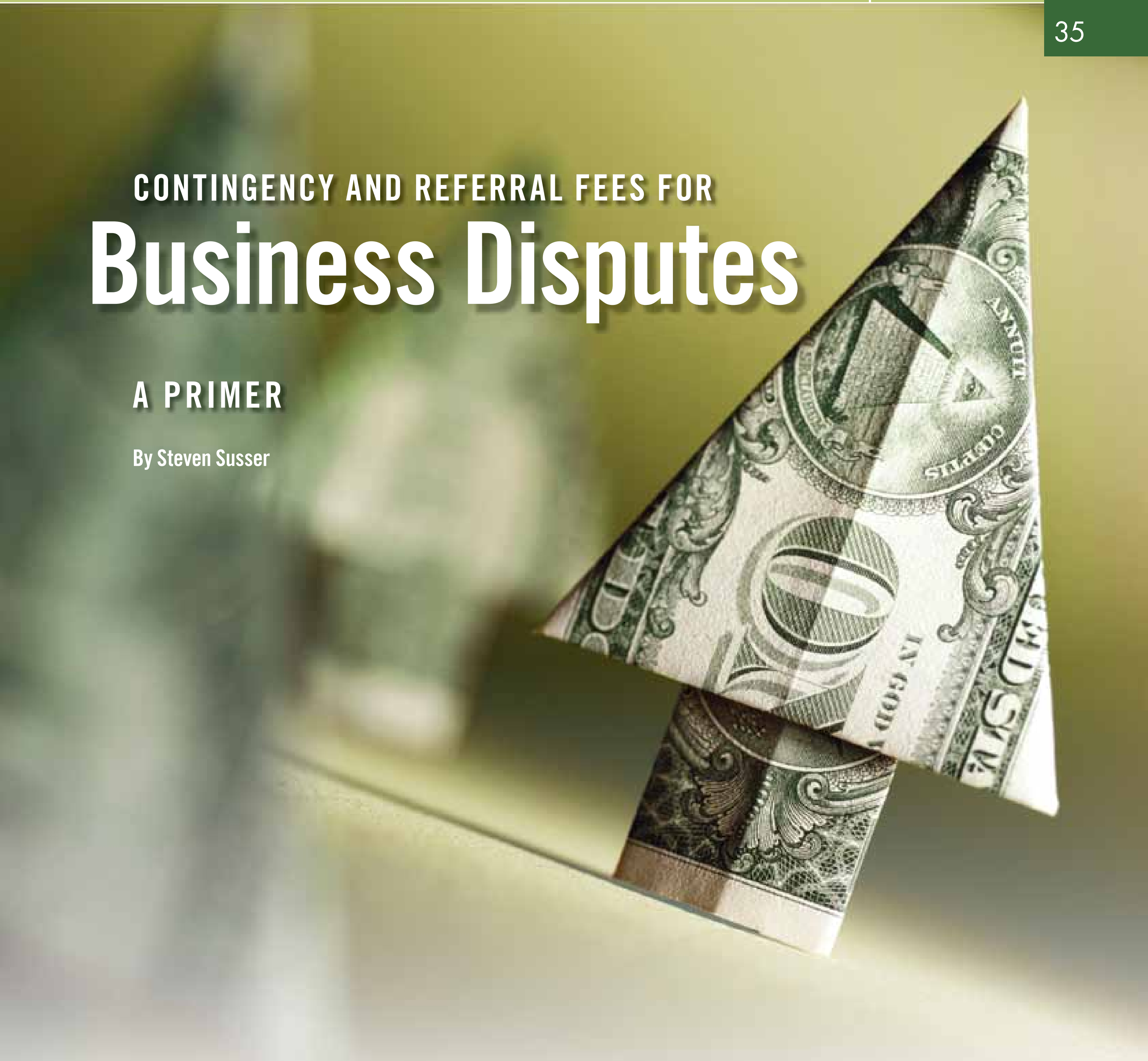


CONTINGENCY AND REFERRAL FEES FOR
Business Disputes

A PRIMER

By Steven Susser

Fast Facts:

Commercial litigation represents an area in which contingency fees should be more widely and effectively utilized.

There is infinite flexibility to construct [contingency fee] arrangements, as long as they are within the appropriate ethical rules.

In the appropriate case, a referral fee is a win-win situation in which the referring attorney is compensated for his of her opportunity cost in foregoing a piece of litigation that did not suit him or her, and the recipient attorney is compensated for a successful outcome.

Many attorneys assume that contingency fee arrangements are best reserved for medical-malpractice and personal-injury cases. But, in reality, contingency fees are appropriate in all situations, including commercial litigation. Indeed, commercial litigation represents an area in which contingency fees should be more widely and effectively utilized. When done properly, a contingency fee arrangement in a business dispute can be a win-win situation, for both the attorney and the client.

Under a contingency fee arrangement, the amount the lawyer receives for a case is dependent (contingent) in some way on the result. The most common example is a fee agreement in which the attorney receives one-third of the client's recovery. But there are many different contingent arrangements that can be agreed upon. For example:

- **Hybrid:** Client pays the lawyer a discounted hourly fee and the lawyer gets a percentage of the client's recovery.
- **Minimum:** Client pays a minimum flat fee per month and the lawyer gets a percentage of the recovery.
- **Reverse:** In the case of a defendant, the lawyer's recovery is dependent on the amount the client is required to pay. For example, obtaining a "no cause" for the client would result in a larger fee than a judgment for $1 million.
- **Bonus:** Client pays a discounted hourly fee with a stipulated bonus tied to predetermined results.

The key to any contingent arrangement is to find common ground for the attorney and client. Ideally, the attorney should feel that he or she is being fairly compensated for the time and risk involved, and the client should be comfortable that the total expected payment will be fair.

The opposite of a contingency fee is an hourly billing or flat-fee arrangement in which the lawyer receives the same amount regardless of the result. In such a situation, the client could score an upset victory resulting in a huge bonanza or, conversely, the client could lose unexpectedly. In either case, the lawyer walks away with the same amount. Many clients feel, perhaps rightly, that there is something vaguely troubling about a lawyer who receives the same paycheck regardless of whether his or her performance was stellar or abysmal.

The beauty of the contingency fee is that the lawyer is "in the game"—sharing the risks and rewards with his or her client. Not only is there nothing wrong with this, it makes sense. Under a contingency fee arrangement, the lawyer is more like other professionals, such as real estate brokers, car salesmen, and even CEOs, who receive percentage commissions and bonuses for their success.

But what are the legal and ethical rules that govern contingency fee arrangements and referral fees for contingency cases in the state of Michigan? After examining this legal framework, we can explore the advantages and disadvantages of taking a case on a contingent basis.

Crafting a Contingency Fee Arrangement

Many lawyers assume there are strict laws governing contingency fee arrangements. However, the court rule imposing strict requirements on contingency fee arrangements applies only to personal injury and wrongful death cases.[1] In the commercial context, attorneys and clients have wide discretion to craft a contingency fee arrangement, as long as the total fee is not "clearly excessive" for the individual circumstances.[2] There are practical advantages and disadvantages to a contingency fee arrangement that attorneys should consider when deciding whether to adopt the arrangement in a given case.

Advantages

Money

From the attorney's perspective, the major benefit of a contingency fee arrangement is that he or she will often make more money upon successful resolution of the case. Indeed, in today's legal market, it is difficult to bill $1,000 on an hourly basis. But the hourly equivalent of $1,000 or more is available at the conclusion of a successful contingency-fee-based representation.

Access

Working under a contingency fee arrangement also broadens the scope of clients who can afford the attorney's services. Many commercial clients with valid legal claims refrain from bringing an action because of their fear of overwhelming legal costs. By offering services on a contingency fee basis, the attorney can open the possibility of litigation to a client that would otherwise be resistant to pursue relief through the judicial system.

"Can we get along when the pressure mounts?" "Do I have full trust and confidence in this potential client?" While these are important questions for an attorney in any case, the attorney and client are truly partners in a contingency fee case and must be able to work as such.

Marketing

In today's tight economic market, many commercial clients are looking for flexible legal cost arrangements. For these clients, an attorney improves his or her marketability by offering to work on a contingency. These prospective clients include both plaintiffs and defendants, who may also be interested in constructing a fee structure that places an incentive on the ultimate result. For example, a commercial defendant's legal fees may be structured so that they are based on a percentage of the damages claimed. Or an attorney may take fees based on a range of results, so that a verdict of no cause of action would yield a fee of $X, while a small award of damages would yield a fee of $Y. There is infinite flexibility to construct such arrangements, as long as the fee structure comports with the appropriate ethical rules.

Disadvantages

Naturally, a contingency fee arrangement presents more risk than a standard hourly-fee structure. To mitigate this potential for risk, some firms require that a client who is represented on a contingency basis pay for all costs, including expert costs. This is a significant buffer, as costs can be quite substantial, especially with patent and other highly complex litigation. Other firms ask for a substantial retainer up front, which they credit to the client at the end of the litigation in the event of a recovery. While making the litigation less attractive to a potential client, these hurdles can actually benefit both the attorney and the client. Indeed, a potential client who faces an early cost threshold will understand the appropriate gravity—that is, the client will "have some skin in the game." Lawsuits are serious enterprises. You take them seriously and so should your clients.

The other disadvantage of contingency fee arrangements is that they typically require a "rainy day fund." Namely, the firm will need to set aside money to fund the lawsuit because there will not be any current cash flow to fund the ongoing legal work. This lack of cash flow can be particularly nettlesome for firms that have both transactional and litigation attorneys, where transactional attorneys are forced to forgo income from their hourly work in the hope that the litigators will ultimately attain a recovery. The possible intra-firm political issues that may arise in this regard are obvious. For this reason, contingency fee arrangements usually work only when all decisionmakers in the firm are committed to making the fee structure succeed.

Practical Steps

For attorneys who decide to enter into contingency fee arrangements, the most important step is to select an appropriate case. Typically, cases must meet three criteria to be viable:

(1) **Damages:** The amount of reasonable potential damages must be enough to make the case worth the risk. Nearly every business litigation matter requires significant effort. Although an attorney will put more time and resources into a million-dollar case than a thousand-dollar case, there is arguably far less of a difference in the amount of energy expended for a thousand-dollar case as compared to a million-dollar case. So, before committing resources to a case, attorneys should be sure that the potential damages will justify the commitment.

(2) **Strength of Case:** Before taking any new case on a contingency fee basis, the attorney must complete extensive due diligence concerning the likelihood of success (however the client defines it). A business lawsuit can last three years or more. During that time, the attorney will face many risky patches. These include legal risks, such as dispositive motions, loss at trial, or loss on appeal. They also include client-related risks, such as the revelation during discovery of critical and outcome-changing information, or a client's change in goals. In light of these risks, it is important that the attorney be realistic about the potential outcome and structure the fee accordingly. As Justice Corrigan wrote in a recent concurring opinion, "Contingency fee percentages express an attorney's expectations of the case and the risks involved."[3]

Needless to say, a contingency fee arrangement in the context of commercial litigation is never a "sure thing." Commercial clients are generally savvy enough to know when they have a simple case that should be paid on an hourly basis or settled without the aid of legal counsel. More often, the best contingency fee case is a "diamond-in-the-rough"—a case that has potential, provided that it is prepared properly. Depending on the attorney's skill, if a case with potential is prepared the right way, the rewards for both the attorney and the client can be substantial.

(3) **Meeting of the Minds:** An attorney must be confident that his or her client shares the same view of the case. While the risk of disagreement with a client is part of any representation, the existence of shared risk makes the potential for such conflict in the contingency fee context more likely. It is always better to be clear about goals and expectations up front. Also, much more so than in hourly cases, attorneys and clients in contingency fee cases are joint venture partners, and thus the attorney should carefully consider whether they mesh from a personality standpoint before taking the engagement. For example, an attorney should ask, "Can we get along when the pressure mounts?" He or she should also ask, "Do I have full trust and confidence in this potential client?" While these are important questions for an attorney in any case, the attorney and client are truly partners in a contingency fee case and must be able to work as such.

Referral Fees

Attorneys who do not want to pursue contingency fee arrangements themselves may wish to consider a referral fee.

A referral fee is a percentage of the contingency recovery obtained by the referring attorney. While referral fees for commercial cases (such as those discussed previously involving contingency fee arrangements) can vary, a firm may pay 10 to 15 percent of the total recovery for referrals, for example. In concrete terms, for a million-dollar recovery on a standard 30-percent contingency, a referring lawyer would net $45,000, and much more for larger recoveries.

The Michigan Rules of Professional Conduct (MRPC) guide the creation of referral fee arrangements. Before the adoption of the MRPC in October 1988, it was improper for any Michigan lawyer to receive a referral fee if the lawyer merely performed a referral function and assumed no responsibility for the case. MRPC 1.5(e) changed this, by omitting the former requirement that referral fees "be made only in proportion to the services performed and the responsibility of each lawyer."[4]

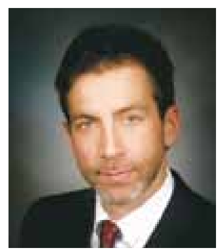
In 1995, the State Bar Standing Committee on Professional Ethics opined that, before agreeing to a referral fee, the client should be advised of certain relevant factors, including the identity of the lawyers who will divide the fee, what services each lawyer will provide, and which lawyer or lawyers will be responsible for the matter.[5] Such client consent should always be confirmed in writing because, without evidence of consent, the referral agreement is void and wholly unenforceable.[6]

Like contingency fee arrangements, referral fees for commercial cases can also be structured in a variety of ways. While "referral fees most often consist of a percentage of contingent fees," it is also ethical to pay reasonable referral fees that are computed as a percentage of the legal fees billed to the client, as long as the client's total bill is not increased as a result.[7]

However, there are some restrictions. First, referral fees are not allowed when the lawyer cannot accept the case because of a conflict of interest. The reason for this is that if "the referring lawyer has a conflict, then any advice might smack of a conflict, even if the advice is to go to a specific lawyer."[8] Second, referral fees can only be paid between attorneys. Lawyers cannot pay for referrals by nonlawyers,[9] and they cannot pay referral fees to unlicensed attorneys.[10] Third, lawyers cannot refuse to refer an otherwise referable matter when the client objects to the referral fee structure.[11]

Conclusion

Referral fees are common in the personal-injury context but much less so with commercial contingency fee cases. This is partially because commercial contingency fee cases are rare and partially because it may be perceived by some as unsavory to ask for a referral fee. I suggest that this illogical stigma be ignored. If you refer a contingency fee case to a fellow attorney, and your fellow attorney decides to accept it, you will have given that attorney an opportunity to make a significant amount of money. If that attorney does, you have every right to expect a portion of the ultimate recovery because you were the genesis for the litigation in the first place. In other words, without you, there would have been no recovery to divide. In the appropriate case, a referral fee—like a contingency fee—can be a win-win situation in which the referring attorney is compensated for his or her opportunity cost in foregoing a piece of litigation that did not suit him or her, and the recipient attorney is compensated for a successful outcome. ■



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FOOTNOTES

1. MCR 8.121.
2. See MRPC 1.5(a). The Michigan Rules of Professional Conduct (MRPC), while technically nonbinding ethical rules, must be adhered to because contracts violating the rules are null and void and hence unenforceable. *Evans & Luptak, PLC v Lizza*, 251 Mich App 187, 196; 650 NW2d 634 (2002); see also *Morad v Cabadas*, unpublished opinion per curiam of the Court of Appeals, issued January 11, 2005 (Docket No. 245976) (holding that contracts violating the MRPC are unenforceable and claims under such contracts cannot be the subject of an unjust enrichment claim).
3. *Smith v Khouri*, 481 Mich 519, 540; 751 NW2d 472 (2008).
4. See MI Ethics Op JI-45 (December 20, 1991).
5. MI Ethics Op RI-234 (May 10, 1995).
6. See, e.g., *Dietrich & Assoc, PLC v Fieger*, unpublished opinion per curiam of the Court of Appeals, issued December 28, 2001 (Docket No. 224870); *Kosinski v Mason*, unpublished opinion per curiam of the Court of Appeals, issued November 27, 2001 (Docket No. 224658).
7. MI Ethics Op RI-124 (March 24, 1992).
8. MI Ethics Op RI-116 (February 19, 1992). But note that this rule does not apply if the lawyer's "conflict" arises solely from the fact that he or she will be a witness in the case and his or her testimony will be consistent with the client's interests. MI Ethics Op RI-211 (June 1, 1994).
9. See MRPC 5.4(a).
10. *Morris & Doherty, PC v Lockwood*, 259 Mich App 38, 44; 672 NW2d 884 (2003).
11. MI Ethics Op RI-158 (March 15, 1993).