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INNOVATIVE LEGAL BILLING, ALTERNATIVES TO BILLABLE HOURS AND ETHICAL HURDLES

Ronald D. Rotunda*

A. INTRODUCTION

In contemporary times, the two main methods that lawyers use to bill clients are, first, the contingency fee (used primarily by plaintiffs' attorneys in personal injury actions1), and, second, billable hours (used by both plaintiffs' and defendants' attorneys in all other cases, ranging from corporate advice to litigation2). In recent years, both types of fees have come under heavy criticism.

Opponents of contingency fees typically claim that the plaintiffs' lawyers are often "over-compensated." Contingency fee lawyers dispute that. Because the lawyer only receives remuneration if the client agrees to a contingency fee and if the case is successful, proponents of contingency fees argue that the fees cannot be "too high." Clients only accept the fees if they choose to do so, and the lawyers have the risk of earning nothing.3

However, in some cases involving class actions, attorneys have received very handsome fees while their clients have walked away with little. For example, in one case, the attorneys for the class action plaintiffs agreed to accept $28 million in fees while their clients would receive $14 each.4

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1. The Albert E. Jenner, Jr. Professor of Law at the University of Illinois College of Law. The author is indebted to Sandra Pulley, J.D., 1999, the Stuart N. Greenberger Research Assistant in Legal Ethics.

2. Some courts have forbidden contingency fees for defense counsel. Wunschel Law Firm, P.C. v. Clabaugh, 291 N.W.2d 331 (Iowa 1980). On the other hand, the American Bar Association has concluded that there is no per se ethical objection. ABA Formal Opinion 93-373 (1993). These issues are discussed below.


In addition, given the greater frequency with which juries mete out punitive damages in recent years, in some cases, contingency fee lawyers are compensated in a way that, if the figure were converted to an hourly rate, amounts to many thousands of dollars per hour.\(^5\) While it is true that the number of cases in which juries award major punitive damages are still rare (as a percentage of all cases seeking punitive damages), a personal injury lawyer with a diversified portfolio of cases is very likely to generate a handsome yearly income. For an individual defendant, the award of punitive damages may be like getting hit by lightning: it hardly ever happens to any one person in particular, but it does eventually happen to someone.

While no particular plaintiff can be assured of winning a punitive judgment, the lawyer representing a series of plaintiffs is much more likely to win a punitive award in one of the cases. Consider, for example, the women who sued McDonald’s because she spilled a hot cup of coffee on herself. She won a punitive award (a settlement followed the jury verdict), but earlier plaintiffs complaining of similar injuries were not so fortunate. Each lawsuit may be likened to a lottery ticket. The more tickets you have, the better chance of holding a winning ticket. The personal injury plaintiff has one ticket; the lawyer representing a multitude of plaintiffs has a lot of tickets. The individual plaintiff’s risk of losing is real; the lawyer’s risk of losing a diversified portfolio of cases is much less.

Another objection to contingency fees is that the fee structure encourages lawyers to take frivolous cases. The latter argument does appear, at first blush, to be counter-intuitive because truly frivolous cases are losers. One would think that the last type of case a lawyer would take on a contingency fee would be a frivolous case. Because contingency fees only offer pay to the lawyer if he or she wins, the contingency fee lawyer should function as a gate-keeper. A lawyer should not want

\(^{5}\) Pfeifer v. Sentry Ins., 745 F. Supp. 1434 (E.D. Wis. 1990); Metro Data Systems, Inc. v. Durango Systems, Inc., 597 F. Supp. 244 (D. Ariz. 1984). See also Richard B. Schmitt, Courts Whittle Down Lawyers’ Fat Contingent Fees, WALL ST. J., Jan. 28, 1998, at B1; Editorial, Texas Tobacco, WALL ST. J., March 19, 1998, at A18 (lawyers’ fees of $2.3 billion for 18 months work). Sometimes the punitive damages can be so severe that their imposition violates due process. BMW of North America, Inc. v. Gore, 517 U.S. 559, 116 S.Ct. 1589, 134 L.Ed.2d 809 (1996). Plaintiff sued BMW because it had not disclosed to him that it had repainted part of the paint on the car. The car had been damaged, probably by acid rain. When the plaintiff discovered the repair (which cost $601), he sued BMW claiming that the nondisclosure was a form of fraud. The jury awarded the plaintiff $4,000 in compensatory damages and $4 million in punitive damages. The Court held, five to four, that the damages were so excessive as to violate due process.
to bring a case if it is frivolous. If the case is a likely to be a loser, the lawyer (who only is paid if the case is successful) should be unwilling to take the case: one-third of nothing is not very much.

On the other hand, contingency fees may encourage litigation of weak (but nonfrivolous) cases involving sympathetic plaintiffs. The lawyer who takes on a portfolio of cases may be quite willing to take an individual case that is not likely to win if he or she thinks that the likelihood of all the cases being lost is small (given the fact that each severely injured plaintiff cuts a sympathetic figure when before a jury).6

A third major objection is that a contingent fee case places the lawyer in a conflict of interest position, with respect to the client. The lawyer may be willing to settle the case very quickly before much work has been done, but it may not be in the best interest of the client to settle before discovery. On the other hand, as the case approaches trial, the lawyer may be more interested in not settling because it is only by playing in the litigation lottery (i.e., going to the jury) that the lawyer can hope to eventually hit the jackpot.7

Because of these issues, commentators have offered various proposals to modify the contingency fee arrangement and reduce litigation. One would expect that contingency fee lawyers would not greet such proposals with a warm welcome because the proposals should translate into a reduction of their income. In fact, that is what has happened.8

B. ALTERNATIVES TO BASIC CONTINGENCY AND FIXED FEES

In the meantime, lawyers, clients, and commentators have also turned their attention to the hourly fee arrangement, which also raises its own problems. Clients often express concern that the hourly fee may cause law firms to overstaff a case, or that the nature of the hourly fee makes it difficult for the client to budget legal expenses. As the Chairman of the Board of I.B.M. once said, the I.B.M. general counsel "is the only department head to whom we've given an unlimited budget—and


he's already exceeded it." However, it is not only large entities, but also small businesses or members of the middle class that share the same concern. When these small businesses and middle class citizens need a lawyer for such matters as representation in a drunk driving charge or drafting a will, they usually pay an hourly fee.10

Thus, while the hourly fee is still the overwhelming method of choice when lawyers charge for their services,11 alternatives to the hourly fee are developing. Some of the most popular alternatives include, for example, the following:12

- **Fee limits or caps.** Usually, the fee is based on an hourly rate but is subject to an agreed maximum. The law firm may agree not to charge more than a certain hourly rate for a maximum number of hours. Or the law firm may impose some sort of safety valve: that is, the firm does not accept the full cost of underestimating the cost of the legal services, but it will agree not to exceed the cap without additional client review and approval.

- **Discounted hourly rates and volume rates.** The firm may agree to charge reduced hourly rates to the extent that the client gives more business to the law firm. This method, like the previous one, is a modified version of the hourly rate.

- **Unbundled fees.** The law firm may offer the client the option of not hiring the law firm to perform certain chores but using other services (duplicating, document indexing, messenger services) to perform this separate, law-related work.

- **Variations on contingency fees.** The client and lawyer may agree that the law firm will charge lower than its normal hourly fee, but then the client will pay a bonus for success, in reaching particular goals or for achieving particular objectives, such as expeditious disposition of a motion or completion of a negotiation. Or the law firm may receive a bonus in addition to the base hourly

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rate if a transaction closes, while risking a reduction to the base hourly rate if the transaction does not close.\textsuperscript{13}

These alternatives are often more appealing to larger corporate clients, which have their own access to duplication services, and so forth. Indeed, they may have their own in-house legal staff to perform basic legal research. However, there is one alternative that is just as suitable to middle-class citizens as it is to larger clients: the fixed fee.

C. THE FIXED FEE

One obvious candidate to replace the hourly fee, at least in some circumstances, is a fixed fee, or what is sometimes called the "flat fee." Sometimes the fee is called a "transaction fee," but it is important to note that the flat fee need not be limited to a transaction (such as a securities offering); the flat fee can cover a particular law suit, or even a class of litigation.

Many clients, particularly businesses that use lawyers repeatedly, are proposing fixed fees when negotiating with their lawyers. These clients, whether large Fortune 500 Corporations or family businesses, are often called "sophisticated" legal consumers. They are "sophisticated" not in the sense that they are world travelers who drink their martinis shaken, not stirred, but they are "sophisticated" in the sense that they have repeatedly used lawyers' services in the past and expect to use lawyers in the future. Sometimes, in the case of small businesses, the owners may be entrepreneurs who are lawyers themselves, although they are no longer practicing law. In the case of larger businesses, the corporation may have its own corporate counsel. Sometimes the corporate counsel are in-house and work full time for the client. At other times, the

\textsuperscript{13} ABA Formal Opinion 94-389 (1994) suggests the client, in a public offering, may wish to avoid paying for the law firm's services in connection with offering until "an identifiable fund is available from the proceeds of a public offering." This particular fee arrangement can raise special conflict of interest issues in certain circumstances. The ABA Section on Business Law, Committee on Lawyer Business Ethics, Report on Alternative Billing Arrangements (Revised Draft, Feb. 17, 1998), at 33, note 25, notes that unlike investment bankers, securities lawyers, "in principle, do not have an interest in the transaction of a public offering closing." It may be true that there can be circumstances where "there may not be a solvent company from which to collect a fee if the financing is not completed." Id. There is a special conflict of interest when the law firm's fee is tied to the completion of a public offering that the law firm put together. SEC v. National Student Marketing Corp., 457 F.Supp. 682, 691-94, 711-12 (D.D.C. 1978)(lawyer, who stood to profit "handsomely" from the merging corporation where he was an officer and shareholder acted improperly when he did nothing after learning that interim financial statements were inaccurate. See ABA Section on Business Law, Committee on Lawyer Business Ethics, Report on Alternative Billing Arrangements (Revised Draft, Feb. 17, 1998), at 34-36, note 26. In re Candie's, Inc., SEC. ACT. RELEASE NO. 7263 (SEC Feb. 21, 1996).
client may have part-time corporate counsel, and this lawyer hires other lawyers from other law firms to work on various projects for the client.

But these clients need not be limited to businesses. They can include middle-class individuals. In such circumstances, the lawyer may be the person who initially proposes the use of a flat fee. The clients do not normally initiate the proposal because they are not "sophisticated," in the sense that they do not repeatedly use lawyers' services. However, these clients—middle class individuals or small businesses without access to in-house counsel—should be considered "fully informed" consumers of legal services, in the sense that the lawyer explains to them the alternative of hourly billing (and the inevitable possibility that the hours expended may be more or less than a good faith estimate at the time that the client approaches the lawyers) and the alternative of a flat fee.

In both cases, these clients—whether called "sophisticated" or "fully informed"—often prefer a fixed fee. In either case, the touchstone is that the client is "fully informed." Even if the client is not a sophisticated, repeat-user of legal services, if he or she is fully informed (including being informed that the client can seek legal services elsewhere if he or she does not want to be offered the alternative of choosing a flat fee), then it is my thesis that the law of ethics, the law governing the practice of law, should let the client and lawyer make that choice.

Clients who favor an effort to obtain more consistent results and to promote more efficient handling of our cases are likely to favor fixed fees. They want to be able to budget for legal fees and move some or all of the risk of an incorrect estimate of costs from the client to the lawyer. They want to give lawyers a monetary incentive to become efficient, and they know that the lawyer who is charging a fixed fee takes on the burdens of running an inefficient law office. For these reasons, many clients have decided to emphasize fixed fee billing arrangements.

Sometimes the task to be performed is relatively straightforward—the preparation of a will, or an adoption, or a divorce. But the fixed fee is not limited to these situations. In litigation, the client also wants the benefits of a fixed fee. Consider, for example, a client that wants to propose to its lawyers (or a law firm that proposes to its client) that the law firm will charge a negotiated fixed fee for certain types of products liability cases. The payer of the legal fees may be a self-insured business or it may be an insurance company (who regularly insures parties who are sued for products liabilities).

In a typical case, the client (or the insurance company on behalf of the insured) solicits fixed fee bids from several law firms on various matters. Attorneys may propose to handle matters (either a particular
task, such as a deposition or series of depositions, or a particular lawsuit or a series of lawsuits) for a fixed amount that will include both attorneys' fees and expenses. The client may also seek to negotiate annual fixed fees for the performance of the balance of litigation (although there might be separate negotiations for particular trials and appeals). The fixed fee would be a lump sum that includes both expenses (such as travel costs, photocopying, and expert witness' fees) as well as the attorneys' fees.

The purpose of this method of billing is not merely to provide a much-simplified billing arrangement, although that result will certainly occur. Rather, it is to provide the proper incentives to reward efficient handling of lawsuits, in essence, encouraging law firms to efficiently manage the use of their time as well as disbursements, expenditures and all out-of-pocket costs.

For example, if a client provided that the law firm would charge a fixed amount for its lawyers' time but had no limit on out-of-pocket costs, we would not be surprised if the law firm ran up out-of-pocket expenses. The lawyers would be flying first-class instead of coach because the costs of the added airfare really mean nothing when someone else is paying the expenses. On the other hand, if the law firm had agreed to a fixed cost, it would have an incentive to reduce costs because any savings would translate directly into its bottom line. Therefore, the lawyers would be more likely to fly coach.

In the past, when clients have proposed fixed-fee arrangements, some lawyers have responded that these proposals violate the ethical rules governing lawyers. In general, some lawyers claim that fixed-fee arrangements will or may violate the ethics rules relating to the obligation of the client to assume the ultimate responsibility for litigation costs, in violation of ABA Model Rule 1.8. The basic argument is that Model Rule 1.8(e) prohibits a law firm from paying or guaranteeing litigation expenses unless a client remains ultimately liable for those expenses.

Model Rule 1.8(e) provides as follows:

"A lawyer shall not provide financial assistance to a client in connection with contemplated or pending litigation, except that:

(1) a lawyer may advance court costs and the expenses of litigation, the repayment of which may be contingent on the outcome of the matter; and

(2) "a lawyer representing an indigent may pay court costs and expenses of litigation on behalf of the client."

The concern that some law firms raise is that the law firm may bid a particular fixed amount to handle a piece of litigation, let us say "x" dollars. Included in that amount is both attorneys' fees and any expenses related to the litigation ("court costs and expenses of litigation"). What if perhaps there is a case where the total expenses are unusually high, so that they end up totaling, let us say, "x + y" dollars. As such the litigation expenses for that case would be greater than the total amount that the law firm had agreed to bill the client (which is "x" dollars, the agreed-upon fixed payment). Under these circumstances, the law firm's attorneys' fee would be zero; more importantly, that would mean that the law firm and not the client would be ultimately liable for the expenses to the extent that the expenses exceeded "x" dollars. Thus, say some lawyers, it would be in violation of ABA MODEL RULE 1.8(e)(1)—and the state rules, which are generally identical to the ABA Model Rule on this issue—because the client (who bargained for a fixed fee) was not "ultimately liable for such expenses."

On one occasion, I know that a law firm, relying on this interpretation of the MODEL RULES, threatened a prospective client (who had proposed a fixed-fee arrangement) by stating that, if the prospective client would go forward with its plan, it would "be exposed to adverse publicity" for hiring lawyers who have violated the ethics rules and, moreover, the law firm would be obligated to report the lawyers who proposed such

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15. Thus, one firm had argued that a state version of Rule 1.8(e) [which corresponds to ABA MODEL RULE 1.8(e)] is violated whenever a client and an attorney agree that the client is responsible for expenses up to a budgetary payment, and then the lawyer is responsible for any and all expenses in excess of that budgetary ceiling, and the lawyer will not be reimbursed by the client for those "excess" amounts.
a fixed fee arrangement to the state's discipline authorities. The client then backed away from proposing fixed fees in that jurisdiction.

No law firm need accept a client's proposal of a fixed fee for a particular task. However, if a law firm does not accept the proposal, it may put itself at a competitive advantage compared to other firms. The law firm may seek to persuade other law firms to put up a united front and not to accept a fixed fee proposal, but such agreements would amount to a restraint of trade under the antitrust laws. But, if the state ethics rules promulgated by the state supreme court prohibit fixed fees, there is no antitrust problem because of the principle that one does not conspire with the state when one merely follows a state law. Thus, it is a much more powerful statement for a law firm to contend that it cannot accept a proposal for a fixed fee because it is unethical and to follow this statement by a threat (veiled or otherwise) to report to the disciplinary authorities any other law firm who broke ranks.

D. Task-Based or Fixed-Fee Billing in Perspective

It is increasingly common for clients or lawyers to propose task-based, or fixed-fee billing. Some clients and law firms have made no secret of a preference for fixed fees, at least in some circumstances. In fact, some prestigious law firms have publicly announced that they are engaging in flat-fee billing. But recent authority raises roadblocks to this development.

1. The Contingent Fee Exception

ABA Model Rule 1.8(e) has two main exceptions. Subsection (2) refers to cases where the client is indigent, and therefore it is not on

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17. The incident, on which I consulted, is not publicly reported.


20. Amy Stevens, Frequent-Client Club Takes Flight in Trend Toward Flexible Pricing, WALL ST. J., July 15, 1994, at B6, col. 1, which notes that the Chicago law firm of Bartlit, Beck, Herman, Palenchar & Scott, a firm created by former partners of Kirkland & Ellis, is "offering flat fees and other alternative billing arrangements." "So far," says partner Skip Herman, "clients have 'reacted extremely well,' opting for nontraditional billing in 75% of new matters." (emphasis added).
point. Subsection (1), however, is applicable. It provides that the client does not have to be ultimately liable for the repayment of the expenses of litigation if “the repayment is contingent on the outcome of the matter.”

The term “outcome” need not necessarily mean “a complete judicial victory” or “a complete judicial loss.” For example, personal injury lawyers routinely charge different contingencies depending on whether the case is settled before trial (a situation where there is no judicial determination at all), it goes to a jury verdict, or whether the case must be appealed on one or more issues, and so forth.

What a client (or law firm) who offers a flat fee for handling a matter is proposing is that any repayment of actual expenses (including litigation expenses) is contingent on whether the expenses are less than the agreed upon flat fee, which includes both expected expenses and an expected attorney fee. This situation is not really different in kind or degree from the situation where a personal injury plaintiff's lawyer agrees with the plaintiff to take expenses out of the verdict or settlement, so that if the expenses exceed the amount of verdict (or the verdict gives the plaintiff nothing), the lawyer makes no profit.

In the case where the law firm proposes, and the client accepts, a particular flat fee [which would include expenses (both litigation expenses and other expenses) as well as the attorneys’ fees], it may be that the total expenses of litigation turn out to exceed that proposed flat fee. In that situation, a contingency (that is, a condition, a possibility, a potentiality, a qualification) has occurred. The repayment of the law firm’s expenses is contingent or conditional on a satisfactory outcome. If the outcome is unsatisfactory, then the expenses alone may exceed what the total flat fee was expected to be. The law firm’s actual expenses of the litigation may be so large that they exceed the law firm’s total bill, which included both out-of-pocket expenses and attorneys’ fees. What has occurred is simply a form of contingent fee where it is the lawyer for the defendant who is being paid based on a contingency. The same thing will occur when the lawyer for the plaintiff charges a contingency fee and the outcome is successful.

We do not often think of contingency fees for defense matters, but the ABA MODEL RULES do not preclude them. MODEL RULE 1.5(d) only prevents contingent fees in divorce or criminal cases. The ABA provision dealing with contingent fees does not limit them to personal injury actions or even to actions brought by plaintiffs. It simply authorizes lawyers to contract with a client “for a reasonable contingent fee in a civil
Neither Rule prohibits contingent fees in defense cases. Commentators have also noted that there may be contingency fees in defense cases.\textsuperscript{22}

\textbf{ABA Formal Opinion 93-373}\textsuperscript{23} specifically approves of contingent fees charged by defense counsel, provided that the total fee is "reasonable" (that is, not excessive), and that the client gives informed consent. The ABA \textit{Opinion} expressed concern that what it called a "reverse contingent fee" might be based on "purely speculative" factors\textsuperscript{24} and that the lawyer might engage in overreaching of the client, to whom the lawyer owes a fiduciary relationship.

However, those risks do not apply here. The client is well-informed and sophisticated and knowledgeable enough to propose (or accept) a flat fee because that is in their best interest. The client can always choose an hourly fee if that is what she wants. The law firm that objects to a flat fee is not objecting to the contingency on the grounds that the total fee it will collect will be too high, but that it might be (in its view) too low. That is not an interest, in this context, that the ethics rules protect. The ABA \textit{Opinion}, in short, concluded that there is no \textit{per se} objection to contingency fees for defense counsel.\textsuperscript{25}

\section{2. The Rationale Behind Model Rule 1.8(e)}

The conclusion that ABA Model Rule 1.8(e)—and the state rules that are derived from this rule—should not preclude a flat fee proposal that is supported by the purpose behind this rule: it exists to prevent what the common law called "maintenance." The lawyer's financial assistance should not "encourage a client to pursue lawsuits that might otherwise be forsaken."\textsuperscript{26}
There is no danger of a lawyer’s improper maintenance of a client who is a defendant. As Justice Cardozo noted in the case of *In re Gilman’s Administratrix*: 27

"The point of those [other] decisions was that the retainer of the attorney was not to attack, but to defend. He was not inciting to litigation. He was protecting the interests of a client against assaults begun or threatened." 28

That, of course, is the situation here. No attorney is being asked to engage in champerty or maintenance by inciting and funding a plaintiff’s frivolous lawsuit against another entity. The client seeking the flat fee is often the defendant whose interests are being threatened. The retainer of the attorney is not to attack but to defend. One can hardly accuse a law firm or client of stirring up litigation when the client is a defendant in the lawsuit and the law firm is representing the defendant.

Model Rule 1.8(e), and the state rules derived from this Model Rule, do place some limits on loans by attorneys to clients. However, as the American Law Institute’s proposed Restatement explains, the dangers from such loans “are absent when the lawyer makes a gift of money to a client rather than lending it.” 29 To the extent that the law firm agrees to a maximum cap on expenses, the amount of expenses in excess of the cap may be treated as sort of a “gift” from the law firm to the client—a gift subject to a condition subsequent (*i.e.*, “if the law firm’s expenses exceed a certain amount, the law firm agrees to treat any figure above that amount as tantamount to a gift”). In other words, the gift is not made with the requirement that the client continue to pursue the litigation unless the lawyer allows the client to settle. The gift, in short, is not part of an improper effort to engage in champerty or maintenance. The gift does not prevent the client from settling the case if she wants to do so. These gifts are not unethical because they come with no improper strings attached.

3. *Alleged Conflicts of Interest*

A. *Introduction.* Some law firms have also objected to flat-fee agreements on the grounds that they create an improper conflict of interest. The argument is that a flat fee creates the possibility that decisions

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27. *In re Gilman’s Administratrix*, 251 N.Y. 265 (1929).
28. *Id.* at 269.
INNOVATIVE LEGAL BILLING

regarding whether to incur a certain expense in the defense of the client will place the firm in a conflicted situation with the client.

This argument proves too much. If accepted, it would prevent any lawyer, even a plaintiff’s attorney in a typical personal injury claim, from ever agreeing that the client’s reimbursement of the expenses of the litigation would be contingent on the outcome. Yet ABA MODEL RULE 1.8(e), and the similar rules of other jurisdictions, specifically permit an attorney to do exactly that.

Moreover, other fee arrangements, such as a pure hourly fee agreement, raise similar conflict problems. As the American Bar Association acknowledges, “continuous toil on or over staffing a project for the purpose of churning out hours is also not properly considered ‘earning’ one’s fees.”

One of the few cases to consider such issues extensively is In re Oracle Securities Litigation, which rejected this conflict argument. In Oracle, various plaintiffs’ law firms bid on the right to become class counsel. An unsuccessful bidder (the Gold firm) challenged the successful bidder (the Lowey firm) on the grounds that the Lowey firm had agreed to limit its claim for reimbursement of expenses to $325,000, and thus, the Gold firm contended, “the limitation will probably force the Lowey firm to pay for some litigation expenses out of its own pocket.” The Gold firm claimed that this limitation created a conflict of interest between the Lowey firm and its client, the members of the class action, because the possibility of paying for expenses out of its own pocket “will deter the Lowey firm from incurring the expenses necessary to maximize the class’ recovery.”

The court analyzed ABA MODEL RULE 1.8(e) and rejected the argument that the Lowey firm violated MODEL RULE 1.8 or was in a conflict situation. In fact, the court found this ethical argument to be “specious.”

If there is a cap on an attorney’s fees, but no cap on the attorney’s reimbursements, there will be a strong incentive for the law firm to favor the use of reimbursements and substitute those reimbursements for

30. ABA Formal Opinion 93-379 (Dec. 6, 1993). This ABA ethics opinion deals with billing problems generally, and does not specifically discuss a fixed fee arrangement. However, footnote 4 of this opinion does state: “Rule 1.5 clearly contemplates that there are bases for billing clients other than time expended.” Later, in the text, it mentions that, if a lawyer is billing on an hourly basis, then it would be improper for that lawyer to charge a client for hours in excess of the estimated hours if “the client agreement turned the original estimate into a cap on the fees to be charged.” (emphasis added). This ABA Formal Opinion appears to recognize that clients and lawyers can agree to a fixed fee.
32. Id. at 642.
33. Id.
hourly work, thus avoiding the previously agreed upon cap on fees. To an extent, non-attorney litigation expenses, such as computerized legal research, factual investigations by non-lawyers, hiring outside legal consultants (such as law professors), and so forth, are substitutes for a lawyer’s hourly efforts.\textsuperscript{34} If a cap on total costs (including expenses) are unethical, then a law firm will favor the use of these nonattorney substitutes, which would not be subject to a cap.\textsuperscript{35}

Moreover, an ethics rule that requires full reimbursement of expenses encourages a form of cheating that is virtually impossible to police. Attorneys will be encouraged to allocate a portion of their overhead to specific litigation. All law firms have overhead: administration of the law office, secretarial services, accounting, filing, paralegal costs, library services, computer training, computerized legal research, general clerical chores and other costs that must be incurred to enable the firm to operate, can under some guise, be allocated to the litigation at hand.\textsuperscript{36} Placing the attorneys’ fees and the expenses under one cap avoids these problems while rewarding the law firm when it makes the most efficient use of its resources.

It makes good economic sense for a law firm to offer a client the option to pay a flat fee for its legal work. Flat fees shift the risks of the unknown—how many hours will the law firm actually have to devote to a case—from the client to the law firm. Many law firms should be able to assume this risk because the law firm is the more efficient risk-spreader. The law firm has, in effect, a diverse portfolio of cases. The client, especially the average middle class citizen, may have only one or two cases to give to the law firm. The client does not have a diverse portfolio of law cases, but the law firm does, so it can more easily accept a series of cases, each for a flat fee, knowing that the losses in one case are likely to be balanced by the gains in another.

\textbf{E. Ethical Objections to Flat Fees}

Notwithstanding the benefits that flat fees can confer on both clients and lawyers, only a few ethics opinions explicitly provide support for this type of flat-fee arrangement.\textsuperscript{37} On the other hand, there is important

\textsuperscript{34} Note that Illinois Rule 1.8(d) refers to litigation expenses as “including, but not limited to, court costs, expenses of investigation . . . .” (emphasis added).

\textsuperscript{35} \textit{Supra} note 31, at 644.

\textsuperscript{36} \textit{Id.}

\textsuperscript{37} Ethics opinions allowing flat fees with insurance companies (and, by analogy, with other clients) include, \textit{STATE BAR OF WISCONSIN OPINION} E-83-15 (1983); \textit{OREGON STATE BAR OPINION} 1991-98 (1991); and \textit{NEW HAMPSHIRE BAR ASSOCIATION, FORMAL OPINION} 1990-91/5 (1991).
authority that is substantially unsympathetic to the concept of flat fees. Consider, for example, *American Insurance Association v. Kentucky Bar Association.* Various insurers objected to a Kentucky State Bar Association Advisory Ethics Opinion that prohibited any lawyer from entering into a contract with any liability insurer to do the insurer's legal work for a set fee. The Advisory Ethics Opinion concluded that flat fees were unethical and prohibited. Later, the Kentucky Supreme Court concurred with this ethics opinion.

The state bar and the state supreme court both concluded that the flat fee would violate the state rule that corresponded to ABA Model Rule 1.7(b), prohibiting lawyers from representing a client if the lawyer's responsibilities to the client would be "materially limited" by the lawyer's responsibilities to third parties (the insurance company in this case). In addition, the state bar and the state supreme court concluded that agreeing to a set fee with the insurance company would interfere "with the lawyer’s independence of professional judgment" in violation of the Kentucky rule corresponding to ABA Model Rule 1.8(f)(2).

The Kentucky court's reasoning is interesting. It did not discuss the fact that ABA Model Rule 1.5, the main rule dealing with fees, expressly recognizes that a fee may be "fixed." Instead, the court argued that a flat fee is inherently different than a retainer or a contingency fee, both of which do not constitute any violation of the ethics rules. First, the court argued that "a set fee arrangement enables the insurer to constrain counsel for the insured by, in effect, limiting the defense budget . . . ." Let us consider that question.

When a client hires a lawyer for a flat fee, it is not really that different from when a patient hires a doctor at a flat fee. Patients make this choice all the time when they decide whether to join an HMO, a Health Maintenance Organization. Some patients prefer to choose their doctor and not be bound by the restrictions of an HMO; other patients prefer the cost savings of joining an HMO and are willing to be bound by its restrictions. In neither case does the patient bargain for an incompetent doctor, but patients are allowed to bargain for an HMO and pay its flat fee. Clients of lawyers, like patients of medical doctors, should also be allowed to join the legal equivalent of an HMO.

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40. *Supra* note 38, at 569.
41. *Id.* at 570.
42. ABA Model Rule 1.5(a)(8).
43. *Supra* note 38, at 572.
Moreover, the fear that flat fees will allow or encourage insurers to interfere with the obligation of a lawyer to provide competent service, by limiting the total amount paid to the lawyers for the insured, is simply unrealistic. It would not normally be in the interest of the insurance company to limit the defense budget in that way. Not only will such a limitation mean that the insured would have a cause of action against both the insurer and the lawyer, but the insurer would be acting adversely to its own interest. If the lawyer does not provide an adequate defense, the insurer will have to pay the damages to the plaintiff. The insurer, after all, is liable to pay the judgment against the insured. The interests of the insured and insurer, in presenting a competent defense, are usually congruent.

There may be cases where the plaintiff sues for an amount in excess of the policy limits, and the chances of a judgment in excess of policy limits is realistic. Yet, even in those cases, the lawyer has little incentive to give less than competent service. First, he or she has to worry about his or her own malpractice liability, and second, performing inadequately in one case is hardly the best way to persuade the insurance company to retain that lawyer in the future. In any event, the Kentucky Court in *American Insurance Association* did not even limit its reasoning to cases where the insured is realistically sued for an amount in excess of policy limits.

The Kentucky court also complained that a flat fee—

"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."

If this possibility—that the lawyer will guess wrong in some cases and suffer a financial loss, and guess right in other cases and make a profit—is enough to invalidate a fee arrangement, then contingent fees in personal injury cases should have been outlawed long ago. But contingency fees are permissible, even though they also create a situation where "counsel will take a financial windfall" in some cases while suffering a "financial loss" in others.

Later in its opinion, the Kentucky court, in the guise of ethics, elaborated on this theme and showed unusual solicitude and concern for the financial well-being of lawyers. The court said that the set fee agreement

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44. For breach of fiduciary duty and malpractice.
45. *Supra* note 38, at 572.
46. ABA Model Rule 1.5(d). *See also* Model Rule 1.8(j).
is "ripe with potential conflicts," such as when representation of the insured "becomes more complex than anticipated, resulting in financial hardship for the attorney . . . ."47 It is not unethical for an attorney to suffer financial hardship when he or she guesses wrong on the outcome of a case. It happens to plaintiff-lawyers who charge continency fees and lose the case.

The court’s repeated concern for the financial well-being of defense lawyers is surprising given the fact, that Kentucky’s ethics rules do not require minimum fees, and the bar associations provide no set fee schedules.48 If the lawyer and client (or the lawyer and the insurance company) want to bargain for flat fees, why should the court be concerned that a flat fee may result “in financial hardship for the attorney”? The attorneys are not ethically obligated to charge any fee. And, in pro bono matters, attorneys are encouraged to charge no fee or charge a reduced fee.49 In fact, no ethics rules require an attorney to charge any fee in representing a client. The attorney is an adult and should be able to choose to take the risk of “financial hardship.” If he wants to represent his brother-in-law for free, he may do so even if the brother-in-law can afford to pay his normal hourly fee.

The Kentucky court added another argument also based on an alleged conflict of interest: “Inherent in all of these potential conflicts is the fear that the entity paying the attorney, the insurer, and not the one to whom the attorney is obligated to defend, the insured, is controlling the legal representation.”50 Yet, once again, the court’s argument proves too much. The risk that the lawyer will be more loyal to the insurer (the repeat client) and not the insured (who often is unlikely to be returning for more legal work) is a risk that is not related to the flat fee. Lawyers can be corrupted just as much by an hourly fee as by a flat fee.

Other jurisdictions appear to be following the lead of the Kentucky court. The Supreme Court of Ohio’s Board of Commissioners on Grievances and Discipline issued its own opinion on the propriety of a law firm agreeing to perform all or a part of an insurer’s defense work for a

47. Supra note 38, at 573.
49. ABA Model Rule 6.1, Voluntary Pro Bono Publico Service (urging 50 hours of pro bono publico service per year).
50. Supra note 38, at 573.
The Opinion candidly admitted that it is unlikely that a fixed fee would be excessive because insurance companies are not without experience and bargaining power. However, the —

"more pertinent concern is that the flat fee agreements between an attorney or law firm and a liability insurer will provide insufficient and inadequate compensation to the attorney or law firm. When a flat fee agreement between an attorney or law firm and a liability insurer provides insufficient compensation in regards to the time and effort spent on the representation, ethical problems emerge."\(^{52}\)

You have read this quotation correctly: the court actually said that the "more pertinent concern is that the flat fee agreements between an attorney or law firm and a liability insurer will provide insufficient and inadequate compensation to the attorney or law firm."

Attorneys must be paid enough, this argument states, so that they will be ethical. If attorneys start to work too cheaply, they can compromise the ethics rules. The ethics rules, it appears, do not merely forbid unreasonably high fees, they also prohibit unreasonably low fees.

The Ohio ethics opinion also announces that, even if the flat fee is high enough so that the attorney can ethically accept it, the attorney cannot agree to include the actual expenses in the flat fee. "In addition to paying the fixed fee, the insurer must remain ultimately liable for the actual expenses of litigation in all circumstances."\(^{53}\)

This statement is also, frankly, peculiar. If the lawyer wishes to assume the burden of paying all expenses out of the flat fee, why should the law prevent the lawyer from making that choice? The ABA Model Rules explicitly recognize that the lawyer can advance expenses of litigation and make repayment of those costs "contingent on the outcome of the matter."\(^{54}\) If the lawyer can advance expenses of litigation and agree to seek no reimbursement if the lawsuit is unsuccessful, should not the lawyer be able to charge a client a fixed fee and assure the client that any expenses will be deducted from the fixed fee?

One might read the Model Rules to provide that, in one circumstance, the client must be liable for expenses of litigation: when the expenses are in excess of the flat fee and the litigation is successful, then ABA Model Rule 1.8(e)(1) may be read to provide that the lawyer cannot absorb the expenses of litigation in excess of the flat fee. That read-

\(^{51}\) The Supreme Court of Ohio, Board of Commissioners on Grievances and Discipline, Ohio Opinion 97-7, (Dec. 5, 1977), 1997 WL 782951.

\(^{52}\) Id. at 3 (emphasis added).

\(^{53}\) Id. at 5.

\(^{54}\) ABA Model Rule 1.8(e)(1).
ing is hardly compelled, for that Rule does specifically allow the lawyer to make repayment of expenses to be contingent on the outcome of the litigation. Nonetheless, even if one interprets that Rule to mean that if the defendant wins the case, then the defense attorney must be guaranteed that he will be repaid all out-of-pocket expenses, then one must anticipate that such case is likely to be quite rare. Nevertheless, the Ohio opinion is much broader, requiring the insurer to pay the "actual expenses of litigation in all circumstances."\(^{55}\)

The ABA Model Rules recognize that a flat fee can include all expenses, but they only caution the lawyer to fully explain to the client what the flat fee means. A lawyer, in other words, "should not enter into an agreement whereby 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."\(^{56}\) This warning seems to be saying that lawyers can include costs in a flat fee, but clients should have the information "adequately explained" to them. The law firm might state that it will pay all out-of-pocket expenses up to a certain amount. Or, it might assume all the liability for disbursements if the litigation is unsuccessful.

The recent ethics opinion of the Connecticut Bar Association, *Set Fee Per Case for Third Party Defense Work*,\(^{57}\) is also quite interesting. In this case, an insurance company asked a law firm to perform all of its defense work in the State of Connecticut for a flat fee per case. The law firm, rather than accepting or rejecting the proposal, asked the Connecticut Bar whether it would be unethical for any law firm to accept this proposal. If no firm can ethically accept the proposal, then no firm would be at a competitive disadvantage if it refused to consider it.

The very brief Connecticut opinion concluded that there is no per se objection to a flat fee, but the burden of proof is on the law firm if the client later complains. The flat-fee arrangement would be permissible only if the law firm is able to "assure that the scope and quality of the defense is not compromised by the fee arrangement, even if the client (the insured) questions it in hindsight . . . ."\(^{58}\)

\(^{55}\) Supra note 51, at 5. See also *Supreme Court of Ohio, Board of Commissioners on Grievances and Discipline, Ohio Opinion 95-2*, 1995 Westlaw 813785, concluding that if a law firm enters into a flat-fee agreement with an insurance company, "the expenses of litigation must be borne by the client in addition to the fixed flat fee . . . ." (emphasis added).

\(^{56}\) ABA Model Rule 1.5, comment 3.


\(^{58}\) Id.
It is always difficult to prove a negative. Moreover, why should the burden of proof change simply because the lawyer changes the method of computing fees? It is the basic rule that, in "an action to recover damages caused by the attorney's malpractice, the plaintiff has the burden of proving every essential element of the cause of action." When the fee is computed on the basis of billable hours, the law firm does not have the burden to prove that its defense was not compromised by the fee arrangement. Nor does the burden change because the plaintiff's attorney charged a contingent fee. Why must the burden change when the defendant's attorney charged a contingent fee? The Connecticut ethics opinion considers none of these issues.

F. Conclusion

In short, flat-fee arrangements should not violate the ABA Model Rules or similar state rules. Sometimes the client will prefer a flat fee because it is easier to budget legal expenses and shift the burden to law firms, which can better assume the risks, because they typically have a portfolio of cases. In other circumstances, the insurer paying for legal counsel will prefer a flat fee for similar reasons.

Admittedly, several ethics opinions and some case authority oppose flat fees, or place significant, special ethical restrictions on them. But a careful analysis of the issue indicates there is no per se conflict of interest that is different in nature or in degree from the interest conflict in any fee arrangement, such as an hourly fee arrangement. Any method of paying lawyer's fees has various inevitable conflicts built into it. Hiring a lawyer on a flat-fee arrangement no more encourages the lawyer to violate his ethical responsibilities than hiring the lawyer on the basis of billable hours encourages the lawyer to drag out the case, put in unnecessary hours, to gold brick, to avoid settlement, to over-staff or over-research a problem.

Whether the insurance company or an individual client chooses a flat fee, the courts should not intervene except in cases where the lawyer misrepresented the nature of the fee agreement or the client otherwise

could not make a knowledgeable choice. The court, however, should not examine the fee arrangement using 20-20 hindsight. In retrospect, the choice may look bad or really good, but the courts should not invalidate these agreements unless the fee agreement is the product of the abuse of the lawyer's fiduciary responsibilities.