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**ETHICAL ISSUES FOR ALTERNATIVE
FEE ARRANGEMENTS**

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ETHICAL ISSUES FOR ALTERNATIVE FEE ARRANGEMENTS

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Especially given current economic issues and pressures, there is greater discussion and increased implementation of alternative fee arrangements. As a group, lawyers and clients are each asking the basis of the service that is sought—is the client purchasing “time, or solutions and benefits?”¹ Depending on the answer, the question presented is then whether there are billing arrangements, other than or in addition to those that have typically been used, that better meet the expectations of the relationship and better match with economic realities.

For many years, lawyers generally billed their clients in one of two ways—through billable hours or contingency fees. As a result of the years of experience with those arrangements, there is a comfort level about the operation of those two billing systems and the ethical issues that are involved with each. As lawyers now work to meet client expectations and seek to manage burgeoning legal fees for clients with increasing pressure to cut expenses, new arrangements are now part of the billing mix. As the types of billing arrangements expand, so too do the potential ethical issues surrounding those arrangements.

I. ALTERNATIVE BILLING ARRANGEMENTS

The types of alternative billing arrangements are limited only by the innovation, imagination, and practical limitations of lawyers and their prospective clients. They can include a variety of arrangements, some of which are related to hourly or contingency billing and others that are entirely new creations.²

A. Hourly Fee Based Arrangements

1. Capped fees—time is billed by the hour but there is an agreed-upon maximum for the total fee.

¹ Laurel L. Burke, “Alternative Billing Methods: Not Just by the Hour Anymore,” 28 APR Colo. Law 59, 59 (1999).

² The information on these billing arrangements is drawn from “Business and Ethics Implications of Alternative Billing Practices: Report on Alternative Billing Arrangements,” 54 Business Law 175, 183-84 (1998).

2. Budgets—a maximum number of hours at an agreed rate set for each task.
3. Firm estimates—establishes a total number of hours and a timetable for each task.
4. Discounted hourly rates—a discount is established from the standard billing rate and often applied progressively across the engagement with the discount amount and percentage growing at particular billing increments.
5. Volume rates—used when there is a large volume of promised work over a period of time.
6. Unbundled fees—the client chooses the services it will purchase, including outsourced services, as if from an *a la carte* menu.
7. Blended rates—a single hourly rate is established for all of the lawyers who work on the file.
8. Partner-based rate structures—the lead partner is paid a premium rate for time on the matter but there is no charge for the work of others on the file.
9. Phased billing—the client and lawyer negotiate fees for each phase of the matter and, if the time on a phase exceeds the agreed-upon amount, those fees are reserved and may be recouped if the lawyer “beats” the amount set for another phase or through a negotiation with the client at the conclusion of the matter or otherwise.

B. Contingency Fee Arrangements

1. Incentive and value billing—the client bases payment on achievement of mutually agreed-upon goals such that the lawyer shares the risk and the reward with the client.

2. Value billing—fees are paid based on the value of the services rendered and is designed to reward results instead of the investment of hours.
3. Incentive billing—includes bonuses or other payments for successes in the matter.
4. Result-based billing—the lawyer gets a bonus if a matter is successfully concluded and, if not, accepts a discounted hourly rate for the time invested.
5. Investment in client—in addition to or instead of fees, the lawyer receives stock or some other ownership-interest in the client.

C. Flat Fee Arrangements

1. Retainer Arrangements—a lawyer agrees to provide a certain range of services for a particular time and a particular fee.
2. Task-based flat fees—counsel charges a preset fee for each defined task.
3. Percentage fees—the lawyer accepts a percentage of the value of the transaction, primarily in repetitive business representations (e.g., real estate closings).
4. Loaned lawyer—a firm loans a lawyer to a client on a daily or monthly basis in exchange for a set payment.

D. Other Variations

1. Teaming Arrangements—the law firm and client form a mixed team of inside and outside counsel, with each focused on particular areas of expertise and tasks within the arrangement as a whole.

The list above is not and is not intended to be exhaustive but does provide a good framework for consideration of ethical considerations of alternative billing arrangements. In many arrangements, the concept is to incentivize efficiency or results. This is seen to be in contrast to the motivations at play in the traditional billable hour arrangement, which is thought to

primarily encourage investment of time. Although the alternative arrangements hold promise for both lawyers and clients, they also have potential ethical pitfalls, as economic motivations could come into conflict with duties of advocacy and competent representation.

II. ETHICAL CONSIDERATION FOR BILLING ARRANGEMENTS

The rules that govern attorney billing are general in nature and not yet specific to particular alternative billing arrangements. In addition, unlike more traditional billing arrangements, there are fewer interpretations of those rules to provide guidance on the appropriate parameters and limitations. Thus, attorneys must apply general principles in new ways. This is made more difficult by the fact that billing arrangements are made prospectively, when the client and lawyer both desire the representation relationship, but the ethical issues are judged retrospectively and often after the relationship has soured.

The primary rule for attorney billing arrangements is Rule 1.5, which provides in part that:

- (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.

Model Rules of Professional Conduct 1.5.³ Under Rule 1.5, it is clear that a lawyer's fee must be "reasonable" and that the lawyer must fully communicate with the client about the fee in advance. What it takes to make sure that the fee is "reasonable" in the context of alternative fees is less clear.

As an initial matter, the fee should be set out in writing to make sure that the relationship is well-defined and understood by all at the outset. If the fee arrangement could in any way be viewed as the lawyer entering into a business transaction or common enterprise with the client, Rule 1.8, which generally prohibits a lawyer from arrangements for ownership or financial

³ This paper references the American Bar Association's Model Rules of Professional Conduct. The practitioner should consult the rules in his/her individual jurisdiction, especially as to any differences between those rules and the Model Rules or for any interpretations of the rules that may impact these issues.

interest in a client, requires that the arrangement be in writing.⁴ This requirement is further underscored by the dictates of Rule 7.1, which provides that a lawyer shall not make a “false or misleading” statement about the “lawyer or the lawyer’s services.”⁵

Additional ethical considerations are found in Rule 5.7, which sets out principles for law-related services provided by a lawyer or law firm.⁶ In

⁴ (a) A lawyer shall not enter into a business transaction with a client or knowingly acquire an ownership, possessory, security or other pecuniary interest adverse to a client unless:

(1) the transaction and terms on which the lawyer acquires the interest are fair and reasonable to the client and are fully disclosed and transmitted in writing in a manner that can be reasonably understood by the client;

(2) the client is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of independent legal counsel on the transaction; and

(3) the client gives informed consent, in a writing signed by the client, to the essential terms of the transaction and the lawyer's role in the transaction, including whether the lawyer is representing the client in the transaction.

ABA Model Rule of Professional Conduct 1.8.

⁵ ABA Model Rule of Professional Conduct 7.1. Rule 7.1 states: “A lawyer shall not make a false or misleading communication about the lawyer or the lawyer's services. A communication is false or misleading if it contains a material misrepresentation of fact or law, or omits a fact necessary to make the statement considered as a whole not materially misleading.”

⁶ (a) A lawyer shall be subject to the Rules of Professional Conduct with respect to the provision of law-related services, as defined in paragraph (b), if the law-related services are provided:

(1) by the lawyer in circumstances that are not distinct from the lawyer's provision of legal services to clients; or

(2) in other circumstances by an entity controlled by the lawyer individually or with others if the lawyer fails to take reasonable measures to assure that a person obtaining the law-related services knows that the services are not legal services and that the protections of the client-lawyer relationship do not exist.

addition, Rule 8.4 provides, among other things, that it is professional misconduct for a lawyer to “engage in conduct involving dishonesty, fraud, deceit or misrepresentation” or “engage in conduct that is prejudicial to the administration of justice.”⁷

In almost all instances when talking about ethics and alternative billing arrangements, the biggest concern or question centers around a lawyer’s duties and abilities to provide independent advice and competent legal services. It is this twin set of fundamental obligations that are most often called into question when the billing arrangement seeks to limit the tasks that will be conducted, the amount that will be paid for a certain task, or creates outcome-based risk that is shared by the lawyer and client.

For instance, in a fixed fee arrangement or one that provides a cap or limit for the representation or particular phases of that representation, the incentive for the lawyer may be to spend as little time as possible on a particular task or to accomplish the task through associates or lower-cost lawyers. Especially when the client and lawyer do not have a track record

(b) The term "law-related services" denotes services that might reasonably be performed in conjunction with and in substance are related to the provision of legal services, and that are not prohibited as unauthorized practice of law when provided by a nonlawyer.

ABA Model Rules of Professional Conduct 5.7.

⁷ ABA Model Rules of Professional Conduct 8.4, which provides:

It is professional misconduct for a lawyer to:

- (a) violate or attempt to violate the Rules of Professional Conduct, knowingly assist or induce another to do so, or do so through the acts of another;
- (b) commit a criminal act that reflects adversely on the lawyer's honesty, trustworthiness or fitness as a lawyer in other respects;
- (c) engage in conduct involving dishonesty, fraud, deceit or misrepresentation;
- (d) engage in conduct that is prejudicial to the administration of justice;
- (e) state or imply an ability to influence improperly a government agency or official or to achieve results by means that violate the Rules of Professional Conduct or other law; or
- (f) knowingly assist a judge or judicial officer in conduct that is a violation of applicable rules of judicial conduct or other law.

with fixed fee or similar arrangements, both the client and lawyer need to be aware of the inherent tension that can exist in such circumstances. “Fixed fees have given rise to two concerns: (1) whether the fixed fee is excessive and (2) whether the fixed fee is inadequate.”⁸ Either circumstance can lead to potential ethical issues for the lawyer—that she is charging an unreasonable fee in the first instance or that her economic interests could interfere with her judgment and the quality of her representation in the second.

One of the concerns in fixed fee arrangements extends to blended or discounted rates as well. In these fee arrangements, the incentive within the law firm can be to use lower-fee attorneys to accomplish the bulk of the work. If these assignments are made without respect to the skills necessary to accomplish particular tasks, such arrangements can cross ethical boundaries. Even if a supervising attorney believes that matters are appropriately staffed, a bad outcome or a poorly-executed task can create client concerns in hindsight that the supervising attorney did not use his best judgment but rather his economic interests in making work assignments for the case.

Contingent fees of any variety have most often been employed when the lawyer is representing a plaintiff, whether an individual or a company, in a matter. Although it is much more difficult to figure out how to apply a straight contingency fee to a defense matter, some alternative fees with contingent components may be workable. In any event, there is no doubt that contingency fees and variations on them are now employed in a wider variety of cases than in the past.

The ABA Committee on Ethics and Professional Responsibility weighed in on the issue of contingent fees, including the use of such fees in non-traditional ways, such as business transactions. In its opinion, the Committee noted: “The use of contingent fees in these areas, for plaintiffs and defendants, impecunious and affluent alike, reflects the desire of clients to tie a lawyer’s compensation to her performance and to give the lawyer incentives to improve returns to the client.”⁹ Although “[f]rom the

⁸ Richard J. Rawson, Lee S. Cutliff, William F. Alderman, and Richard E. Donovan, “Ethical Considerations—Fixed Fees,” 1 *Successful Partnering Between Inside and Outside Counsel* § 8:22 (2010).

⁹ ABA Standing Comm. on Ethics and Professional Responsibility, Formal Op. 94-389 (1994).

client's perspective the contingent fee arrangement tends to encourage quality and discourage excessive work,"¹⁰ the flip side is that the lawyer has a financial interest in the case that could affect the lawyer's judgment. Thus, the largest ethical danger to a lawyer with a contingency fee, as with most other alternative billing arrangements, is that a situation will arise when the client's best interests comes into conflict with the best interests of the lawyer. Even if the lawyer avoids acting for his interests in the face of such a conflict, tension can arise when the client has reason to question whether a lawyer is providing the best legal advice as opposed to the advice that squares with the lawyer's pecuniary interests.

As clearly provided in Rule 1.5, any fee arrangement must be "reasonable" under the factors set out in that rule. As lawyers and clients search for billing arrangements that match expectations for the representation and that meet economic requirements, alternative fees are an experiment that is likely to last. While they may work well in some matters, others may be less suited for departure from tradition. Regardless of whether a traditional or non-traditional fee arrangement is to be employed, lawyers and their clients must be aware of the motivations and economic pressures that come with each type of fee agreement. More than that, they must make sure that the arrangement meets their expectations while still allowing a representation relationship based on trust and independent advice rather than other considerations. If the lawyer believes that an arrangement will not allow for the complete exercise of independent judgment or that it will compromise the lawyer's duties with respect to competent representation, the lawyer should not agree to the arrangement. This is especially true since the arrangement is most likely to be subjected to scrutiny in hindsight after a bad result or after other problems have arisen in the attorney-client relationship. In order to stand up to that scrutiny in the end, lawyers and clients must be definite in their discussions and scrupulous in defining the parameters of the billing agreement.

III. CONCLUSION

A key to making sure that the attorney-client relationship is not derailed by an untested alternative billing arrangement is clear and effective

¹⁰ Richard J. Rawson, Lee S. Cutliff, William F. Alderman, and Richard E. Donovan, "Ethical Considerations—Contingency Fees," 1 *Successful Partnering Between Inside and Outside Counsel* § 8:23 (2010).

communication as the arrangement is established. Clients and inside counsel are motivated by containing legal costs and incentivizing efficiency while getting the best representation possible for their legal-service dollars. Outside counsel must consider the economics of their practices and whether the representation arrangement fits within their profit and revenue goals. Each party is wise to recognize the interests of the other and to make sure that the goals of each are likely to be met by the proposed arrangement. If the proposed arrangement fails to meet those expectations of either party, there is likely to be dissatisfaction with the representation, the fee or both. Thus, “both inside and outside counsel should consider whether a proposed fee arrangement aligns their interests; promotes a long-term working relationship; avoids surprise or embarrassment; achieves the optimum mix of thoroughness and cost-effectiveness; utilizes technology to reduce costs and improve results; advances the diversity, career development and training of their respective staffs; and promotes increased understanding of their mutual client’s business and needs.” When both the client and the lawyer get an equally good or an equally bad deal, the fee arrangement is most likely to be deemed fair and reasonable. Other outcomes, especially if the lawyer receives a fee that, in the end, is out of proportion to both the time invested and the risk undertaken, are more likely to create conflicts with the client and ethical issues for the lawyer.

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Prior to joining Smith Moore, Allison clerked for the Honorable N. Carlton Tilley, Jr. on the United States District Court for the Middle District of North Carolina in 1996-97 and for the Honorable Susan H. Black on the United States Court of Appeals for the Eleventh Circuit in 1997-98. She graduated from Wake Forest University School of law in 1996 *cum laude* and Order of the Coif.

Allison has been named by *Law & Politics Magazine* as a *North Carolina Super Lawyer*, Civil Litigation Defense (2006 to present) and as one of the "Top 50 Women" attorneys in North Carolina (2007, 2008, 2009). She is listed *The Best Lawyers in America*® 2009, 2010 (Copyright 2007 by Woodward/White, Inc., of Aiken, S.C.), Appellate Law, First Amendment Law, Personal Injury Litigation, Product Liability Litigation. She has also been the recipient of the *Triad Business Journal's* 40 Leaders Under Forty award (2005), awarded to outstanding young business and community leaders in the Greensboro area.

In addition to the Federation of Defense and Corporate Counsel, she is a member of DRI, the Council of Appellate Lawyers, as well as DRI's Appellate Advocacy Committee. She serves in the leadership groups for both the Litigation Section and the Constitutional Rights and Responsibilities Section for the North Carolina Bar Association and is a member of the North Carolina Association of Defense Attorneys.