THE BAR ASSOCIATION OF SAN FRANCISCO

Legal Ethics

Ethics Opinions

OPINION 1999-1

An attorney may contract with a client to receive both an hourly rate and a contingency fee as long as the fee agreement is negotiated in an arms length transaction and the fee charged is not unconscionable.

ISSUE:

Whether an attorney may enter into a fee agreement with a client that provides that the attorney will be paid both an hourly rate and a contingency fee.

DIGEST:

As long as the client enters into the fee agreement in an arms length transaction and agrees to the fee with informed consent, such an arrangement would be permissible under California Rules of Professional Conduct, Rule 4-200 so long as the fee charged is not unconscionable. The hybrid nature does not per se render the fee-agreement unconscionable

AUTHORITIES INTERPRETED:

California Rules of Professional Conduct, Rule 4-200

DISCUSSION

A. The right to charge fees for attorney services is based on contract principles which are circumscribed by conscionability.

While the measure and mode of attorney-compensation is generally a matter of contract between the attorney and client, CCP § 1021; Witkin Cal.Proc. 4th 1 Attorneys §§177-179. See also Todd v. City of Visalia (1967) 254 Cal.App.2d 679, 62 Cal.Rptr. 485, 492 ["An attorney has a right to contract for compensation..."], Tracy v. Ringole (1927) 87 Cal.App. 549, 550-51, 262 p. 73; Lee v. Gump (1936) 14 Cal.App.2d 729, 58 P.2d 941, the California Rules of Professional Conduct ("RPC") circumscribe an attorney's boundaries in establishing fees. Specifically:

> A member may not enter into an agreement for, charge, or collect an illegal [1], or unconscionable fee.

RPC Rule 4-200(A).

In determining whether a fee is unconscionable, "except where the parties contemplate that the fee will be affected by later events," the Rule prescribes eleven factors to be considered, from the standpoint of the parties at the time the agreement is entered. RPC Rule 4-200(B). These factors include, where appropriate:

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 services 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.

RPC 4-200(B).

Further defining the weighing process is the fact that unconscionability has two inversely related components: Procedural unconscionability involves "oppression" related to adhesion contracts, or "surprise" from hidden language or terms. Substantive unconscionability refers to:

an overly harsh allocation of risks or costs which is not justified by the circumstances under which the contract was made.

Shaffer v. Superior Court (*Simms*) (2nd Dis., 1995) 33 Cal.App.4th 993, 1000. 39 Cal.Rptr.2d 506, 511. The more egregious the procedural factors are, the less disparity in substantive factors is required for the contract to be deemed unconscionable, and vise versa. *Id* .

Within the confines of the above factors, both hourly and contingent fee agreements are permissible. See Bus. & Prof. §§ 6147, 6148; Ramirez v. Sturdevant (1st Dist., 1994) 21 Cal.App.4th 904, 913, 26 Cal.Rptr.2d 554, 558; Shaffer , (supra).

B. Even if a contract is not unconscionable, it may nonetheless be unenforceable to the extent the ultimate fee is deemed excessive.

Rule 4-200 is a rule of discipline, RPC Rule 1-100(A); Ames v. State Bar (1973) 8 Cal.3d 910, 106 Cal.Rptr. 489, which takes a prospective view of the contract to determined conscionability. RPC 4-200(B). Attorneys ought to bear in mind, however, that although a contract may be conscionable (thus riot subject to discipline), the fee may nevertheless be retrospectively deemed "unreasonable" or excessive in light of the services performed. People v. Pinedo (1st Dist., 1998) 60 Cal.App4th 1403, 1406, 71 Cal.Rptr.2d 151, 153, citing People ex rel. Dept. of Transp. v. Yuki (6th Dist., 1995) 31 Cal.App4th 1754, 1769-71, 37 Cal.Rptr.2d 616, 624-26 [quoting Rule 4-200(B) factors]. In such an event, courts may refuse to enforce the agreement or the fee may be subject to reduction in a subsequent fee dispute.

Witkin notes that while the courts' authority in this regard may be premised variously on "undue influence, constructive fraud.... public policy..., or an exercise of the inherent power of the court over conduct of attorneys," it is not entirely clear from the authorities, and "perhaps all of these theories are involved." See Witkin Cal.Proc4th 1 *Attorneys* § 203. See e.g., Blattman v. Gadd (1931) 112 Cal.App. 76, 92, 296 p. 681

[confidential relationship requires attorney to apprise client of the legality of the claim for proper evaluation of contingent-fee agreement (informed consent)]; In re Michaelson (9' Cir., 1975) 511 F.2d 882, 888 [inherent power of the courts over attorneys], cert. denied, 421 U.S. 978; Isrin v. Superior Court of Los Angeles County (1965) 63 Cal.2d 153, 45 Cal.Rptr. 320, 403 P.2d 728 [Contingent-fee agreements are subject to rules of construction of relating to fiduciaries].

C. Like hourly and contingent agreements, hybrid agreements are a matter of contract, and are permissible so long as they are not unconscionable.

Contingency fees are favored in America because they promote access to justice by those who may not otherwise be able to afford an attorney. 37:1 U.C.L.A. L.Rev 29, 43 (1989) *Contingent Fees Without Contingencies* ... (L. Brickman); 37:2 U.C.L.A. L.Rev. 949, 952, 962 (1990) *Comment* : *the Validity and Propriety of Contingent Fee Controls* . Some authors have suggested however, that risk to the attorney is an essential element of a conscionable contingent fee, and therefore, hybrid hourly/contingent agreements, which may be void of risk, are unethical. See e.g., 37:1 UCLA L.Rev. At 74. They assume that most clients are unsophisticated, and that financial risk is necessarily attached to a contingent fee. They also acknowledge a dearth of authorities supporting their proposition. Id; see also 37 U.C.L.A. L.Rev. at 955. In fact, the authorities do not hold risk to be paramount to the other factors of Rule 4-200(B). While several decisions do refer to the "gamble" or "risk" presumed to be inherent in a traditional contingent-fee agreement, those decisions do not preclude agreements so lacking.

For instance, in Rader v. Thrasher (1962) 368 P.2d 360, 18 Cal.Rptr. 736, the attorney offered a $25,000 contingent fee, payable if the case prevailed at trial. The client rejected the offer, and they ultimately agreed upon a contingency fee of 30% of the net profit from the timber (the subject of the suit). 18 Cal.Rptr. at 738. In upholding the fee agreement and the reasonableness of the fee, the court commented upon two elements of risk present in the instance case, specifically 1) whether the litigation would be successful, and 2) whether a profit would be realized from the timber sale. The court noted:

A contingent fee contract, since it involves a gamble on the result, may properly provide for a larger compensation than would otherwise be reasonable.

19 Cal. Rptr. at 74 1. In other words, the gamble factor (4-200(B)(9)) may mitigate an imperfect fit in the proportionality factor (4-200(B)(1)). The opinion thus supports the factor weighing described in 4-200(B). Although it viewed the risk present as mollifying the amount of the fee, the court did not address whether risk was a necessary element of a contingent-fee agreement, nor did it imply that such agreements are per se unreasonable if there is no risk. The issue of a no-risk contingent fee was not before the court.

The language quoted above from Rader, was taken from In re: Raphael's Estate (1951) 103 Cal.App.2d 792, 230 P.2d 436, a more telling case. In Raphael, the fee agreement provided, in addition to a 50% contingent-fee of all property the attorney was able to establish was community, the attorney was entitled to a (risk-diminishing) $1,000 retainer. *Id* at 438. Again, the court commented upon the risk involved: "a gamble. . .fraught with uncertainty" which "hinged upon persuading the trial court that admittedly separate property had been transmuted to community property." *Id* at 438-39. The court upheld the trial court's finding that the fee was "equitable and reasonable." *Id* at 438. The court weighed the amount of the fee (4-200(B)(1)), against the gamble-winning the case (4-200(B)(9)), and the difficulty of the case (4-200(B)(3)). The court also found significant that the client gave informed consent to the agreement (4-200(B)(11)). *Id* . This court likewise did not address whether risk was essential, but it did expressly uphold a hybrid flat and contingent fee.

While these cases did involve risk, and did discuss it as a factor in considering the conscionability of the agreement and reasonableness of the fee, consistent with Rule 4-200(B), they did not elevate the factors sounding in risk (particularly factor 9), above the other 10 factors. Cf. Cazares v. Saenz (4' Dist. 1989) 208 Cal.App.3d 279, 287-88, 256 Cal.Rptr. 209, 214 [construing a traditional contingency agreement].

The risk involved in many contingent agreements is often illusory. The personal-injury arena, for instance, typically employs contingency agreements. Witking Cal.Proc4th 1 *Attorneys* §202. Sometimes, however, liability in those matters is clear or admitted, and given the nature of some injuries, a high damage award appears likely. Nonetheless, contingent-fees of one-third to fifty per cent are routinely upheld. See e.g., Hendricks v. Sefton (1960) 180 CaI.App2d 526, 532, 4 Cal.Rptr. 218 [one-third]; Estate of Raphael, (supra); Gelfand, Greer. Popko & Miller v. Shivener (1973) 30 Cal.App.3d 364, 377, 105 Cal.Rptr. 445 [50% for services in a two-hour hearing]. Moreover, there are many different kinds of risk, beyond financial, which may justify an attorney in charging a higher rate. Indeed the client may be less concerned with obtaining a large favorable judgement, than establishing a favorable (or unfavorable) precedent, or bad publicity. Such circumstances may alter the strategy of the case, for instance, a decision to waive certain, economically advantageous causes of action. Accordingly, a focus exclusively on apparent financial risk may thus be misplaced.

In any event, the courts have consistently upheld creative fee agreements when they are not unconscionable, irrespective of the novelty of the payment scheme, or the absence of risk. In Brobeck. Phleger & Harrison v. Telex Corp., (9th Cir., 1979) 602 F.2d 866, cert. denied 100 S.Ct. 483, 444 US 981, 62 L.Ed2d 407, for instance, the court upheld a complex hybrid fee agreement between the multi-million Telex Corporation, and a large law firm retained to handle a hearing in the US Supreme Court, in Telex' action against IBM. The agreement called for an initial $25,000 retainer, which would be its sole compensation if the petition were denied. If review was granted the firm would receive an additional $15,000 for all additional Supreme Court proceedings. If settlement was reached prior to filing of the petition, the firm would be paid an additional $125.00 per hour, not to exceed $100,000, against which the retainer would be applied. After the petition was filed, the firm was entitled to an additional fee in the event of recovery by judgment or settlement, of 5% of the first $100-million recovered in excess of cross-claims, with a floor of $1 million, and a ceiling of $5 million. After the petition was filed, the parties settled in a "wash settlement," waiving all claims and cross-claims. The firm demanded its $1 million fee.

In affirming the fee, the court noted that "although the minimum fee was clearly high" (Rule 4-200(B)(1)):

> a) Telex sought out the best anti-trust/Supreme Court lawyer in the country (Rule 4 200(B)(8) and (B)(3));
>
> b) The attorney advised Telex he would need to rearrange his workload (Rule 4-200(B)(4));
>
> c) Telex insisted upon the contingency agreement, had more experience with them than the attorney, and the negotiated minimum $1,000,000 contingent fee was included in the contract (Rule 4-200(B)(2));
>
> d) The relative sophistication of the parties and the absence of unequal bargaining power (Rule 4-200(B)(2) and (B)(11)); and

e) The fact that the firm's petition yielded substantial bargaining power to Telex vis a vis IBM, specifically leverage to obtain settlement including discharge of the large counterclaim judgment, which prevented Telex' bankruptcy (Rule 4-200(B)(5)).

Id, at 875.

Although the parties and the magnitude of the amount in dispute in the Telex case were perhaps striking, other more ordinary cases have yielded similar results. In Krieger v. Bullpitt (1953) 40 Cal.2d 97, 251 P.2d 673, the court upheld a contingency agreement to settle property divisions following a dissolution proceeding - the agreement called for a 10% contingency fee, with a minimum of $5,000 and a maximum of $7,500. In In re: Kerr's Estate (1966) 63 Cal.2d 875, 48 Cal.Rptr. 707, the court upheld a fee agreement between an attorney and the sole heir of an estate, to obtain probate of the will, when one of two duplicate original wills had been defaced. The agreement called for a "guaranteed fee.for their services" of $200 plus 50% of the recovery in the estate. See also, Youngblood v. Higgin (1956) 146 Cal.App.2d 350, 303 p.2d 637 [$500 plus 1/3 and $1,000 respectively, if a cross-complainant was filed]; In re Raphael's Estate, (supra); But see, Ramirez v. Sturdevant (1 st Dist., 1994) 21 Cal.App4th 904, 913, 26 Cal.Rptr.2d 554, 558 [noting the "questionable nature" of the attorney's entitlement to a contingent fee and a separate award of attorney's fees, but nonetheless finding the attorney did not breach a duty to the client]; Cf. Mahoney v. Sharff (1961) 191 Cal.App.2d 191, 12 Cal.Rptr. 515, 518 [$1.000 retainer in addition to 40% upheld, but absent a contract expressly providing otherwise. court awarded fees offset pro rata the contingency fee the client owes the attorney under the contract].

CONCLUSION

While the level of risk (be it economic or otherwise) assumed or anticipated may affect the weight of the various factors in determining whether a fee agreement is conscionable or fees reasonable, there is no basis to assume Rule 4-200 precludes no-risk contingent fee agreements, or hybrid hourly/contingent agreements when contracted with informed consent by attorneys and clients, dealing at arms length. Nonetheless, the better practice when engaging in a creative (indeed any) fee agreement is to consider both prospective conscionability, and retrospective reasonableness when drafting. Consistent with *Shaffer, supra,* if an unjustified allocation of risks or costs is avoided, and the parties incorporate a clear articulation of probable outcomes into the agreement, they will bolster the client's informed consent, thus protecting the client at the inception, and the attorney at the conclusion of the engagement.

Footnotes:

1. This Ethics Opinion is limited in scope to a discussion of fee agreements that are not illegal. It is well established that entering into an illegal fee agreement or charging an illegal fee (e.g., fees violating MICRA, fees in excess of estate administration schedules, fees for services for a minor without court approval, etc.) can subject a member to discipline. See In re _M. Harney (Rev. Dept. 1995) 3 Cal.StatcBarCt.Rptr. 266.