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How to Manage the Risks of Fee Disputes in a Tough Economy

The downturn in the economy has had wide-ranging effects on the practice of law. Lawyers and law firms are tightening their belts – and clients are taking a similar approach. Many clients are slow to pay their outstanding legal fees – or in some cases, they are not paying at all. Others are filing for bankruptcy protection. As a consequence, lawyers are left with increasing and aging outstanding receivables, prompting stepped up collection efforts such as suing clients or filing unpaid fee claims in bankruptcy proceedings.

Attorneys have long known that suing a client for unpaid fees increases the risk they'll face a legal malpractice counterclaim and/or an ethical grievance. In the down economy, however, attorneys are willing to "roll the dice" and sue their client more than they may have in better economic times.[1]

But, while their appetite for risk has changed, the risks associated with fee suits or claims in bankruptcy have not. It is important – now more than ever – to make good choices about whom to sue and when, and to work hard to avoid fee disputes in the first place.

What Are The Risks of Suing Your Client for Unpaid Fees?

First, the risk of a client filing a counterclaim for legal malpractice is very real. An American Bar Association (ABA) study found that almost seven percent of all insured malpractice claims in the study arose in connection with an attempt to collect an unpaid fee.[2] The study went on to suggest that the percentage may even be higher, since the statistics did not

[1] *See, e.g.*, Weiss, Debra Cassens, "Some Law Firms Step Up Collection Efforts," ABA Journal, August 26, 2008; Neil, Martha, "Critical Legal Skill in Hard Times: Collections," ABA Journal, October 2, 2008; Van der Pool, Lisa, "Law Firms Scramble to Collect Year-End Billings," Boston Business Journal, December 24, 2008.

[2] Gates, William H., "Characteristics of Legal Malpractice: Report of the National Legal Malpractice Data Center" (1989); Osaku, David P. and McMonigle, Joseph P., "On Suing For Fees: Don't," Legal Malpractice Report, (1991).

include uninsured and unreported claims.[3] Experienced legal malpractice defense attorneys estimate that at least twenty to thirty percent of all malpractice claims and counterclaims are directly or indirectly attributable to disputes over legal fees and expenses.[4]

Even in bankruptcy proceedings, lawyers who file claims as creditors for unpaid legal fees are at risk of cross-claims or adversary proceedings alleging legal malpractice.[5] Additionally, bankruptcy court is a notoriously poor venue for litigating malpractice claims; the bankruptcy trustee is duty bound to maximize recoveries on behalf of creditors, and bankruptcy courts generally lack experience in legal malpractice matters and may "fast track" these matters to expedite resolution of the bankruptcy estate.

There also is the possibility that the counterclaim will result in a large verdict against the attorney. In recent cases in Texas and New York, juries have awarded clients $1.4 million and $7 million verdicts in counterclaims to fee suits filed by the lawyers that represented the clients.[6] Damages sought in a client's counterclaim typically exceed the outstanding fees originally demanded by the attorney.

Defending a counterclaim also may cost more than the amount sought in collection. If a suit to recover $3,000 in outstanding fees generates a counterclaim that must be reported on a professional liability policy with a $5,000 deductible, it may not be worth the trouble.

Fee suits also can lead to the filing of ethical grievances by clients disputing legal fees. According to a report by the Attorney Registration & Disciplinary Commission (ARDC) in Illinois, in 2005 nearly fourteen percent of docketed ethical grievances against attorneys were based on fee related issues.[7]

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[3] Osaku, David P. and McMonigle, Joseph P., "On Suing For Fees: Don't," Legal Malpractice Report, (1991).
[4] See, Mallen, R. and Smith, J., "Preventing Legal Malpractice," s 2:20 at 211 (2008 ed).
[5] See, Mallen, R. and Smith, J., "Preventing Legal Malpractice," s 2:15 at 186 (2008 ed).
[6] See, e.g., Neil, Martha, "Client Turns Tables on Firm in Fee Dispute," September 5, 2007; Neil, Martha, "Fee Suit Scores Own Goal: $7M to Client," June 20, 2007.
[7] See, Attorney, Registration & Disciplinary Commission, "Lawyer Regulatory Process: The ARDC Perspective" 2006.

The manner in which outstanding fees are sought can be a separate basis for liability. For example, the attachment of a detailed statement for services could result in the disclosure of confidential information about litigation strategy that allegedly prejudices the client. Or, the client may allege that their credit rating was damaged by an unjustified fee claim by the attorney. The unpaid fees may also be unreasonable, providing a basis for a claim by the client. [8]

In addition, there are less quantifiable risks in suing for fees, such as the amount of time it takes you to file and pursue the fee claim or to defend a counterclaim for malpractice. Even after a judgment is obtained, the client may not be able to pay, or the attorney may need to pursue wage garnishment or other time-consuming post-judgment remedies. Last, there is the potential for the loss of good will with the client and possibly the community.

Successfully Managing the Risk of Fee Disputes with Clients

The best way to manage the risk of fee suits is to be proactive and reduce the likelihood of building up unpaid accounts receivable. You should focus on minimizing the amount of outstanding fees owed by each client. To do that requires effective communication with the client at the outset regarding money matters; consistent and timely billing; swift follow-up as soon as you spot trouble; and careful judgment about which claims to pursue and which to forgo.

Be Upfront About Costs and Billing Issues with Your Client

Whether you are a sole practitioner or a law firm, make the discussion of fees with clients and the practice of billing a priority in your practice. Discuss fees and billing at the first meeting with a new client. It may be an uncomfortable topic, but the more upfront you can be, the less uncertainty will exist down the line. Manage their expectations about the anticipated cost of the proposed representation in the same manner you manage expectations about the outcome of the matter.

[8] See, Mallen, R. and Smith, J., "Preventing Legal Malpractice," s 2:20 at 186 (2008 ed).

Keep the billing surprises to a minimum. Explain that you bill hourly and how much you bill per hour. Be explicit: if you bill for every telephone call, tell the client. Explain overhead costs for mail, faxes, and storage of documents that will be billed.

Explain the billing cycle and when you expect payment. Create a clear expectation that you will be paid on time. Explain that the less time you spend trying to secure payment of bills, the more time you can spend working on resolving their case with the best result possible.

Bill often and regularly. It is much easier to ascertain whether payment will be a problem with a client if bills are being sent out on a regular basis. Also, clients are far more likely to pay a lawyer's bill while the matter is still active and the client needs the attorney's services.

Discuss how fee disputes will be handled. You may practice in a jurisdiction that offers or even mandates participation in some type of fee arbitration or fee dispute resolution system.[9]

Obtain an Advanced Fee Payment Retainer

Consider requesting an advance fee payment at the beginning of the representation. This will help demonstrate that the client has the ability to pay your fees and will provide a cushion against which to bill. Explain to clients that once an advance payment retainer is exhausted, they will be required to make another advance payment. This process will continue until the representation is complete.

Prepare a Written Fee Agreement or Engagement Letter

One of the best methods to avoid fee collection problems is to draft a clear, concise fee agreement or engagement letter for signature by the

[9] Levin, John, "Fee Disputes: Time for Illinois to Take Action," CBA Record, p. 63 (April 2009); See ABA Center for Professional Responsibility Standing Committee on Client Protection 2008 ABA Fee Arbitration Survey (where survey found 32 states offer voluntary fee arbitration programs and 9 states have mandatory fee arbitration); Mandatory fee arbitration jurisdictions include AK, CA, DC, ME, NJ, NY, NC, PA and WY.

client. The most effective agreements state everything that the lawyer will do for the client and what the client should expect. They spell out the attorney's rates and the exact terms of the engagement.

Effective agreements clearly incorporate and document anticipated issues with regard to the charges, costs, billing and payments as discussed earlier. They specify the consequences of non-payment, including your right to withdraw from the representation, or suspend work until bills are paid.

The fee agreement is also the place to document how billing disputes will be resolved. Depending on your jurisdiction, you may be required to notify the client of, and spell out, the pros and cons of any fee dispute arbitration or mediation provisions included in the agreement.[10] Also specify any other actions you may take with respect to unpaid fees. For instance, if you intend to use a collection agency and/or pass along the cost of collection to the client, explain this in the fee agreement.[11] Also discuss interest charges on unpaid fees, following jurisdictional rules in that regard.

Take Swift Action When Bills Go Unpaid

If the client does not pay a bill, it is crucial to follow up immediately. While lawyers often do not like calling clients about unpaid fees, by placing the call immediately, this emphasizes to the client the importance of staying current. It also allows the client to explain any circumstances interfering with their ability to pay and, if warranted, reach agreement with the attorney on an alternative payment arrangement, making it less likely that you will need to suspend work, withdraw from the engagement, or deal with a large unpaid fee.

[10] See, "Retainer Agreements in Texas May Require Binding Arbitration of Malpractice Disputes," ABA/BNA Lawyers' Manual on Professional Conduct.

[11] Note in some jurisdictions, it may be required that an attorney disclose in a written fee agreement the use of a collection agency. See Arizona Ethics Op. 2000-07, 16 Law. Man. Prof. Conduct 664 (2000).

If You Must Sue Your Client for Fees

If the amount of unpaid fees is simply too large to walk away from and you have decided to sue the client, do so with your eyes open.

If it is jurisdictionally appropriate, consider waiting to file suit until after the limitations period for bringing a legal malpractice action has run. Or, take advantage of opportunities to file fee petitions before the court in the underlying matter if it is allowed in your jurisdiction. The advantage of filing fee petitions during the course of the representation is that a judicial determination of the reasonableness of your fees may prevent a client from alleging malpractice against you in a subsequent proceeding, under principles of *res judicata*.[12]

Consider the result of the underlying representation before filing suit. Did you obtain a good result for the client? A client may have a hard time alleging malpractice if they received a good result or "won" the case. Conversely, if the case was "lost," the client may be more inclined to pursue a counterclaim and may receive a more sympathetic reaction before the court or a jury.

Most importantly before filing suit, outline the pros and cons of filing suit against the client. Note how your representation of the client will stand up in the face of a counterclaim. Take a look at the reasonableness of your fees. Analyze the likelihood of recovery and the amount you could reasonably expect to recover (i.e., could the client actually satisfy a judgment in the full amount of your unpaid fees). Consider the expected costs associated with filing suit, including both your time and out of pocket costs, as well as the loss of good will and public relations. Lastly, evaluate the risk that the client will file a counterclaim for malpractice.

[12] See, *Grausz v. Englander*, 321 F.3d 467 (4th Cir. 2003)(Where the court found that the fee petition was a final judgment on the merits and that the legal malpractice claim was based on the same cause of action involved in the earlier fee petition and that the requirements of *res judicata* had been met. The ruling on the fee petition impliedly found that the firm's services had been acceptable).

Getting Paid While Reducing Risk in a Tough Economy

The key to avoiding risks associated with fee disputes is to prevent them from occurring. While that may not help with outstanding fees from services that have already been completed, one benefit of the economic downturn is that discussing billing issues is now a business necessity and will be expected by clients, who are also focused on reducing costs and watching the bottom line.

By working closely with clients from the beginning, explaining the billing process and creating a confident and consistent billing culture, attorneys can minimize the hassles and risks of chasing outstanding fees and suing clients.

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