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Ethical Limits to the Contingency Fee

Case Note: *In the Matter of the Settlement/Guardianship of A.G.M. et al* (154 Wn. App. 58, 223 P.3d 1276 (2010))

by Michael Caryl

Is the contingency fee always reasonable? Stated otherwise, can a contingency fee ever be unreasonable? We should all be aware of the dictate of RPC 1.5(a): "A lawyer shall not make an agreement for, charge or collect an unreasonable fee, or an unreasonable amount for expenses." Comment 3 to RPC 1.5 makes clear that the rule of reasonableness of attorneys' fees applies to all fees, including the contingency fee.

RCW 4.24.005 accords the client in a tort case the right to seek a determination of reasonableness of the fee sought to be charged. See *Barrett v. Freise*, 119 Wn. App. 823, 82 P.3d 1179 (2003), where the trial court determined that the contingency fee agreement was valid and enforceable, and that the contingency fee was earned, but nonetheless set the case for trial to determine if the earned fee was reasonable. A similar right of review of the reasonableness of attorneys' fees exists in the context of medical malpractice claims. (See RCW 7.70.070.) RPC 1.5(a) effectively provides the same right of review for reasonableness in all cases. Further, courts are directed in certain guardianship and trust matters involving minors or incapacitated persons to determine the reasonableness of settlements involving such persons and the reasonableness of attorneys' fees sought to be charged in those cases. (See SPR 98.16W.) So by law, a contingency fee can clearly be unreasonable, under certain circumstances.

Virtually all attorneys' fees in personal injury claims are handled on contingency. Contingency fees are also routinely used in many other civil contexts, ranging from collections of debt to damages claims from condominium defects.

The law properly honors the contingency fee as the key to the courthouse for persons of ordinary means.[1] Appellate decision after decision and most commentators credit the contingency fee as an integral means of providing justice to those who could not possibly retain competent counsel on an hourly basis. (See, e.g., *Richette v. Solomon*, 187 A.2d 910, 919 (Pa. 1963), "If it were not for contingent fees, indigent victims of tortious accidents would be subject to the unbridled, self-willed partisanship of their tortfeasors.") The contingency fee is also a critical means by which lawyers may be paid in class action cases.

How Might a Contingency Fee Be Unreasonable?

In a typical plaintiff's personal injury case, the contingency fee is almost always the only fee arrangement a client could afford. That being the case, one might ask how such an arrangement could be unreasonable if the client could not afford the alternative — a substantial advance plus hourly fees. A good question, indeed! The attorney's fees charged and agreement for charging such fees might be determined to be unreasonable for a number of reasons: 1) the fee arrangements might not have been properly disclosed to the client under RPC 1.5(b); 2) the written fee agreement might contain language that is not consistent with what the lawyer told the client in the RPC 1.5(b) fees discussion at intake; 3) the written fee agreement might contain provisions that are unethical or unenforceable; or 4) the lawyer may simply have grossly overcharged the client (e.g., a 75 percent contingency fee). There are undoubtedly others. But most of the time, in the contingency fee context, the unreasonableness is in the size of the fee in relation to the risk and the work actually required to recover.

There are two subjects of this case note. The first is the question of the reasonableness of the fee where the size of the fee is simply unreasonably large in relation to the type of case, its circumstances, the skill required, the work necessary, and all the other factors that courts take into account under RPC 1.5(a) (or RCW 4.24.005). This is the issue the court decided in *Guardianship of A.G.M.*, 154 Wn. App. 58, 233 P.3d 1276 (2010). The second subject, not really addressed by the court in *A.G.M.*, is the fairly apparent policy limits tort claim, as perceived from the outset, and what ethical duties lawyers must exercise in such a case. Put differently, may a lawyer ethically sign up a client to a contingency fee under circumstances existing from the outset where the lawyer knows or reasonably should know that the contingency fee may well be unreasonable? In such a case, what are the lawyer's ethical duties to the client? *A.G.M.*, and the ethical rules and case law here in Washington and elsewhere, should serve as a wake-up call for plaintiff's counsel in contingency-fee cases.

Factual Background in *Guardianship of A.G.M.*

The general facts of the *A.G.M.* case are relatively simple. In March 2006, an entire family of five was injured in an intersection collision where the driver of another vehicle ran a red light and struck the family car. A law firm was retained to represent all injured family members.[2] However, only two very young children appeared to have been more than slightly injured. One child, 11 months old, suffered a laceration on her face and required emergency room treatment costing a little over $3,000. Three-year-old "A.G.M." suffered what the court termed "severe injuries that required hospitalization in the pediatric intensive care unit." The medical expenses for this child exceeded $68,000. The individual policy limit for this child was only $100,000. Liability for the collision clearly rested with the driver who ran the red light.

The law firm signed the family up to a one-third-of-the-gross contingency-fee agreement that applied to *all* of the vehicle occupants. In October 2006, the lawyer submitted to the insurer a three-page settlement demand letter representing claims for all five of the vehicle's occupants. Only seven lines of the demand addressed the serious injuries of A.G.M., and no medical records had even been obtained. The court opinion does not describe what the law firm's work-up of this case consisted of before the demand was prepared. In any event, less than a month after the demand was presented, the insurer tendered its $100,000 individual policy limit for A.G.M.'s injuries. The insurer also offered $4,500 for the 11-month-old's laceration injury. Both offers were accepted by the law firm shortly thereafter.

The insurer petitioned the court for the appointment of a settlement guardian *ad litem* (SGAL) to report to the court on the reasonableness of the two settlements and the attorney's fees, under SPR 98.16W. The SGAL, an experienced Tacoma lawyer with substantial SGAL background, investigated the above facts and reported to the trial judge. The SGAL approved of both settlements as reasonable and concluded that the contingency fee in the case of the 11-month-old child was reasonable. But the SGAL found that the contingency fee in the case of A.G.M. — one-third of the $100,000 policy limit — was unreasonable. Given the large medical expenses owed from the settlement, such a fee left insufficient compensation for the injured child and resulted in a windfall to the lawyer, reasoned the SGAL. The SGAL found that the bulk of the law firm's time was spent on the parents' claims, while the children's claims settled quickly. The SGAL report included the following:

> Based upon my investigation and examination of the work done by the minor's attorney and staff concerning the claim of this child, it is my estimate that no more than a few hours of attorney time and a few more hours of staff time were involved in this claim to date. I am convinced that the offer of policy limits was made by the adjuster once she confirmed the hospital discharge assessment and the amount of medical specials.
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> Taking into consideration the desire to see to it that the minor is fully compensated, while also considering the novelty of the claim or lack thereof, as well as the time devoted to settlement of the claim, it is my opinion that attorney fees for (the law firm) of between $ 10,000 and $12,000 would represent fair compensation. (*In re A.G.M.*, 154 Wn. App. at 65.)

Based on the SGAL's report, the trial court approved a fee of $15,000, not the $33,333.33. The *A.G.M.* opinion states that the trial court used the "lodestar" basis (reasonable hourly rate times reasonable number of hours spent on the case) in arriving at $15,000 as the reasonable fee, the method required to be used in Washington in fee shifting applications.[3] The law firm admittedly did not keep any

contemporaneous time records nor attempt to reconstruct any later for the proceeding conducted to examine the reasonableness of the settlement and contingency fee. Further, for nine to 10 months the law firm did not provide the SGAL even with medical records, bills, medical liens, subrogated interests, and "what amounts had to be paid back," delaying payment to the injured child. The plaintiff's lawyer originally submitted a declaration to the trial court that claimed the law firm had spent 2.5 hours of lawyer time and 56 hours of paralegal time on the A.G.M claim. The SGAL challenged the accuracy of the lawyer's declaration, including the statement that the law firm spent over 11 hours of lawyer time and nearly seven hours of paralegal time dealing with the SGAL.[4] The Court of Appeals approved of the trial court's decision in this way:

> The superior court then discussed the information (the lawyer) had provided for each of these (RPC 1.5(a)) factors, noting specifically that (the lawyer) had failed to provide information for several factors, despite the superior court's request. With regard to the time, labor, and difficulty involved in the case, the superior court stated that (the lawyer) had "admitted on the record that it was a relatively easy case" and that "[n]ot much effort was necessary to be expended in order to secure [the policy limits settlement]." RP (June 6, 2008) at 4–5. Based on its analysis of the above factors, the superior court determined that $15,000 was a reasonable amount for AGM's attorney fees. (*Id* at 69–70.)

The plaintiff's law firm unadvisedly took an appeal from the more than 50 percent reduction of its fee by the trial court. The Court of Appeals affirmed and determined that the appeal was frivolous. The court ordered that the law firm pay the SGAL's lawyer's fees on appeal as a sanction under RAP 18.9(a). Presumably, the law firm lost all of its fee and possibly more for this misadvised appellate challenge.

The Appellate Court's Reasoning

Prudent lawyers handling contingency fee cases would be wise to study this case carefully. Multiple lessons are revealed here. First, the trial court unquestionably has the authority to reduce the contingent fee provided in the lawyer's contingency fee agreement. The appellate court delineated the authority of the trial court in this way:

> First, *SPR 98.16W* authorizes attorney fees for settlements on behalf of a minor and contemplates the superior court's exercise of discretion over these fees. For example, *SPR 98.16W(f)* provides in relevant part, "At the time the petition for approval of the settlement is heard, the *allowance* and taxation of all fees ... shall be considered and disposed of by the court." (Emphasis added.)

> Second, this rule also contemplates that in determining a reasonable fee amount for representing a minor, the superior court will consider both the minor's attorney's submissions and the SGAL's recommendations. *SPR 98.16W(g)* requires "[a]ny attorney claiming fees, costs or other charges incident to representation of the [minor]" to file an affidavit or declaration in support of the request for fees or costs and to attach a copy of the written fee agreement. And *SPR 98.16W(e)(12)* requires the SGAL to include in his report "a discussion and *recommendation* regarding the expenses and fees for which payment is requested." (Emphasis added.)

Division II then noted that the trial court had properly taken into account the nine factors underlying the reasonableness of fees contained in RPC 1.5(a).

The lawyer argued that the trial court should have considered only the contents of the lawyer's declaration in determining reasonableness, rather than an itemized "lien" the lawyer later provided.[5] Division II observed that the declaration was an insufficient basis upon which to make the reasonableness determination. Lastly, the lawyer criticized the trial court's use of the lodestar method in determining reasonableness of fees. Division II responded to this argument this way:

> Although there is no published opinion approving the lodestar method in a minor settlement case where *SPR 98.16W* applies, *the lodestar method is, nevertheless, the clearly preferred method for calculating attorney fees in Washington*. *Somsak v. Criton Techs./Heath Tecna, Inc.*, 113 Wn. App. 84, 98, 52 P.3d 43, 63 P.3d 800 (2002) (citing *Mahler v. Szucs*, 135 Wn.2d 398, 433, 957 P.2d 632, 966 P.2d 305 (1998)). And we are aware of no other required method for determining attorney fees. The superior court determined that (the law firm) failed to meet its burden of proving the reasonableness of its requested fees and that the contingent fee agreement attorney fee was unreasonable as applied to AGM's claim. We hold that the superior court did not abuse its discretion by applying the accepted lodestar method. (Emphasis added.) (154 Wn. App. at 79.)

What *A.G.M.* Does Not Address — the Fairly Apparent Limits Case with Little or No Risk

Because it was not raised by the SGAL or the child's parents, Division II in *A.G.M.* did not address the issue of a fairly apparent policy limit case, i.e., where settlement for the policy limit was easily foreseeable, there was virtually no risk of the lawyer not being paid, and the whole exercise would clearly require little real work or passage of much time. In *A.G.M.*, the $100,000 settlement was obtained with seven lines of a three-page demand letter and only 2.5 hours of lawyer work. What are the ethical duties

and considerations of the lawyer in such a situation who is prepared to take a one-third contingency fee? This is the crux of the rest of this article.

Basic Ethical Rules

The ABA Model Rules of Professional Conduct replaced the old Code of Professional Responsibility in 1985. Most states have adopted the ABA Model Rules in their entirety or substantially. Washington has largely adopted the Model Rules.[6] We begin with Washington's RPC 1.5(a) (identical to the Model Rule and largely followed across the nation), which is quoted above in this article: "A lawyer shall not make an agreement for, charge, or collect an unreasonable fee or an unreasonable amount for expenses." As a rule nationwide, lawyers are prohibited from charging or collecting unreasonable and excessive fees. "A lawyer may not charge a fee larger than is reasonable in the circumstances or that is prohibited by law." Restatement (Third) of the Law Governing Lawyers, §34 (American Law Institute, 2010). The Restatement rule takes into account the lack of sophistication of most clients, the tendency of some lawyers to overreach, the inability of most clients to bargain, and the difficulty most clients have in finding information about typical lawyer compensation. See Comment b to Restatement, §34. Where a lawyer charges an unreasonable fee, or refuses to refund unearned or unreasonable fees, such practices are ethical violations under RPC 1.5.

Contingent Fees Usually (and Properly) Will Result in Higher Compensation than the Typical Hourly Engagement

Contingency fees usually (and properly) will result in a higher fee per hour than might be the case in a strictly hourly engagement. (See comment c to §35, Restatement (Third) of the Law Governing Lawyers, p. 258.) A very recent decision of the Colorado Court of Appeals discusses the raison d'etre of contingency fees and this fact:

> We readily acknowledge that "[t]he whole point of contingent fees is to remove from the client's shoulders the risk of being out-of-pocket for attorney's fees upon a zero recovery. Instead, the lawyer assumes the risk, and is compensated for it by charging what is (in retrospect) a premium rate." (*Berra v. Springer and Steinberg, P.C.*, 2011 Colo. Lexis 91, 251 P.3d 567 (Colo. App. 2011), citing the Restatement comment.)

This greater-than-hourly fee rationale is often justified on a number of bases: 1) the risk that the case might be lost entirely, or the end result poor, yielding little or no fee; 2) the lawyer works now to get paid later, thus losing the time value of money; 3) the amount of work required to get the end result might

well exceed the fee to be earned; and 4) the defendant might not be able to pay any judgment, however favorable.

Contingency fees provide salutatory benefits to clients: 1) enabling persons without means the access to justice they otherwise would not have; 2) providing lawyers with an additional incentive to seek their clients' success and to encourage only claims with a substantial likelihood of success; and 3) enabling the client to share the risk of losing with the lawyer. (See comment b to §35, Restatement (Third) of the Law Governing Lawyers, p. 257.)

Contingent fees are not *per se* unreasonable merely because the lawyer does not have to spend hundreds of hours or try the case to the jury. In many cases, where lawyers have to undergo a trial, the lawyer's contingency fee might well be meager, in light of the number of hours actually spent. A contingent-fee lawyer must make more per hour on most contingency cases than his or her normal hourly rate in order to make up for the cases that pay little or nothing. *"However, large (contingent) fees unearned by either effort or a significant period of risk are unreasonable."* (Emphasis added.) (Comment c to §35, Restatement (Third) of the Law Governing Lawyers, p. 258.) The case law nationwide exemplifies the principle that contingency fees are inappropriate and unreasonable where there is virtually no risk, no probable delay in payment, or no significant work required. (See, e.g., *Anderson v. Kenelly*, 37 Colo. App. 217– 219, 547 P.2d 260 (1975); *Colorado v. Egbune*, 58 P.3d 1168, 1173-74 (Colo. 1999); *State of Tennessee on behalf of Brooks, v. Gunn*, 667 S.W. 2d 499, 501 (Tenn. App. 1984).)

What are the Lawyer's Ethical Duties in the "Fairly Apparent Policy Limits case"?

The key factors discussed in the case law for determining whether a contingency fee is unreasonable in policy limits cases are three-fold:

- Is the likelihood of a policy limits settlement reasonably clear at the outset, such that there is little or no likelihood of no recovery?
- Is it probable that the limits settlement will not require substantial legal services?
- Is it probable that there will not likely be any significant delay in the lawyer getting paid?

These factors directly address the considerations that underlie the law's support for the contingency-fee system. Contingency fees may and should provide for greater-than-normal hourly rates typically charged to paying hourly clients, for the very reason that in most contingency-fee engagements, the lawyer risks losing the case entirely, or having a bad result, after putting in a lot of work and advancing substantial costs and expenses. Bad or no results affect the lawyer's compensation and ability to recover the costs and expenses. Where the amount of work required is small, the probability of a limits

settlement is high, there is little or no risk of non-recovery, and all of this is or should be apparent from the outset to the lawyer, signing the lay client up to a substantial contingency fee is ethically dubious.

What duties does a lawyer have when the probable policy-limit case walks into his or her office? There is no case law guiding us in Washington in this situation. Nonetheless, the RPCs offer some clear guidance. To start, "a lawyer may not make an agreement for an unreasonable fee." (RPC 1.5(a).) Comment 3 to the ABA Model Rule, adopted in Washington, specifically raises the question "whether it is reasonable to charge any form of contingent fee, . . ." RPC 1.4(a) states that the lawyer shall "promptly inform the client of any decision or circumstance with respect to the client's informed consent, as defined in Rule 1.0(e), is required by these Rules." Further, RPC 1.4(b) provides, "A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation."

There can be no aspect of legal representation more fundamental than how the client will be charged for legal services. Washington's RPC 1.5(b) requires that the lawyer must explain to every new client the basis by which the lawyer is to charge the client. Strong public policy exists throughout the nation that requires counsel to fully disclose and explain the contingent fee agreement to the client. (See, e.g., *Luna v. Gillingham*, 57 Wn. App. 574, 580, 789 P.2d 801 (1990); *Joyce v. Elliott*, 857 P.2d 549, 552 (Colo. App. 1993).) What would be more important to the client than to be informed that a contingency fee in his or her particular circumstances might well be excessive and unreasonable?

The lawyer must ask him/herself the three questions recited above. If the answers reasonably point in the positive direction, does not the lawyer then have duties of disclosure to the client? In my view, RPC 1.4(a)(1) and (b) mandate disclosure to the client of circumstances that bear on the reasonableness of the contingency fee. When reading these disclosure requirements with RPC 1.5(a) (make no agreement for an unreasonable fee), the requirement to meaningfully discuss the fee arrangement in RPC 1.5(b), and comment 3 to RPC 1.5 (whether it is unreasonable to charge any form of contingent fee), does not a duty arise on the lawyer's behalf to advise the client that a contingency fee might be unreasonable under the circumstances? Further, even if the lawyer is slow to grasp the three positive answers to the key questions above, once it becomes reasonably apparent, does not the lawyer have a duty to disclose that the contingency fee might be excessive?[7]

ABA Formal Opinion 94-389 answered the question, among others, whether a contingency fee agreement is reasonable where there is no risk of non-recovery and liability is clear. The opinion states that such a contingent-fee agreement "may" be reasonable. However, the opinion went on the state:

> For example, if in a particular instance a lawyer was reasonably confident that as soon as the case was filed the defendant would offer an amount that the client would accept, it

> might be that the only appropriate fee would be one based on the lawyer's time spent on the case since, from the information known to the lawyer, *there was little risk of non-recovery and the lawyer's efforts would have brought little value to the client's recovery.* (Emphasis added.) (ABA Formal Op. 94-389, at p. 8.)

Blithely going ahead with the contingency fee, aware that it is likely to be unfair and unreasonable, opens the door to a later fee dispute and possibly discipline. So what should the lawyer do in the intake interview or a few weeks later when he/she realizes that the contingency fee is unreasonable, given the absence of risk of recovery, no delay in getting paid, and little work to be done? The lawyer can simply offer to handle the case hourly, with a maximum fee, or offer a rather small flat fee that estimates the probable time to process an easy limits settlement. How to address this situation in detail is a subject for another day.

Plaintiffs' counsel needs to be sensitive to this issue as new cases arise. Any case with serious injuries and potentially large damages, but with a small policy limit, should raise red flags. If the three risks discussed above cannot clearly be said to exist, then the contingent fee is probably unreasonable. Taking the contingent fee anyway is unethical and unwise. The best interests of the client in personal injury practice, as elsewhere, must always be paramount. Full disclosure to the client, including reasonable alternative fee arrangements, is the wisest course.

Michael Caryl, a graduate of Georgetown University Law Center (J.D.) and George Washington School of Law (LL.M), is a civil trial lawyer in his 40th year of practice. He is the author of Chapter 3 of the WSBA Legal Ethics Desk Book*. His practice is limited to matters of disputed lawyers' fees, including lawyer ethics relating to attorneys' fees, and providing expert testimony in litigated matters of disputed lawyers' fees. He can be reached at michaelc@michaelcaryl.com.*

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1. See, e.g., Pollack, Book Review, 90 *Harvard L. Rev.* 484, 1976; Carboy, Contingency Fees: The Individual's Key to the Courthouse, 2 Litigation 27 (1976); Wikipedia, Contingent Fee "A contingency fee arrangement provides access to the courts for those who cannot afford to pay the attorney's fees and costs of civil litigation. Contingency fees also provide a powerful motivation to the attorney to work diligently on the client's case. In other types of litigation where clients pay the attorney by the hour for their time, it makes little economic difference to the attorney whether the client has a successful outcome to the litigation. Finally, because lawyers assume the financial risk of litigation, the number of speculative or unmeritorious cases may be reduced."

2. The opinion does not discuss whether the law firm discussed the apparent conflicts where the insurance coverage may not have been sufficient to cover all claimants' injuries, and whether potential conflicts were disclosed and waived under RPC 1.7(a). See *Gustafson v. Seattle*, 87 Wn. App. 298, 941 P.2d 701 (1997). This matter of potential conflicts played no part in the decision.

3. Fee shifting is the situation where a prevailing party in litigation is entitled to an award of reasonable attorney's fees, in contrast to the American Rule that parties ordinarily have to bear their own attorney's fees. See Talmadge and Jordan, *Attorney's Fees in Washington*, pp. 21– 26. Fee shifting is permitted where provided for in a contract between the litigating parties, pursuant to a statute or where based upon some other ground in equity. The fee shifting opportunities known to most plaintiffs' tort counsel are *Olympic Steamship* fees, fees awardable under the Consumer Protection Act and fees incurred in an unsuccessful trial *de novo* from mandatory arbitration, RCW Chapter 7.06 and MAR 7.3

4. The Court of Appeals noted in its opinion certain falsehoods and inaccuracies in the lawyer's declaration and the lawyer's failure to offer any hard evidence of what work was actually done. The lawyer did not show up for the initial hearing on reasonableness of the settlement and fees, and misled the court on the reasons for the no-show. A second hearing was held, at which time the trial court learned that only 2.5 hours of lawyer time had been spent to justify a $33,333 fee. The lawyer ultimately admitted on the record that the case was a fairly easy case and little effort was necessary to secure the policy limits offer.

5. This "itemized lien" does not appear to have been an RCW 60.40.010 attorney's lien, and little about this lien but its existence is really discussed in the opinion. The "lien" apparently purported to show what had been done by the lawyer.

6. The Rules have been amended several times since 1985, most recently in 2008. In 2008, Washington adopted some but not all of the official comments to the Model Rules, and adopted some of its own comments.

7. For instance, Colorado's comment 5 to RPC 1.5(a) states, "…When there is doubt whether a contingent fee is consistent with the client's best interests, the lawyer should offer the client alternative bases for the fee and explain their implications…"