

# Hybrid Fee Agreements: Okay Or No-kay?

BY ROY SIMON

Hourly rate fee agreements are the traditional lawyer-on-top “missionary position” of commercial litigation. Contingent fee agreements are the equivalent standard in personal injury matters, and flat fees are the norm in house closings and other routine transactions. If you want to spice up your law life, maybe you should try some new positions. How about combining two or three? Is it ethical to enter into a “hybrid” fee agreement that combines elements of hourly fees, contingent fees, and flat fees?

Three years ago, the State Bar Committee on Professional Ethics addressed part of this question in N.Y. State op. 697 (1997). More recently, Nassau County Bar Op. 99-4 (1999) tackled the same subject. This article will summarize both opinions and offer some general observations and advice about hybrid fees.

But first, a word from the folks who bring you the New York Disciplinary Rules, the courts.

## Court Rules Limit Contingent Fee In P.I. Cases

We all know that the courts in New York promulgate the Disciplinary Rules, which are codified at 22 NYCRR Part 1200. The most pertinent rule here is DR 2-106(A), 22 NYCRR § 1200.11(a). This rule provides that a lawyer “shall not enter into an agreement for, charge or collect an illegal or excessive fee.” The remainder of DR 2-106 lists factors for determining whether a fee is excessive, flatly prohibits contingent fees in criminal cases and domestic relations matters, and requires certain disclosures in writing regarding contingent fees. Unfortunately, the factors that supposedly help lawyers to determine whether a fee is excessive are far too vague and general. They provide, as Prof. Anthony Amsterdam once said of the entire Code of Professional Responsibility, “as much guidance to a lawyer as a valentine gives to a heart surgeon.”

More helpful are the court rules expressly governing fees and setting strict upper limits in certain cases. In most personal injury and wrongful death actions, court rules set maximum contingent fees. In the First Department, for example, if a lawyer’s fee is “dependent in whole or in part upon the amount of recovery,” then 22 NYCRR §603.7(e) offers a personal injury lawyer two choices: either “**Schedule A**,” which specifies a sliding scale for contingent fee (50% of the first \$1,000, then 40% of amounts between \$1,000 and \$3,000, then 35% of amounts between \$3,000 and \$25,000, and only 25% of amounts over \$25,000), or “**Schedule B**,” which is a traditional contingent fee of up to 33-1/3% on the entire recovery. The other three departments have the same rule. The same court rules provide that fees within this range are “deemed fair and reasonable,” and any fee in excess of this range “shall constitute the exaction of unreasonable and unconscionable compensation in violation of” the code of Professional Responsibility.

**Thus, any lawyer who wants to use a hybrid fee arrangement that combines both contingent and hourly elements must make sure that the total fee *actually received* does not exceed the maximum percentages allowed by the court rules.**

### **Sliding Scale Offers Advantage In Some Cases**

The sliding scale obviously has a lot of advantages for lawyers who handle numerous small matters. To pick the simplest illustration, a lawyer who settles 100 cases for \$1,000 each on the sliding scale will rake in a hefty \$50,000 in fees, compared to only \$33,333 earned by a lawyer who uses the traditional 33-1/3% formula for the same cases.

For larger matters, however, the standard 33-1/3% fee earns more money for the lawyer. For example, a lawyer who nets the client \$3000,000 after expenses on a 33-1/3% contingent fee gets a \$100,000 fee. On the court-prescribed sliding scale ("Schedule A") the same lawyer would get only \$77,250, which is nearly \$23,000 less. On the other hand, a lawyer who handles a case on the Schedule A sliding scale may apply to the court for additional fees in "extraordinary circumstances" – but these applications are seldom granted. A lawyer who handles a case on the traditional 33-1/3% fee allowed by Schedule B may not apply for additional fees.

The problem, of course, is that if a case turns out to be weak, or even a dead-flat loser, an attorney who charges a contingent fee gets little or nothing. How can an attorney reduce this risk?

One way for an attorney to reduce risk is to screen cases more carefully—investigate the facts more intensively before accepting a retainer, and turn away cases if the pre-retainer investigation turns up significant weaknesses. This is the way the elite personal injury firms work. The premier medical malpractice lawyers, for example, screen out about 95% of the cases they see, and seldom suffer a total defeat. (Some critics of contingent fees argue that contingent fees are too high exactly because personal injury lawyers take only those cases that they know will result in a recovery, this eliminating the risk that supposedly justifies high contingent fees. But do these critics consider how much it costs to find the strong cases—or how much it costs to litigate even a strong case against an obstinate insurance company that can earn handsome returns on its money while it fights the suit?)

Another way to reduce risk is to enter into hybrid fee agreements—agreements that combine features of hourly rates, minimum fees, and contingent fees. Is that permissible? Do hybrid fee agreements comport with the Code of Professional Responsibility?

### **N.Y. State Bar Op. 697: A Qualified "Yes"**

Hybrid fee agreements are addressed in N.Y. State Bar Op. 697 (1999). The question posed there is simple: "May a lawyer charge both an hourly fee, irrespective of outcome, and, in the event of a recovery by settlement or verdict, a percentage of the net recover?"

The State Bar Ethics Committee began by noting that contingent fees "are normally greater than the hourly fees that would be charged for the same representation, because the contingent-fee lawyer bears the risk of receiving no pay if the client loses and the higher fee is compensation for that risk." Thus, a contingent fee may be valid even though a lawyer devotes relatively little time to a matter because "the

lawyer going in risks having to provide services without extra pay if the representation entails a greater expenditure of time than the lawyer anticipated when the contingent fee was negotiated.”

The Committee recognized that a lawyer who charges a “modified contingent fee” avoids the full risk of no recovery (since the lawyer is receiving an hourly fee). Nevertheless, the Committee said, “we believe that the lower risk to the lawyer is balanced by the lower bonus in the event of a successful completion, as defined in the retainer agreement.”

At its bottom line, the State Bar Committee stated:

We believe a hybrid or modified contingent fee is permissible as a matter of ethics as long as the total fee is not excessive. This will usually mean that the contingency percentage will be lower than it would be if the fee were based on a pure contingency. Whether the hourly fee must also be reduced depends on whether the fee as a whole exceeds a reasonable fee.

...[I]f the hourly fee is reduced, it is likely to make counsel available to clients whose cases do not have such a high probability of success that a straight contingency fee would be attractive to prospective counsel. Thus it meets the goal expressed in EC 2-20 of providing a means by which a client may economically afford, finance and obtain the services of a competent lawyer to prosecute a claim.

### **Agreements Must Conform To Maximum Fee Schedules**

Finally, the Committee reminded lawyers that any combination of hourly and contingent fees must conform to the maximum fee schedules in the court rules. “A fee in a personal injury matter that exceeded the Appellate Division’s fee schedule for certain contingency fees would not be reasonable,” the Committee said. In addition, DR 2-106(A) provides that a lawyer shall not charge an “illegal” fee.

Thus, the State Bar Ethics Committee gave a green light to hybrid fee agreements as long as the total fee is “reasonable” and comports with any applicable court rules.

But some clients cannot pay even a reduced hourly rate, or at least not for long. Let’s put this problem in concrete terms. A client, Roberta Gomez, comes to Attorney with an employment discrimination claim, alleging that her employer fired her because of her national origin. Ms. Gomez has some savings, but not enough to pay Attorney’s regular rate of \$200 per hour through trial. At the same time, Attorney is unwilling to handle the entire matter on a contingent fee, especially: (a) because employment discrimination matters must begin in administrative agencies that have not power to award damages; (b) because employment discrimination evidence is typically in the hands of the employer, attorneys often cannot evaluate an employee’s discrimination claim until the administrative proceedings are over; (c) because plaintiffs cannot go to court until administrative proceedings are exhausted; (d) because court proceedings take a long time and a lot of effort; and (e) because many employment discrimination plaintiffs lose or win meager damages. What kind of fee arrangement makes sense in this situation?

### **Nassau County Bar Op. 99-4: Hybrid Fees In Employment Discrimination Matters**

The Nassau County Bar Professional Ethics Committee analyzed an employment discrimination situation at the end of 1999. The inquiring attorney asked if he could use a fee agreement that would begin as an hourly rate retainer but convert to a contingent fee agreement if the attorney spent more than a certain number of hours. To be specific, the attorney proposed a retainer agreement with three main features:

- (1) The attorney will charge \$200 per hour to represent the client in administrative proceedings before the New York State Division of Human Rights and the U.S. Equal Employment Opportunity Commission, but in no case will the total hourly charges be less than a specified amount (for example, \$2,000) in other words, the \$2,000 amount is a “minimum fee” that the client will pay even if the case settles or the administrative proceedings end quickly.
- (2) If the hourly charges exceed the specified amount, then the fee will convert to a contingent fee under which the client will pay, out of any recovery, both the full specified amount plus one-third of any recovery exceeding the specified amount. For example, if the attorney spends ten hours in the administrative proceedings and settles for \$35,000, the fee will be \$2,000 plus one-third of the remaining \$33,000 (making a total fee of \$13,000).
- (3) The attorney has no obligation to represent the client beyond the administrative proceedings, and will not represent the client in a court unless the client at that point signs a separate retainer agreement to cover the judicial stage of the matter.

Regarding DR 2-106(A) and (B), which bar “illegal or excessive fees,” the Nassau Committee agreed with N.Y. State Bar Op. 697 that a “hybrid or modified contingent fee is permissible as a matter of ethics as long as the total fee is not excessive.” Applying that concept to the proposed retainer—and temporarily putting aside the court rules—the Nassau Committee said that whether a fee would be otherwise “excessive” under DR 2-106(a) depends upon the circumstances of the individual case under the factors set forth in DR 2-106(b). But the Committee’s bottom line was disappointing. The Committee said it was “impossible and inappropriate” for the Committee to opine on whether any particular fee for any particular case was “excessive” or “unreasonable” unless the Committee knew all of the facts and circumstances.

The Nassau Committee then moved to a more important question: was the proposed retainer agreement covered by the court rules regulating contingency fee agreements in personal injury, property damage, and malpractice cases? The Committee recognized that it lacked jurisdiction to interpret the court rules or the scope of their application, but the Committee noted that if the client recovered nothing (or if one-third of the settlement was less than the amount paid under the retainer), the client would have already paid a retainer amount above the fee permitted under the court rules. Thus, whether the fee was “illegal” depended on whether the court rules applied to employment discrimination matters. If so, the retainer would be governed by Nassau Bar Op. 93-24 (1993). In that opinion the Committee said that court rules in a legal malpractice matter “would bar a hybrid arrangement in which the attorney would receive a minimum retainer fee (based on agreed hourly rates and hours worked) if the recovery was zero.”

## Committee Cites Holding In P.I. Case

To support that conclusion, the Nassau Committee cited *Belzer v. Bollea* (a/k/a "Hulk Hogan"), 150 Misc.2d 925, 571 N.Y.S.2d 365 (Sup. Ct. N.Y.Co. 1990), in which the court condemned the use of a hybrid fee in a personal injury case. The plaintiff, suing the famous wrestler Hulk Hogan for assault signed a retainer agreement with personal injury attorney Roy Grutman providing for a fee of 33-1/3% of the gross proceeds "or whatever the firm's straight time billing charges would have been whichever was greater." At the conclusion of the matter, attorney Grutman asked the court to approve a 50% contingent fee in recognition of the "angst, aggravation and life's blood which this case had caused." The client submitted an affidavit in support of the higher fee. (With tongue in cheek, the court said: "The client's affidavit could not have been more supportive of the application for additional fees and more lavish in praise of the attorneys' efforts if the attorneys themselves had drafted it.")

The court denied the request for the higher fee. "The whole point and purpose of the rules fixing contingent fees in personal injury actions," the court said, "is to prevent attorneys from exacting unconscionable fees even though there appears to be agreement by the client." In the late 1950's, the court noted, "more than 60% of the filed contingent fee agreements called for attorneys' compensation of 50% of the recovery." To control this situation, the courts adopted rules regulating the amounts that attorneys could charge.

Turning to the agreement in the case at hand, which called for the higher of 33-1/3% or the lawyer's straight time charges, the court said that the agreement on its face called for "compensation possibly greater than the permissible limit." Expressly addressing the hybrid character of the agreement, the court said:

...An attorney may handle a case on the basis of a flat retainer, on the basis of charges for time incurred, or on a contingency. If there is a contingency agreement, the attorney cannot exceed the permitted percentages by providing for alternatives which would result in even higher compensation. The contingent fee is permitted because the attorney takes the risk of recovering nothing at all. If the agreement provides for the certainty of recovery in any event, the risk which justifies the contingency fee is removed, especially if there can be a recovery on a time billing basis should that turn out to be more remunerative.

The attorney in the Hulk Hogan case claims that on the basis of straight time charges, including over 50 hours for the preparation of an assault complaint (sic!), the value of the firm's services was well above what a 1/3 contingent fee would permit. But an attorney cannot have it both ways. If he fixes a 1/3 contingent retainer, his ultimate fee is tied in with the client's recovery, for better or for worse. He takes the risk of a loss if the ultimate recovery is too low, but he may have a windfall if the recovery is much greater. The essence of a contingent fee is risk—shared risk. Sometimes the attorney wins, sometimes he loses, sometimes he breaks even.

Under the court rules, the court said:

[T]he court will treat any provision of the agreement which calls for compensation greater than 33 1/3% a nullity, and whether the client in fact agreed or disagreed to additional fees, and no matter how sterling the representation may have been to the time of trial, the court concludes that there is no authority for the award of additional compensation.”

In sum, the recent N.Y. State and Nassau ethics opinions and the old Hulk Hogan case teach us that an attorney’s retainer agreement may provide for a combination of hourly, flat, and contingent fees, but only if (1) the total fee is reasonable under all of the circumstances, and (2) if the court rules apply in the particular case then the total fee does not exceed 33-1/3% of the client’s net recovery.

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