsibilities to the client under the particular state's professional code of responsibility. For the defense lawyer operating under a flat fee arrangement who

receives an adverse verdict and the client is either threatened with bankruptcy or a significant loss of wealth, the defense lawyer may be accused of providing poor quality legal work and of violating their ethical obligations to the client. The lawyer may also find herself or himself named in a lawsuit for negligence in defending the very client who hired the lawyer on a flat fee basis.

A prominent defense lawyer recently found himself in this very position! After an insurer hired the defense lawyer on a flat fee basis, the insured corporation suffered an adverse verdict which threatened the very existence of the corporation. In return for a release from the plaintiff, the corporation assigned to the plaintiff its rights against the defense lawyer for negligence in defending the original lawsuit. In the negligence case against the lawyer, the plaintiff has questioned the quality of the defense lawyer's legal work, based in part on the fact the lawyer was being paid a flat fee for defending the corporation. Fortunately, the lawyer has not yet been the subject of any investigation by the state ethics board.

As defense lawyers we all have to ask ourselves what are the ethical obligations and rules we must follow in entering into alternative fee agreements. Every state has rules governing the professional conduct of lawyers and a disciplinary process to enforce those rules against lawyers who violate their ethical obligations. The American Bar Association model rules of professional conduct

serve as the basis for virtually all of the various states ethical codes. The model Code of Professional Responsibility adopted by the ABA in the 1960 served as the initial basis for most state's rules on a lawyer's professional conduct. In the 1980's the ABA adopted the model Rules of Professional Conduct. The ABA model Rules of Professional Conduct or the model Code of Professional Responsibility now forms the basis for virtually all ethical codes in the United States.

THE RULES OF PROFESSIONAL CONDUCT

In considering any fee agreement a lawyer should review the rules of professional conduct in their particular jurisdiction to determine whether a fixed or flat fee agreement, or a reverse contingent fee agreement complies with the rules of professional conduct. As an example, the following are pertinent rules from the Massachusetts Rules of Professional Conduct that a Massachusetts lawyer should review in analyzing any fee agreement. These rules are based on the ABA model Rules of Professional Conduct with some variations.

RULE 1.1 COMPETENCE

A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation.

Comment (5) provides that competent handling of a particular matter includes adequate preparation. The required attention in preparation are determined in part by what is at stake: major litigation and complex transactions ordinarily require more elaborate treatment than matters of lesser consequence.

RULE 1.2 SCOPE OF REPRESENTATION

(c) A lawyer may limit the objectives of the representation if the client consults or consents after consultation.

Comment 4 of this section provides that “The objective or scope of services provided by a lawyer may be limited by agreement with the client or by the terms under which the lawyers services are made available to the client.”

Comment (5) provides that “Any agreement concerning the scope of representation must accord with rules of professional conduct and of the law.”

RULE 1.3 DILIGENCE

A lawyer shall act with reasonable diligence and promptness in representing a client. The lawyer shall represent a client zealously (within the bounds of the law).

Comment (1) provides that “A lawyer shall act with commitment and dedication to the interest of the client and zeal and advocacy upon the clients’ behalf. However, a lawyer is not bound to press for every advantage that might be realized for a client. A lawyer has professional discretion in determining the means by which a matter should be pursued subject to Rule 1.2. A lawyer’s workload should be controlled so that each matter can be handled adequately.”

RULE 1.5 FEES

(a) A lawyer shall not enter into an agreement for, charge, or collect an illegal or clearly excessive fee. The factors to be considered in determining whether a fee is clearly excessive include the following:¹

(1) the time and labor required, the novelty and difficulty of the questions involved, and the skill requisite to perform the legal service properly;

¹ ABA Model Rules of Professional Conduct allows a lawyer to charge a reasonable fee for services.

- (2) the likelihood, if apparent to the client, that 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.**
- (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 (paragraph d prohibits a lawyer from entering into a contingent fee agreement in criminal cases and domestic relations matters)**

Comment (2) provides that “A lawyer may require advanced payment of a fee, but is obliged to return any unearned portion.”

Comment (3) Provides that “An agreement may not be made whose terms might induce the lawyer improperly to curtail services for the client or perform them in a way contrary to the clients interest. For example, a lawyer should not enter into an agreement where by services are to be provided only up to a stated amount when it is foreseeable that more extensive services probably will be required, unless the situation is adequately explained to the client.... However, it is proper to define the extent of services in light of the client’s ability to pay.A lawyer should not exploit a fee arrangement based primarily on hourly charges by using wasteful procedures. When there is doubt whether a contingent fee is consistent with the clients best

interest, the lawyer should offer the client an alternative basis for the fee and explain their implications.”

RULE 1.7 CONFLICT OF INTEREST: GENERAL RULE

- (b) A lawyer shall not represent a client if the representation of that client may be materially limited.... by the lawyers own interest unless: (1) the lawyer reasonably believes the representation will not be adversely effected; and (2) the client consents after consultation.**

Comment (6) to Rule 1.7 provides as follows “the lawyers own interest should not be permitted to have an adverse affect on representation of a client. For example, a lawyers need for income should not lead the lawyer to undertake matters that cannot be handled competently and at a reasonable fee.”

RULE 1.8 CONFLICT OF INTEREST: PROHIBITED TRANSACTIONS

- (e) A lawyer shall not provide financial assistance to a client in connection with pending or contemplated litigation, except that: (1) A lawyer may advance court costs and expenses of litigation, the repayment of which may be contingent on the outcome of the matter;**
- (f) A lawyer shall not accept compensation for representing a client from one other than the client unless: (1) the client consents after consultation;**
 - (2) there is not interference with the lawyers independence of professional judgement or the client lawyer relationship;**
- (j) A lawyer shall not acquire a proprietary interest in the cause of action or the subject matter of litigation the lawyer is conducting for a client, except that the lawyer may; (1) acquire a lien granted by law to secure the lawyers fee or expenses; and (2) contract with a client for a reasonable contingent fee in a civil case.**

RULE 1.13 ORGANIZATION AS A CLIENT

- (a) A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents.**

- (b) If a lawyer for an organization knows that, an officer, employee, or other person associated with the organization is engaged in action, intends to act or refuses to act in matter related to the representation that is a violation of a legal obligation to the organization,... the lawyer shall proceed as is reasonably necessary in the best interest of the organization.**

RULE 1.15 SAFE KEEPING PROPERTY

- (a) A lawyer shall hold property of clients or third persons that is in a lawyers possession in connection with a representation separate from the lawyers own property. Funds should be kept in a separate account maintained in a state where the lawyers offices are situated, or elsewhere with the consent of the client or third person... Complete records of the receipt, maintenance and disposition of such account funds and other properties shall be kept by the lawyers from the time of receipt to the time of final distribution and shall be preserved for a period of six years after termination of the representation.**

REVERSE CONTINGENT FEES

Some clients pay for their lawyers' services through a reverse contingent fee agreement. Typically such a case involves the client who has been sued for a certain sum of damages. The lawyer is then asked to dispose of such cases either by settlement or judgment for an amount less than the amount originally demanded by the plaintiff. The defense lawyer agrees to charge the client a contingent fee dependent upon the result achieved and measured as a stated portion of the difference between the amount originally claimed by the plaintiff and the amount the client is ultimately required to pay.

The Iowa Supreme Court considered the ethical propriety of a reverse contingent fee agreement in Wunschel Lawfirm, P.C. v. Clabaugh, 291 N.W.2d, 331 (Iowa 1980). In Clabaugh, which was decided under the Iowa Code of Professional Responsibility, the Iowa Supreme Court ruled that a reverse contingent fee agreement for the defense of a tort claim, which is based on a percentage of the difference between the addendum claim by the plaintiff and the amount awarded to the plaintiff, was void as contrary to public policy. The court adopted the opinion of the Ethics Committee of the Iowa State Bar Association and ruled that an unliquidated tort damage claim was a purely speculative amount and that a fee based upon such a speculative amount could not under any circumstances be reasonable. Clabaugh id at 337.

The American Bar Association's committee on ethics and professional responsibility issued a formal opinion with respect to reverse contingent fee agreements in April of 1993. *See ABA Formal Opinion 93-373*. The ABA concluded that when "reasonably determinable civil damages between private parties are at issue... there is no basis in public policy for prohibiting a fee arrangement based on the percentage of the amount saved a defendant, so long as the reasonableness and informed consent requirements of Rule 1.5 are satisfied". The ABA Ethics Committee further noted that in each case the fee paid to the lawyer must be reasonable. Moreover the reasonableness should be judged at the

time the parties entered into the reverse contingent fee agreement. Finally the ABA Ethics Committee held that the reverse contingent fee must be based upon a reasonably ascertainable savings to the client as opposed to a purely speculative one. The ABA Ethics Committee further pointed out that the comments to Rule 1.5 of the ABA Model Rules provide that “when there is a doubt whether a contingent fee is consistent with the client’s best interests, the lawyer should offer the client alternative basis for the fee and explain their implications”.

In summary the ABA Model Rules of Professional Responsibility do not prohibit reverse contingent fees if:

- (a) The amount saved is reasonably determinable;
- (b) The fee is a reasonable amount under the circumstances; and
- (c) The client who agrees to the fee agreement is fully informed.

The ABA Model Rules list eight factors that should be considered in determining whether a fee is reasonable:

- (1) the time and labor required, the novelty and difficulty of the questions involved, and the skill requisite to perform the legal services 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 their 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. See ABA Model Rule 1.5

FIXED OR FLAT FEE ARRANGEMENTS

Relatively few state ethics boards have weighed in on the ethical proprieties of fixed or flat fee agreements between lawyers and clients. For the most part the ethical rulings that have been issued by state ethic boards have focused on fixed or flat fees agreements dictated by insurance companies to lawyers who are representing insured's. The ethics committees' decisions from the few states that have considered the issues of flat or fixed fees have been mixed with extremes such as Kentucky barring all fixed or flat fee agreements as unethical per se to New Hampshire taking the opposite view that a fixed or flat fee arrangement between a defense lawyer and an insurer is not unethical even if the lawyer enters the agreement and loses money performing the work. See Kentucky Bar Association KAB E-368 (1994); New Hampshire Bar Association Ethics Committee Opinion 1990-91/5 (1991).

By far the most controversial ethics opinion issued by any state on the issue of fixed or flat fee agreements is that of the Kentucky Ethics Commission and the resulting legal decision issued by the Kentucky Supreme Court in American Insurance Association v. Kentucky Bar Association, 917 S.W. 2nd 568 (KY 1996). In 1994 the Kentucky Bar Association issued ethics opinion KBA E-368. KBA E368 provides as follows:

- (1) That a lawyer may not enter into a contract with a liability insurer in which the lawyer or his firm agrees to do all of the insurer's defense work for a set fee; and
- (2) The lawyer may not agree to accept cases from an insurer with the understanding the attorney will be responsible for all expenses of litigation including such items as experts, court reporters, etc., without expectation of reimbursement from the insurer.

In arriving at its ruling the Kentucky Ethics Commission reasoned that a lawyer is placed in a position of a conflict of interest between the insurer and the insured when they agree to a flat fee for legal services. The Ethics Commission further noted that "the lawyer stands to gain by limiting the services rendered to the client". The Ethics Commission further added that the client, namely the insured, will have no control over the choices that will be made with respect to the fees paid to the lawyer. The Ethics Commission also noted that "we emphasize the fact that this is not a case in which a lawyer is striking a bargain or reaching an agreement with a particular client regarding a particular case, cases, or body of work".

With respect to the issue of defense lawyers absorbing litigation expenses as a condition of employment, the Kentucky Ethics Commission concluded this was unethical because it required the lawyer to buy the client's legal work and to buy a position in the litigation adverse to the interest of the client.

The Kentucky Supreme Court in affirming the Kentucky Ethics Commission's opinion noted as follows:

“the pressures exerted by the insurer through the set fee interferes with the exercise of the attorney’s independent professional judgment, in contravention of Rule 1.8(f)(2). The set fee arrangement also clashes with Rule 1.7(b) in that it creates a situation whereby the attorney has an interest in the outcome of the action which conflicts with the duties owed to the client; quite simply, in easy cases, counsel will take a financial windfall; in difficult cases, counsel will take a financial loss.”

The Kentucky Supreme Court further noted that it was greatly concerned with the appearance of impropriety in lawyers accepting fixed or flat fee agreements. The court stated “the mere appearance of impropriety is just as egregious as any actual or real conflict.” “(E)-368 in the same manner as... acts as a prophylactic device to eliminate the potential for a conflict of interest or the compromise of the attorneys ethical and professional duties.” Id.

The Supreme Court of Ohio has also issued a decision with respect to whether fixed or flat fee agreement to perform an insurer’s work is ethical and whether the expenses of litigation may be included in a flat fee agreement. See Ohio Board of Commissioners on Grievances and Discipline 1997 WL 782951(Opinion No. 97-7, December 5, 1997). In the above decision the Ohio Supreme Court ruled that an attorney or a law firm may enter into a contract with a liability insurer in which the attorney or law firm agrees to do all or a portion of an insurer’s defense work for a fixed or a flat fee. The Court noted, however, that the fee agreement must provide reasonable and adequate compensation to the lawyer

or law firm. The court stated that “the legal fee to the lawyer or law firm may not be so inadequate that it compromises the attorneys professional obligations as a competent and zealous advocate.” Id. “Nor may the fee agreement be so low as to adversely effect the attorney’s independent professional judgement and the attorneys competent, zealous and diligent representation of the client.” Id.

The Ohio court concluded that when a flat fee agreement between an attorney or a law firm and a liability insurer provides insufficient compensation for the time and effort spent on the representation, ethical problems emerge. Id. According to the Ohio Court, fixed fee agreements between an insurer and a lawyer or law firm, which provides inadequate compensation so as to effect an attorneys duties, violates disciplinary Rule 5-10-7(B) which governs an attorney’s duty to exercise independent professional judgement. It would be unethical, said the Ohio Supreme Court, for an attorney or a law firm to enter into such an agreement. In reaching its decision the Ohio Supreme Court noted that the ethics board had previously stated in Ethics Opinion 95-2 that an attorney “should not enter into fee agreements that provided compensation so inadequate as to denigrate the profession and have a deterrent effect upon the quality of work that can be performed.” Citing Ohio Supreme Court, Board of Commissioners Grievance and Discipline, OP 95-2 (1995).

The Ohio Supreme Court further noted that a fixed flat fee agreement between an attorney or a law firm and an insurer may not provided compensation so inadequate as to effect the attorney's obligations under DR 7-101 "to represent every client competently, zealously and diligently." Any attorney or law firm entering into such an agreement violates his ethical obligations. 1997 WL 782951, Ohio Board of Commissioners on Grievances and Discipline, Op 97-7 December 5, 1997.

With respect to expenses included in a flat fee agreement, the Ohio Supreme Court noted that Ohio DR 5-103(b) prohibits a lawyer from advancing or guaranteeing financial assistance to the client, except that a lawyer may advance or guarantee the expenses of litigation, including court costs, expenses of medical examination and costs of obtaining and presenting evidence, provided the client remains ultimately liable for such expenses. The Ohio Court ruled that the insurer must remain ultimately liable for paying the actual expenses of litigation in all circumstances. The court reasoned that this prevents an attorney "from acquiring a personal financial interest in the result of the litigation which might adversely affect the attorneys exercise of independent professional judgement." Id.

The Lawyer Disciplinary Board of the Office of Disciplinary Counsel, which is the ethics board for lawyers in West Virginia, has also had an opportunity to weigh in on the ethical obligations of lawyers entering into fixed or flat fee

arrangements for insurance defense work. See West Virginia Lawyer Disciplinary Board Opinion 98-01. The Board concluded that “the use of fixed or flat fee arrangements does not constitute a per se violation of the Rules of Professional Conduct.” The Board opined that the use of fixed or flat fee arrangements does create the potential for an ethical violation of the Rules of Professional Conduct and, as a result, “lawyers are cautioned to be careful in this regard as the arrangements, in a particular case, could violate the rules.” In a footnote, the Board noted that the Board’s opinion is not intended to imply that all fixed or flat fee arrangements are acceptable.

The Board suggested that lawyers entering into fixed fee agreements are advised to analyze fee agreements on a case by case basis. The Board concluded that if a fixed legal fee is so low that it forces the lawyer to perform less than competently, the fee would not be reasonable and the agreement would violate the Rules of Professional Conduct. Also, if the fixed fee is so low that the lawyer must put his own personal and financial interests ahead of the interest of the insured client, a conflict of interest would result and this would be a violation of the Rules of Professional Conduct. Similarly, if the fee is so low as to impair the lawyer’s independent professional judgment that would be a violation of the Rules of Professional Conduct. Finally, the Board noted that a fixed fee that was so low that it impaired a lawyer’s “ability” and/or incentive to provide competent

representation or to act diligently would violate the attorney's ethical obligations under the Rules of Professional Conduct. In conclusion, the Board noted that ultimately any fixed fee for insurance defense work must be sufficient for the attorney to provide a competent defense otherwise the agreement would violate the Rules of Professional Conduct.

The West Virginia Ethics Board also opined that a lawyer was required to disclose any fixed or flat fee arrangement with the insured including the specific dollar amounts the lawyer is paid and the payment limits; what activities the lawyer is hired to do; and those limits that are imposed on the lawyer by the insurance company. Finally, the lawyer must provide an affirmation to the insured client that he can competently defend the insured's case under the disclosed fee arrangement.

In Ethics Opinion 86-13 (February 11, 1997), the Iowa Supreme Court Board of Professional Ethics and Conduct was asked to consider whether a flat fee agreement to prepare settlement papers for worker's compensation cases would violate the applicable rules of ethics in Iowa. The Iowa Supreme Court Board of Professional Ethics and Conduct stated that in the opinion of the Committee, a written agreement to provide specific professional legal services for a fixed fee would not be improper provided as follows:

1. The service is inherently capable of being specifically stated and circumscribed, and,
2. There appears to be no probability of further professional services (other than those specified) being required in handling the matter, and
3. The agreement provides that in any instance where counsel believes additional professional service has become necessary, he shall furnish it at his or her regular hourly rate.

The Iowa Ethics Board went on to state that in “matters involving continuing legal evaluations and more than limited counsel’s specific professional service, the potentials for interference with exercise of professional judgment or ‘for cutting corners’ or limiting professional service are significant” (sic) when a lawyer is paid a fixed fee. In the Iowa Ethics Committee’s opinion, a flat fee agreement that did not provide for additional legal fees at an attorney’s regular hourly rate when counsel believed that the additional professional services are necessary beyond the specifically stated legal services, “would be improper as being or potentially being in violation of” the Iowa Code of Professional Responsibility. Id.

The Connecticut, New Hampshire, Oregon and Wisconsin ethics boards have all considered flat fee agreements in the insurance defense context and have held that a flat fee representation is permissible and does not violate the Rules of Professional Conduct in each of their respective states. In informal opinion 97-20, the Connecticut Bar Association Committee on Professional Ethics was requested to issue a decision as to whether a flat fee agreement by a law firm to perform all

of an insurers defense work in Connecticut violated the Connecticut Rules of Professional Conduct (namely Rules 1.7(b) and 1.8(f)(2)). The Committee on Professional Ethics for the Connecticut Bar Association ruled that flat fee agreements are permissible. In so ruling, the Committee on Professional Ethics noted that a flat fee agreement does not limit the attorneys obligations to the client under Rules of Professional Conduct for lawyers. The Committee on Professional Ethics further stated that if the law firm can “assure that the scope and quality of the defense is not compromised by the fee agreement, even if the client (the insured) questions it in hindsight, than the flat fee arrangement would be permissible.” Id.

The Oregon State Bar Board of Governors on Ethics issued a similar finding in formal opinion No.1991-98. In a conclusory opinion with little analysis, the Oregon Board of Governors concluded that a flat fee agreement by a lawyer for an insurance defense matter would not violate the lawyer’s ethical obligations. The Oregon Board noted that simply because a lawyer was paid a flat fee per case does not limit the attorney’s obligations to his or her client. Id.

The Wisconsin Ethics Board also issued a conclusory decision in approving flat fee agreements for insurance defense cases. See Wisconsin Ethics Decision E-83-15. The Wisconsin Ethics Board’s opinion considered the simple issue of whether a fixed fee was clearly excessive. The Board concluded that a flat fee was

not clearly excessive and was thus not in violation of the rules of ethics. In arriving at its decision, the Wisconsin Ethics Board noted that the American Bar Association has previously opined that fixed fees do not violate a lawyer's ethical responsibilities.

The New Hampshire Bar Association Ethics Committee issued its opinion on fixed fees for insurance defense work in Opinion 1990-91/5 (January 28, 1991). The New Hampshire Ethics Committee ruled that nothing in the rules of Professional Conduct prevent a lawyer from charging a fixed fee for the defense of a lawsuit. The Ethics Committee noted that the only prohibition with respect to fees is that they may not be excessive and that since an insurance company was negotiating with lawyers, there is no danger of the lawyer receiving an excessive fee. The Ethics Board dismissed the notion that legal fees which are too low might affect a lawyer's defense because according to the ethics board no matter what the fee arrangement, a lawyer is duty bound to act with diligence in his or her representation of the client and the amount of diligence a lawyer owes to his/her client is not limited to the amount of fee paid. Id.