AMERICAN BAR ASSOCIATION
STANDING COMMITTEE ON ETHICS AND PROFESSIONAL RESPONSIBILITY

Formal Opinion 93-373 **April 16, 1993**

Contingent Fees in Civil Cases
Based on the Amount of Money Saved for the Client

The Model Rules do not prohibit "reverse" contingent fee agreements for representation of defendants in civil cases where the contingency rests on the amount of money, if any, saved the client, provided the amount saved is reasonably determinable, the fee is reasonable in amount under the circumstances, and the client's agreement to the fee arrangement is fully informed.

The Committee has been asked whether under the Model Rules of Professional Conduct (1983, amended 1993) it is proper for a lawyer to charge a "reverse" contingent fee--that is, a fee based on the amount of money saved a client rather than the amount of money recovered for a client. The situation presented to us is as follows: A lawyer is asked to represent a client who has been sued for damages. The lawyer typically is able to dispose of such cases either by settlement or by litigation to judgment for an amount less than the amount originally demanded. The lawyer proposes to charge the client a contingent fee dependent on the result and measured as a stated portion of the difference between the amount originally demanded and the amount the client is ultimately required to pay.

Restrictions on Contingent Fee Agreements

As a preliminary matter, the Committee notes that in many jurisdictions there are statutes and court rules imposing limits on the fee agreement for which the lawyer may contract. In addition, contingent fee arrangements in litigated matters are often regulated by courts.[1] The Committee does not opine on matters of law and we address only the issue of whether the fee arrangement contemplated in the instant inquiry is permissible under the Model Rules.

Both the subject of fees in general and that of contingent fees in particular

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1. See generally, Note, Judicial Power Over Contingent Fee Contracts: Reasonableness and Ethics, 20 CASE W.RES.L.REV. 523 (1980).

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are dealt with in Model Rule 1.5.[2] The only instances in which a contingent fee arrangement as such is prohibited are those specified in Model Rule 1.5(d), which prohibits contingent fees in domestic relations and criminal matters. Disciplinary Rule 2-106(C) of the predecessor Model Code of Professional Responsibility (1969, revised 1980) prohibited a contingent fee in a criminal case. The predecessor Model Code had no outright prohibition on contingent fees in domestic relations cases but Ethical Consideration 2-20 stated that such arrangements were "rarely justified."[3]

The Model Rules prohibit contingent fee arrangements in criminal and domestic relations cases because such arrangements may present the risk of giving the lawyer an interest that is in conflict either with the client's interests or with important public interests. In domestic relations cases, it is inappropriate for the lawyer to have a stake in the dissolution of a marriage.[4] In criminal representation, the fear is that such arrangements will promote unscrupulous representation or discourage plea bargaining.[5] An additional problem in these representations is the difficulty of defining a successful outcome.[6]

However, in the view of the Committee, when reasonably determinable

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2. Rule 1.5(c) states as follows:

A fee may be contingent on the outcome of the matter for which the service is rendered, except in a matter in which a contingent fee is prohibited by paragraph (d) or other law. A contingent fee agreement shall be in writing and shall state the method by which the fee is to be determined, including the percentage or percentages that shall accrue to the lawyer in the event of settlement, trial or appeal, litigation and other expenses to be deducted from the recovery, and whether such expenses are to be deducted before or after the contingent fee is calculated. Upon conclusion of a contingent fee matter, the lawyer shall provide the client with a written statement stating the outcome of the matter and, if there is a recovery, showing the remittance to the client and the method of its determination.

3. Ethical Consideration 2-20 states in relevant part:

Contingent fee arrangements in civil cases have long been commonly accepted in the United States in proceedings to enforce claims. The historical bases of their acceptance are that (1) they often, and in a variety of circumstances, provide the only practical means by which one having a claim against another can economically afford, finance, and obtain the services of a competent lawyer to prosecute his claim, and (2) a successful prosecution of the claim produces a res out of which the fee can be paid. Although a lawyer generally should decline to accept employment on a contingent fee basis by one who is able to pay a reasonable fixed fee, it is not necessarily improper for a lawyer, where justified by the particular circumstances of a case, to enter into a contingent fee contract in a civil case with any client who, after being fully informed of all relevant factors, desire that arrangement....

4. See generally, C. WOLFRAM, MODERN LEGAL ETHICS 538-541 (1986).

5. Id. at 535-38.

6. See generally, RESTATEMENT OF THE LAW GOVERNING LAWYERS ß 47(c)(i) & (d) (Tent.Draft No. 4, 1991).

civil damages between private parties are at issue, there is no similar basis in public policy for prohibiting a fee arrangement based on a percentage of the amount saved a defendant, so long as the reasonableness and informed consent requirements of Rule 1.5 are satisfied.[7]

Evaluating the Reasonableness of a "Reverse" Contingent Fee

Model Rule 1.5(a) sets out several factors by which the reasonableness of a fee may be determined, one of which is "whether the fee is fixed or contingent."[8] These factors are substantially identical to those listed in DR 2-106(B) of the predecessor Model Code of Professional Responsibility.[9]

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7. See G.C. HAZARD & W.W. HODES, 2 THE LAW OF LAWYERING ß 1.5 at 113 (1990):

> Contingent fee arrangements are traditionally used by plaintiffs' lawyers in civil cases. However, except for the situations controlled by Rule 1.5(d), there is no restriction against such arrangements in other contexts. For example, a defendant in a civil case could agree to pay a fee inversely related to the size of the plaintiff's recovery. Similarly, a lawyer engaged in complex negotiations on behalf of a client might charge a fee based upon the ultimate terms of the contract.

See also, cases gathered at ANNOTATED MODEL RULES OF PROFESSIONAL CONDUCT 80-81 (2d ed. 1992).

8. Rule 1.5(a) states as follows:

(a) A lawyer's fee shall be reasonable. 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.

9. DR 2-106 states:

(A)A lawyer shall not enter into an agreement for, charge, or collect an illegal or clearly excessive fee.

(B)A fee is clearly excessive when, after a review of the facts, a lawyer of ordinary prudence would be left with a definite and firm conviction that the fee is in excess of a reasonable fee. Factors to be considered as guides 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.

This Committee discussed the factors that should be considered in determining whether a contingent fee is reasonable in Informal Opinion 86- 1521--Offering Alternatives to Contingent Fees (1986):

> Contingent fees are subject to the "reasonableness" and "clearly excessive" tests of the Model Rules and the Model Code. Whether a contingent fee is reasonable and whether it is in the best interest of the client may be dependent on many factors, including the estimated amount of a reasonable fixed fee, the degree of contingency in fact involved and the probable size of the recovery, factors which the client normally has the right to consider before agreeing to a fee arrangement.

The Committee there was addressing the reasonableness of a "straight" contingent fee--i.e., one based on a recovery for a claimant. Whether a "reverse" contingent fee is reasonable can well be a more difficult question. In a straight contingent fee agreement, two factors determine the fee: the percentage to which the lawyer is entitled and the amount of the settlement or recovery. The setting of the percentage, of course, provides a possibility of over-reaching, but by virtue of the profession's long experience with straight contingent fees and the active regulation by the courts and legislatures with respect to what percentages are permissible, the range of reasonable percentages is pretty well established. And the reasonableness of a straight contingent fee arrangement is rendered the more readily determinable by the fact that the res out of which the contingent fee will be paid is an objectively determined number.

In a reverse contingent fee arrangement, the reasonableness will not be so readily determinable. The setting of a fair percentage carries more pitfalls and opportunities for overreaching because the profession has not built up a long term common experience with the concept. The fact that straight contingent fees typically range from 25% to 33% does not necessarily mean that the same percentage is reasonably applied to the potential savings of a defendant.

But even assuming a fair percentage is set, an added imponderable is how the benefit to defendant is to be calculated. In contingent fee agreements for the representation of defendants in civil cases, there is no recovery or res created in the usual sense. In this situation, the lawyer's success is gauged by the amount of money saved the client, rather than the amount of money recovered for the client. That may not be so easily calculated.

A plaintiff may sue defendant for $1,000,000, but the fact that that sum is named in the complaint does not necessarily mean that plaintiff's claim can fairly be said to be for that amount. Plaintiff's counsel often overstate the amount to which their client is entitled, and indeed have little incentive for restraint. Thus, the amount demanded cannot automatically be the number from which the savings resulting from a judgment or settlement can reasonably be calculated. Moreover, there are many jurisdictions where naming a specific damage figure is forbidden ("plaintiff seeks damages in excess of $50,000"). Where the dollar amount of plaintiff's claim is unspecified, it is up to negotiation between the lawyer and the client defendant to establish a fair dollar figure to attribute to

plaintiff's claim. Whether or not a specific ad damnum figure is mentioned, for an unliquidated claim, it is incumbent on the defendant's lawyer fairly to evaluate the plaintiff's claim and set a reasonable number as the amount from which the plaintiff's recovery will be subtracted to determine defendant's savings. The sensitivity of this exercise becomes apparent when it is recognized that to the extent defendant's lawyer exaggerates the value of plaintiff's claim, defendant's lawyer enhances his or her prospect of recovering on the contingent arrangement. Needless to say, the lawyer negotiating with the unsophisticated client will have a significantly greater burden of demonstrating fairness in this process than the lawyer, for example, who negotiates a reverse contingent agreement with an experienced in-house counsel.

This problem was addressed in Wunschel Law Firm, P.C. v. Clabaugh, 291 N.W.2d 331 (Iowa 1980), a case decided under Iowa Code of Professional Responsibility DR 2-106 (identical to DR 2-106 of the Model Code of Professional Responsibility). The plaintiff's complaint sought damages of $17,500 for defamation. The jury awarded $1,750. Under the fee contract, the defense lawyer's fee was to be one-third of the supposed savings, or $5,250. The Iowa Supreme Court held that a contingent fee contract for the defense of an unliquidated tort damages claim which is based on a percentage of the difference between the prayer of the petition and the amount awarded is void as contrary to public policy. The court adopted the view of the ethics committee of the Iowa State Bar Association that because an unliquidated tort damage claim is purely speculative in amount, a fee based upon such an amount cannot be reasonable. 291 N.W.2d at 337.

While in the view of the Committee the Wunschel court quite properly condemned the use of the prayer for relief as the sole basis for calculating a reverse contingent fee, the Committee believes that the ethical propriety of a reverse contingent fee does not necessarily depend on the damages sought being for a liquidated amount.[10] However, the reasonableness of the amount

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(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.

(8) Whether the fee is fixed or contingent.

(C) A lawyer shall not enter into an arrangement for, charge, or collect a contingent fee for representing a defendant in a criminal case.

10. See e.g., RESTATEMENT OF THE LAW GOVERNING LAWYERS ß 46(e) (Tent.Draft No. 4, 1991), which defines a contingent-fee contract as "one providing for a fee the size or payment of which is contingent on some measure of the client's success...."

See also, C. WOLFRAM, MODERN LEGAL ETHICS 533 (1986):

> Such fee contracts [contingent fee contracts with civil defendants] should be permissible despite the fact that the Code's rationale for contingent fees--providing counsel to the poor and creating a res out of which the fee can be paid--are inapplicable. As in all cases, the mechanism employed to measure the size of the fee must be reasonable.

See also, Leighton v. New York, Susquehanna & Western Railway, 303 F.Supp. 599 (S.D.N.Y.1969), aff'd 455 F.2d 393 (2d Cir.), cert. den., 406 U.S. 920 (1972).

of a "reverse" contingent fee does depend on the degree to which the saving from liability is reasonably ascertainable rather than a purely speculative one, which in turn may well depend on the character of the damages claim on which it is based.[11]

In the view of the Committee, the propriety of a contingent fee must be judged upon the facts of each case, and no per se rule applies. It is evident that the reasonableness of a fee contingent on the savings or reduction of financial losses of a client necessarily depends upon the reasonableness of the percentage as well as the reasonableness of the setting of the benchmark figure from which savings will be calculated. In each case reasonableness should be judged on the basis of the way the engagement looked at the time the reverse contingent fee arrangement was set.

In the situation where the lawyer's fee is based on the amount of money actually saved a client, such an arrangement may be in the best interests of the client. The lawyer will receive no fee if not successful in saving the client money, whereas, if the case had gone forward on a fixed fee basis, failure to reduce the amount owed would mean that the client would be obligated to pay the original amount anticipated plus the lawyer's fee.

Consultation with the client

The Comment to Rule 1.5 states in relevant part: "When there is doubt whether a contingent fee is consistent with the client's best interest, the lawyer should offer the client alternative bases for the fee and explain their implications."

In Informal Opinion 86-1521, this Committee concluded that "[W]hen there is any doubt whether a contingent fee is consistent with the client's best interest, which can normally be determined only in light of all the facts and circumstances after consultation with the client, the lawyer must offer the client the opportunity to engage counsel on a reasonable fixed fee basis before entering into a contingent fee arrangement." The lawyer contemplating a "reverse" contingent fee agreement should advise the client in accordance with the opinion of this Committee in Informal Opinion 86-1521.

Conclusion

The Committee concludes that the Model Rules do not prohibit contingent fee agreements for representation of defendants in civil cases based on the amount of money saved a client--provided the amount of the fee is reasonable under the circumstances, and the client has given fully informed consent.

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11. See generally, Lam, Toward a Valid Defense Contingent Fee Contract: a Comparative Analysis, 67 IOWA L.REV. 373 (1982) (arguing that defense contingent fee contracts that contain nonspeculative provisions should be allowed).