COLUMN: ETHICS WATCH: NEGOTIATING ATTORNEYS' FEES

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Author: By Nathan Crystal

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[*13] Attorneys' fees are obviously the economic heart of the practice of law, but some tricky contractual and ethical issues face lawyers when negotiating for payment of legal fees. This article examines two aspects of negotiation for legal fees: between lawyer and client and between lawyer and adverse party.

Negotiation of legal fees with clients

When lawyers enter into engagements with clients, they must communicate to their clients how they will charge for their services. See S.C. Rule of Prof. Conduct 1.5(b) (SCRPC). In contingent fee cases, the rules require additional disclosures. See SCRPC 1.5(c). In the typical case, whether hourly or contingent, the client will pay for the lawyers' services. South Carolina follows the "American rule" that attorney fees are not recoverable from the opposing party unless provided by statute, court rule, contractual provision, or when the case generates a common fund. See Layman v. State of South Carolina, 376 S.C. 434, 658 S.E.2d 320 (2008). However, many statutes at both the federal and state levels do provide for recovery of attorney fees. See, e.g., Robert M. Wilcox & Nathan M. Crystal, ANNOTATED SOUTH CAROLINA RULES OF PROFESSIONAL CONDUCT 72 (2016 ed.) (listing many South Carolina statutes that allow recovery of attorney fees).

Agreement regarding consequences of fee shifting. An important provision for lawyers to include in their engagement agreements is one dealing with the treatment of any attorney fees that may be recovered from the opposing party. The general rule that would apply in the absence of an agreement between lawyer and client is the "offset approach." Under this standard any award of attorney fees "offsets" the amount that the attorney is entitled to receive under the engagement agreement with the client. See Cambridge Trust Co. v. Hanify & King Professional Corp., 721 N.E.2d 1 (Mass. 1999); Restatement (Third) of the Law Governing Lawyers § 38(3) ("RLGL"). Cf. Louthian and Merritt, P.A. v. Davis, 272 S.C. 330, 251 S.E.2d 757 (1979) (holding that in divorce action statute provides that attorney fees are allowed to the litigant not the lawyer). For example, if the client hired the lawyer under an engagement agreement providing for a 40% contingency fee, and the client recovers $ 100,000 in damages and $ 20,000 in attorney fees, the attorney would be entitled to a $ 40,000 fee, with the $ 20,000 fee award being credited against the fee. Of the total award of $ 120,000, the lawyer receives $ 40,000 and the client obtains $ 80,000. The offset approach means that the lawyer is not entitled to a "fee on a fee," i.e. a fee on

the amount of attorney fees that are awarded. The offset approach seems sound as a matter of policy. Clients are likely to expect that awards of attorney fees reduce the amount that they must pay to their lawyers; in addition, the offset approach is consistent with the proposition that silence or ambiguity in a contract between lawyer and client is construed against the lawyer.

Because attorney fees are a matter of contract between lawyer and client, the parties could change the offset rule and agree that the attorney would be entitled to a fee on any attorney fees that are recovered. However, given the policy reasons in support of the offset rule, a contractual provision allowing a "fee on a fee" should be very clear to be enforceable as a matter of contract law. In addition, even if agreed to by the client, such a fee arrangement must still be reasonable under SCRPC 1.5(a). See Cambridge Trust, 721 N.E.2d at 6-7.

One situation that arises frequently in mass torts involves "common fund fees" that courts assess against the overall settlement or recovery in the case. These fees typically cover legal fees for members of the steering committee or members of other committees that performed services benefitting the entire class. In the absence of a provision in the lawyer's engagement agreement or a court order, a lawyer who receives a portion of such common fund fees should treat them like a recovery of attorney fees subject to the offset rule. In addition, courts may assess "common fund expenses" against the settlement or recovery. Such expenses should be treated as "case costs," which under the standard contingency fee agreement used by plaintiffs' lawyers would be deducted from the clients' share of the recovery. Lawyers representing clients who are or may be involved in a mass tort action should take these assessments into account when drafting their engagement agreements or in preparing court orders dealing with such assessments.

Renegotiation of agreed-upon fees. Another important aspect of fee negotiation between lawyer and client involves renegotiation of agreed upon fees. Circumstances can change from the time when the original agreement was executed. For example, the original engagement may have called for a contingent fee with the attorney advancing expenses, but the case may have gone on for a long period of time and may have become more expensive and burdensome than the lawyer anticipated. As a result the lawyer may suggest a modification of the fee agreement; for example, with the client paying a portion of the expenses and increasing [*14] the contingency fee. Modifications of lawyer-client agreements are subject to special scrutiny and are unenforceable "unless the lawyer shows that the contract and the circumstances of its formation were fair and reasonable to the client." See RLGL § 18(1))(a). To meet these requirements the lawyer must show that "the client was adequately aware of the effects and material disadvantages of the proposed contract and that the client was not pressured to accede in order to avoid the problems of changing counsel, alienating the lawyer, missing a deadline or losing a significant opportunity in the matter, or because a new lawyer would have to repeat significant work for which the client owed or had paid the first lawyer." *Id*. comment e. *See also ABA Formal Opinion* #11-458 (imposing various limitations on fee modifications). In addition, if the modification involves an acquisition of an interest in a client's property as security for the payment of fees, the modification is subject to SCRPC 1.8(a), which includes a requirement that the client be advised in writing and given a reasonable opportunity to seek the advice of independent counsel. *See id*.

Negotiation of legal fees with the adverse party

In cases in which the plaintiff is entitled to recover attorney fees, defendants frequently want to negotiate a "global" settlement that includes both damages and attorney fees. The situation can arise in class actions

where any settlement and the award of attorney fees is subject to court approval and in ordinary litigation where such judicial supervision often does not occur. What are the ethical implications of this situation?

South Carolina Rule of Professional Conduct 1.7(a)(2) provides that a lawyer has a "concurrent" conflict of interest if "(2) there is a significant risk that the representation of one or more clients will be materially limited … by a personal interest of the lawyer." If a lawyer negotiates a settlement when part of the settlement includes the lawyer's fees, the lawyer has a personal financial interest that poses a significant risk of materially limiting the representation. See, e.g., Wise v. Wash. Cnty., 2015 U.S. Dist. LEXIS 50926, *92-*103 (W.D. Pa. 2015) (discussing the conflict involved in simultaneous negotiation of settlement and attorney fees).

The existence of a concurrent conflict does not *per se* prevent the lawyer from participating in global settlement negotiations. The Supreme Court's decision in Evans v. Jeff D., 475 U.S. 717 (1988), is particularly instructive in this regard. *Evans* is usually cited for the proposition that attorney fee awards belong to the client and not the lawyer; accordingly, a client is free to waive a right to recover attorney fees without the consent of the lawyer. However, the opinion also discusses whether it is proper for lawyers to negotiate simultaneously fees and terms of settlement. Both the majority and dissenting opinions agreed that such negotiation was proper--particularly in the context of class actions where settlement and fee terms are subject to judicial approval under FRCP 23(e)--because the contrary rule would discourage settlements by increasing the uncertainty about settlement terms. The Court stated:

> The Court is unanimous in concluding that the Fees Act should not be interpreted to prohibit all simultaneous negotiations of a defendant's liability on the merits and his liability for his opponent's attorney's fees … We agree that when the parties find such negotiations conducive to settlement, the public interest, as well as that of the parties, is served by simultaneous negotiations … This reasoning applies not only to individual civil rights actions, but to civil rights class actions as well. 475 U.S. at 738, n.30.

While the Court's decision was an interpretation of the federal civil rights laws, the Court's ruling implies that such negotiations would not be unethical.

How then should lawyers proceed with regard to settlement negotiations when both damages (or other substantive terms) and attorney fees are involved? As an initial point, if a lawyer contemplates that settlement negotiations will include both substantive terms and legal fees, the lawyer should obtain either in the engagement agreement or in a separate consent preceding negotiations informed client consent authorizing such negotiations. To be informed, the consent should state both the advantages and disadvantages of the authorization. The major disadvantage is that such negotiation may not benefit the client because any amount negotiated for attorney fees may reduce the amount or favorable terms of the substantive settlement. On the other hand, consent to simultaneous negotiation may well be advantageous to the client because such negotiation is likely to increase the possibility of settlement. In addition, the client has protections against a possible conflict because the lawyer has a fiduciary obligation to put the client's interest above his own; the client has the right to review, approve, or reject the settlement, including the amount of attorney fees; and the terms of the settlement either are or may be made subject to judicial approval.

Lawyers have a number of options for how they can approach the issue of negotiation of settlement terms and attorney fees, ranging from the safest ethically to the riskiest.

. *Separation of negotiation of settlement terms and attorney fees, with judicial determination of attorney fees*. The safest approach involves two parts: First, separate negotiations of the settlement of the client's case, whether for damages, injunctive relief, or other remedy, from the issue of attorney fees. Second, submission of the issue of attorney fees to the court or special master appointed by the court to determine the amount of fees the defendant will pay. While this approach is the safest way to proceed ethically because [*15] it avoids any conflict between lawyer and client over legal fees, it may not be acceptable to defendants, who seek the certainty of a global settlement without the uncertainty of amount and expense associated with a proceeding to determine attorney fees. A variant of this approach would involve negotiation of settlement of substantive claims, followed by negotiation of attorney fees after substantive settlement is complete, followed by judicial review of all settlement terms. This variation avoids the conflict of interest by separation of negotiation of substantive terms and attorney fees, but it should reduce uncertainty and the costs associated with judicial determination of legal fees.

. *Global settlement including attorney fees subject to court allocation of the amount of attorney fees*. The parties could negotiate a global settlement that includes substantive relief, whether damages or specific relief, and attorney fees. In class actions or other settlements that are subject to court approval, the court would review the reasonableness of the terms of the settlement and would allocate a portion of the settlement to attorney fees. In cases in which court approval is not required, the overall settlement could still be submitted to the court for approval at least as to the reasonableness of the fees. As discussed above *Evans* and other cases seem to approve the propriety of this approach with judicial oversight serving as a protection against a conflict of interest in settlement. This solution avoids the uncertainty deriving from a separate judicial determination or negotiation of attorney fees.

. *Client "waiver" of conflict involving negotiation of attorney fees*. Finally, the client could by informed consent allow counsel to engage in global negotiations including both the client's substantive claims and attorney fees. This approach has the greatest risk ethically because informed consent requires significant disclosures to the client. See SCRPC 1.0(g) and comments 6 and 7. In addition, it can be argued that such negotiation is improper even with informed consent. See SCRPC 1.7(b)(1) (providing that a lawyer may not proceed with representation when a lawyer has a concurrent conflict unless the lawyer "reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client"). These ethical risks are substantially reduced, however, if the client is sophisticated in business or legal matters, particularly an entity client that is independently represented. See comment 6 to SCRPC 1.0.

These options are not exclusive. Other frameworks for negotiation could be envisioned. In Cisek v. National Surface Cleaning, 954 F. Supp. 110 (S.D.N.Y. 1997), the court stated two preferred methods for dealing with the conflict of interest involved in settlement negotiations involving attorney fees:

> (1) abstain from discussion of attorney's fees until an agreement is reached on the relief to be obtained by the plaintiffs themselves or (2) negotiate a lump sum settlement and allow the court to allocate the fund between counsel and client … Id. at 111.

However, the court stated that a court "is not required to deny fees or disapprove class action settlements where this course is not followed." *Id*. See also Silva v. Miller, 307 Fed. Appx. 349 (11th Cir. 2009) (holding that in Fair Labor Standards Act case settlement of claim for damages and fees was subject to judicial review for reasonableness).

In my opinion the key to ethical propriety when handling settlement negotiations involving attorney fees is for lawyers to adhere to their fiduciary obligations to their clients by not sacrificing their clients' substantive interests in favor of their own financial interests. The client must come first.
