

# Ethical Considerations in Alternative Fee Arrangements

ACC SoCal  
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Michael Duvall, Esq.  
Kelly Graf, Esq.

## What is an Alternative Fee Arrangement (“AFA”)?

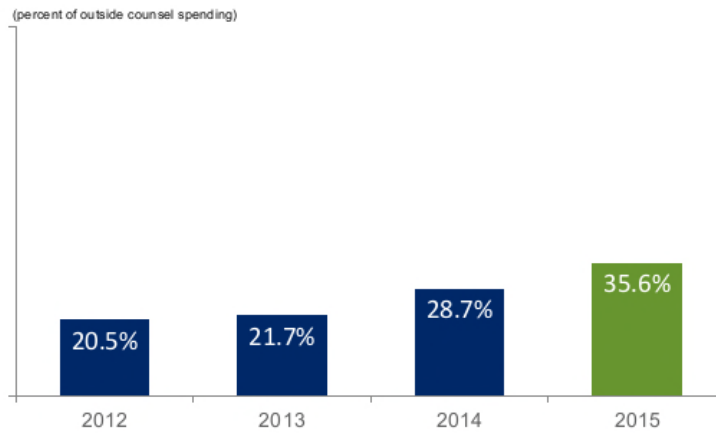
## Defining Alternative Fee Arrangements

- An AFA is any type of fee arrangement *other than* traditional hourly rates.
- Examples of AFAs:
  - Contingency fees
  - Blended rates
  - Value billing
  - Success fees
  - Retrospective billing
  - Project billing
  - Fixed profit billing
  - Volume-based discount
  - Others?

## AFAs - Frequency

- Twenty-six percent of the work corporate legal sends to outside counsel is structured under an AFA.  
(<http://www.corpcounsel.com/id=1202778112659/GCs-May-Get-Rid-of-Underperforming-Firms-in-2017-Survey-Says>).
- “Across the board, use of AFAs continues to trend upward.”  
(<https://www.acc.com/aboutacc/newsroom/pressreleases/acc2016closurveypressrelease.cfm>).

## Percentage of Outside Counsel Spending on AFAs

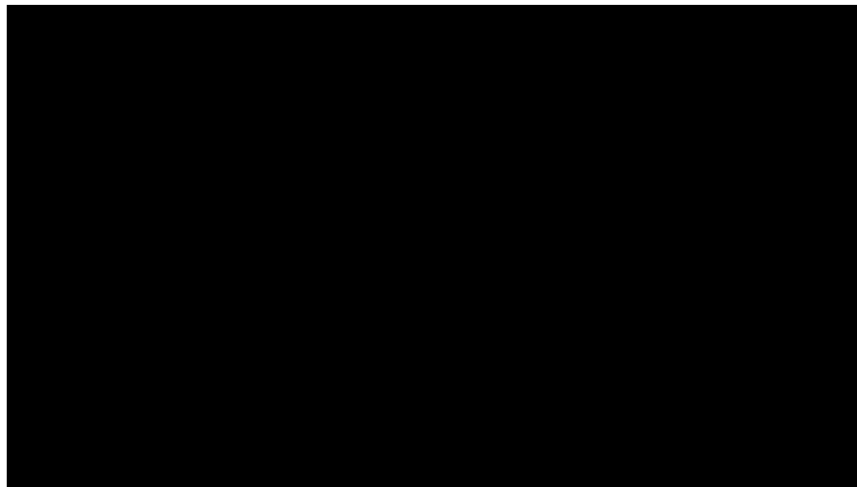


\*Source: BTI, State of AFAs

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## Dentons Innovation Panel AFA Discussion (April 2018)



Speaking: Matt Lepore, Senior Vice President and General Counsel, BASF Corporation

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## Advantages to AFAs

- Cost control
- Increased Communication
- Aligned interests

## Types of AFAs

## Types of AFAs

# Blended Rates

## Types of AFAs *(cont'd)*

# Fixed Fees

**Types of AFAs** *(cont'd)*

**Portfolio Fees**

**Types of AFAs** *(cont'd)*

**Success fees**

**Types of AFAs** *(cont'd)*

**Collared Fee**

**Types of AFAs** *(cont'd)*

**Performance Fees**

**Types of AFAs** *(cont'd)*

**Defense Contingency Fee**

**Types of AFAs** *(cont'd)*

**Acquiring an ownership interest  
in lieu of a fee**

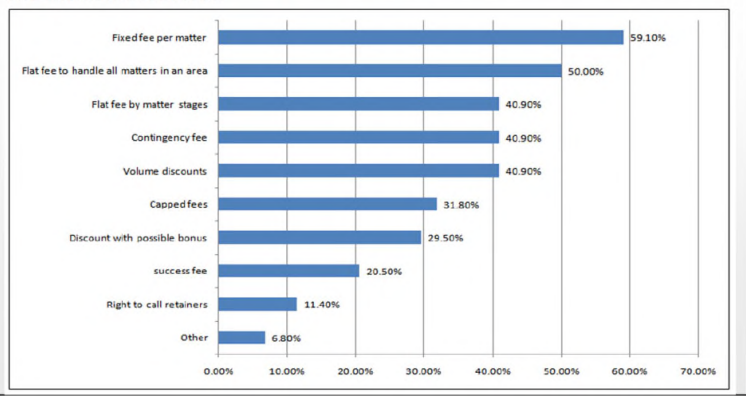


## Types of AFAs (cont'd)

# Reverse auction

## AFA Types - Frequency

What types of Alternative Fees are being used? A majority of respondents use at least one alternative fee model



\*Inside Counsel and Blickstein Group – The Third Law Department Operations Survey, Dec 2010

# Ethical Issues in AFAs

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## Excessive or Unearned Fees

- Contingency and success fees
  - Evaluated at Time of Contracting...
- ...or Client's Right to Retroactively Elect?

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## California Rule of Professional Conduct 4-200: Unconscionable Fees

- **California Rule of Professional Conduct 4-200(A):**  
A member shall not enter into an agreement for, charge, or collect an illegal or **unconscionable fee**.

## California Rule of Professional Conduct 4-200 (*cont'd*)

- **California Rule of Professional Conduct 4-200(B):**  
Unconscionability of a fee shall be determined on the basis of **all the facts and circumstances existing at the time the agreement** is entered into **except** where the parties contemplate that the fee will be **affected by later events...**

## California Rule of Professional Conduct 4-200 (cont'd)

- **California Rule of Professional Conduct 4-200(B): ...**

**Among the factors to be considered, where appropriate, in determining the conscionability of a fee are the following:**

- (1) The **amount of the fee in proportion to the value of the services performed.**
- (2) The relative **sophistication of the member and the client.**
- (3) The novelty and difficulty of the questions involved and the skill requisite to perform the legal service properly.
- (4) The likelihood, if apparent to the client, that the acceptance of the particular employment will preclude other employment by the member.
- (5) The amount involved and the **results obtained.**
- (6) The time limitations imposed by the client or by the circumstances.
- (7) The nature and length of the professional relationship with the client.
- (8) The experience, reputation, and ability of the member or members performing the services.
- (9) Whether the fee is fixed or contingent.
- (10) The time and labor required.
- (11) The **informed consent of the client** to the fee.

## Coming Soon: California Rule of Professional Conduct 1.5 (effective Nov. 1, 2018)

- **Rule 1.5 Fees for Legal Services: ...**The factors to be considered in determining the unconscionability of a fee include without limitation the following:

- (1) whether the lawyer engaged in fraud\* or overreaching in negotiating or setting the fee;
- (2) whether the lawyer has failed to disclose material facts;
- (3) the **amount of the fee in proportion to the value of the services performed;**
- (4) the relative sophistication of the lawyer and the client
- (5) the novelty and difficulty of the questions involved, and the skill requisite to perform the legal service properly;
- (6) the likelihood, if apparent to the client, that the acceptance of the particular employment will preclude other employment by the lawyer;
- (7) the amount involved and the **results obtained;**
- (8) the time limitations imposed by the client or by the circumstances;
- (9) the nature and length of the professional relationship with the client;
- (10) the experience, reputation, and ability of the lawyer or lawyers performing the services;
- (11) whether the fee is fixed or contingent;
- (12) the time and labor required; and
- (13) whether the client gave **informed consent\*** to the fee.

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

- ABA Comm. on Ethics & Prof'l Responsibilities, Formal Op. 93-373 (1993), "Contingent Fees in Civil Cases Based on the Amount of Money Saved for the Client."

## Counsel's Duties of Competence and Diligence

- Working for "free" when cap exceeded
- Litigation (especially) unpredictable
- Junior staffing, leverage and "margins"

## California Rule of Professional Conduct Rule 3-110: Failing to Act Competently

- **Rule 3-110 Failing to Act Competently**

- (A) A member **shall not intentionally**, recklessly, or repeatedly fail to perform **legal services with competence**.
- (B) For purposes of this rule, "**competence**" in any legal service **shall mean** to apply the 1) **diligence**, 2) **learning and skill**, and 3) mental, emotional, and physical ability reasonably necessary for the performance of such service.
- (C) **If a member does not have sufficient learning and skill** when the legal service is undertaken, the member may nonetheless perform such services competently by 1) **associating with** or, where appropriate, professionally consulting **another lawyer reasonably believed to be competent**, or 2) by acquiring sufficient learning and skill before performance is required.

## Coming Soon: California Rule of Professional Conduct 1.1 (effective Nov. 1, 2018)

- **Rule 1.1 Competence**

- (a) A lawyer shall not intentionally, recklessly, with gross negligence, or repeatedly fail to perform legal services with competence.
- (b) For purposes of this rule, "competence" in any legal service shall mean to apply the (i) learning and skill, and (ii) mental, emotional, and physical ability reasonably\* necessary for the performance of such service.
- (c) If a lawyer does not have sufficient learning and skill when the legal services are undertaken, the lawyer nonetheless may provide competent representation by ....
- (d) In an emergency a lawyer may give advice or assistance in a matter in which the lawyer does not have the skill ordinarily required if referral to, or association or consultation with, another lawyer would be impractical. Assistance in an emergency must be limited to that reasonably\* necessary in the circumstances.

## Coming Soon: California Rule of Professional Conduct 1.3 (effective Nov. 1, 2018)

- **Rule 1.3 Diligence**

- (a) A lawyer shall not **intentionally**, repeatedly, recklessly or with gross negligence fail to act with **reasonable diligence** in representing a client.
- (b) For purposes of this rule, "**reasonable diligence**" shall mean that a lawyer acts with **commitment and dedication to the interests of the client** and does not neglect or disregard, or unduly delay a legal matter entrusted to the lawyer.

## Counsel's Duty to Exercise Independent Judgment

- Staffing & Zealousness (cont'd)
- Unaffected by counsel's economic interest
  - Settlements
  - Ownership stakes

## Coming Soon: California Rule of Professional Conduct Rule 2.1 (effective Nov. 1, 2018)

- **California Rule of Professional Conduct Rule 2.1:**  
In representing a client, a lawyer shall exercise independent professional judgment and render candid advice.

## California Rule of Professional Conduct 3-300: Business Transactions with Clients

- **California Rule of Professional Conduct 3-300:**  
A **member shall not** enter into a business transaction with a client; or **knowingly acquire an ownership**, possessory, security, or other pecuniary interest **adverse to a client**, unless each of the following requirements has been satisfied:
  - (A) The transaction or acquisition and its terms are **fair and reasonable** to the client and are **fully disclosed and transmitted in writing** to the client in a manner which should reasonably have been understood by the client; and
  - (B) The client is advised in writing that the client may seek the advice of an independent lawyer of the client's choice and is given a reasonable opportunity to seek that advice; and
  - (C) The **client thereafter consents in writing** to the terms of the transaction or the terms of the acquisition.
- ABA Comm. on Ethics & Prof'l Responsibilities, Formal Op. 00-418 (2000)  
"Acquiring Ownership in a Client in Connection with Performing Legal Services"



## California Rule of Professional Conduct 3-700(A)(2): Counsel's (In)Ability to Withdraw

- **California Rule of Professional Conduct 3-700(A)(2):**

A member shall not withdraw from employment until the member has **taken reasonable steps to avoid reasonably foreseeable prejudice** to the rights of the client, including giving due notice to the client, allowing time for employment of other counsel, complying with rule 3-700(D), and complying with applicable laws and rules.

...

A member whose employment has terminated shall: ...

(D)(2) **Promptly refund any part of a fee paid in advance that has not been earned.** This provision is not applicable to a true retainer fee which is paid solely for the purpose of ensuring the availability of the member for the matter.

## Coming Soon: California Rule of Professional Conduct 1.16(d)-(e) (effective Nov. 1, 2018)

- **California Rule of Professional Conduct 1.16**

(d) A lawyer shall not terminate a representation until the lawyer has taken reasonable\* steps to **avoid reasonably\* foreseeable prejudice to the rights of the client**, such as giving the client sufficient notice to permit the client to retain other counsel, and complying with paragraph (e).

(e) Upon the termination of a representation for any reason:

- (1) subject to any applicable protective order, non-disclosure agreement, statute or regulation, the lawyer promptly shall release to the client, at the request of the client, all client materials and property. " .... and
- (2) **the lawyer promptly shall refund any part of a fee or expense paid in advance that the lawyer has not earned or incurred.** This provision is not applicable to a true retainer fee paid solely for the purpose of ensuring the availability of the lawyer for the matter.

## Navigating Potential Ethical Issues with AFAs

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### Due Diligence at the Outset

- Assumptions
- Costs and tasks not covered
- Put it in writing
  - Cal. Bus. Prof. Code Sec. 6147(a)

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## Reassess Regularly

- Phased AFAs
- Adjusted Retainers
- Lengthy matters, inflation, rate increases
- \*Subject to revision based on future developments

# Constant Communication!

## Bibliography

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## Thank you

Dentons US LLP  
601 S. Figueroa Street  
Suite 2500  
Los Angeles, CA 90017-5704  
United States



**Michael J. Duvall**

Los Angeles  
D: +1 213 892 2818  
michael.duvall@dentons.com



**Kelly R. Graf**

Los Angeles  
D: +1 213 892 2811  
kelly.graf@dentons.com

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