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Taking Stock of a Potential Fee Collection Suit

The Great Recession has evolved into an economic recovery, yet many law firms continue to experience the lingering effects of the economic downturn. Some law firms that have never filed a lawsuit to recover unpaid fees against clients are doing so now out of financial necessity. The outcome of these suits may not be as envisioned, however, as suits for unpaid fees frequently lead to legal malpractice counterclaims and other negative consequences for law firms. While suits for unpaid fees may sometimes be appropriate for law firms, they should be filed only as a last resort, after implementation of internal risk management procedures, assessment of the risks and benefits of litigation, and consideration of other reasonably available steps.

Risks of a Suit for Unpaid Fees

Although hard data does not presently exist, anecdotal evidence suggests that an increased number of law firms may be resorting to filing suits against clients to recover their unpaid legal fees.¹ Instituting a suit for unpaid fees poses potential risks for law firms. As an initial business consideration, the suit may not succeed in recovering any unpaid fees, notwithstanding the firm's investment of significant resources in the lawsuit. Furthermore, if the client declares bankruptcy, a bankruptcy trustee also may seek to recover past payments made to the law firm.

Moreover, suits for unpaid fees raise serious risk management concerns for law firms, since clients often will respond by filing a legal malpractice counterclaim against the firm. Some lawyers who specialize in representing law firms in legal malpractice suits estimate that in as many as 42 to 47 percent of fee collection suits, the client responds to a suit for unpaid fees with a legal malpractice claim.² Furthermore, in many jurisdictions, where an attorney files a fee collection suit and the client fails to raise a counterclaim alleging legal malpractice, the client has then waived the right to file a separate legal malpractice action. Therefore, legal malpractice is a common counterclaim to a fee collection suit.³ Accordingly, clients may have strong incentives to pursue such counterclaims when sued for recovery of fees. Law firms should also realize that, if the client files a legal malpractice counterclaim, the firm's overall representation of the client will be examined in great detail. Almost any aspect of the representation could form the basis of a future legal malpractice counterclaim.

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1 Simmons, Christine. "Firms Grow Bolder about Suing Clients for Unpaid Fees," New York Law Journal, 23 October 2012; see also Tillman, Zoe. "Patton Boggs Issues Flurry of Fee Suits," The National Law Journal, 18, 2013. Web. 14 Mar. 2014.

2 Weiss, Debra Cassens. "NY Law Firms Aggressively Pursue Fees; Up to Seven Suits Filed Weekly in Manhattan," ABA Journal, 23 Oct. 2012. Web. 20 Feb. 2014.

3 See, e.g., *Capital Hill Grp. v. Pillsbury Winthrop Shaw Pittman LLP*, 574 F.Supp.2d 143 (D.D.C. 2008); *Allen v. Martin*, 203 P.3d 546, 24 Law. Man. Prof. Conduct 343 (Colo. Ct. App. 2008); *Adams v. Key*, 193 P.3d 599 (N.M. Ct. App. 2008), *CLS Assoc. Ltd. v. AB*, 762 S.W.2d 221 (Tex. App. 1998), *Harper v. Anthony*, Ohio Ct. App. 2014).

Additionally, despite the existence of strong defenses to the legal malpractice counterclaim, the counterclaim may not be susceptible to a motion to dismiss. The law firm may then be required to defend the matter through the discovery stage or beyond, at significant cost and expense to the firm. Further, the possibility exists that fact finders will find fault with some aspect of the law firm's representation of the client. In short, the filing of a fee collection suit can have adverse consequences for law firms, such as the following:

- The firm could be required to pay the cost of defending the legal malpractice counterclaim up to the amount of its insurance deductible, which may exceed the amount of fees owed to the law firm.
- The law firm's reputation could be damaged if a legal malpractice counterclaim is filed.⁴
- The law firm may be required to report the fee collection suit, as well as any counterclaim for legal malpractice that results from it, on future applications for professional liability insurance.
- An ethical grievance or complaint may be filed against the firm based upon allegations of unreasonable legal fees or other unethical conduct by the law firm.
- The client could seek disgorgement of legal fees that the client previously paid to the law firm.⁵
- The court may enter a judgment against the law firm for legal malpractice.
- The firm and its insurance carrier may be required to pay a judgment or settlement arising out of the client's allegations of legal malpractice.
- In a worst case scenario, the firm could face monetary damages that exceed its available insurance coverage.

Given the significant risks associated with fee collection suits against clients, law firms should consider litigation only as a last resort.

⁴ For example, the law firm of DLA Piper, LLC's fee suit against a client for \$675,000 in unpaid legal bills resulted in a well-publicized counterclaim for fraud and punitive damages of \$22.5 million, accusing the firm of a "sweeping practice of overbilling." *DLA Piper LLP v. Adam Victor*, Index No. 650374 /2012 (Sup. Ct. N.Y. Co.).

⁵ In one case, the attorney filed suit for \$500,000 in claimed unpaid fees plus interest. The client then countersued, claiming that the attorney engaged in over-billing. The attorney eventually agreed to pay the client more than \$102,000 and settled the case. Lat, David "Lawyer of the Day: Suing a Client for Nonpayment of Fees – and Ending Up Owning the Client Money," *Above the Law*, 30 Sept. 2010.

Risk Management Strategies to Avoid Fee Disputes

Solid internal risk management practices can aid firms not only with collection of legal fees, but also with avoiding disagreements with clients over fees that could eventually snowball into acrimonious litigation. The following are some effective risk management practices that law firms should consider implementing:

1. Talk about Fees and Expenses on Day One

Fee disputes often arise from miscommunications with clients about how billing will be handled. Law firms should set their clients' expectations at the initial onset of the attorney client relationship by communicating material information about fees and expenses during the client intake process. For example, the firm should discuss with clients the frequency with which bills will be sent and the firm's expectations regarding the time period within which clients must pay. Prior to accepting the representation, it is also important for firms to assess the client's ability to pay. Do not accept clients that can not afford the law firm's legal services. For a client whose matter is likely to incur significant legal fees, firms may wish to consider requesting the client's permission to run a credit check. Further, since dabbling in unfamiliar practice areas can lead to unreasonable legal fees and disgruntled clients – as well as potential ethics violations—attorneys should accept only those cases that they are competent to handle.⁶

2. Get it in writing

A written engagement agreement memorializing the agreed-upon payment terms, in addition to the other material terms of the representation, should immediately follow the client intake stage. Memorializing this agreement documents the agreed scope and terms of the representation, and reduces the chance of a later misunderstanding or disagreement with the client. In addition, some states, such as New York and California, require all fee agreements to be in writing when the matter involves more than a certain minimum dollar amount.⁷

The agreement should specify whether the representation will be billed on a contingent, hourly or flat fee basis. If it will be billed on an hourly basis, the law firm should include the fee structure of all attorneys and legal support staff who will be involved in the representation. The written engagement agreement also should clarify those expenses that are the client's responsibility and those expenses that will be absorbed by the firm. It should also address how the firm will handle the client's late payment or failure to pay. This engagement agreement must be executed by both the attorney and the client. Attorneys also should review and confirm the specific requirements applicable to their jurisdiction. Finally, law firms should carefully review their retainer agreement with the client to ensure that they do not impermissibly limit the contractual rights and obligations of the parties. For sample language in an engagement agreement addressing these points, see CNA's "Lawyer's Toolkit 3.0: A Guide to Managing the Attorney-Client Relationship," which is available on the CNA risk control website.

⁶ See ABA Model Rule of Professional Conduct 1.1 (competence) and the corresponding state rule for the attorney's respective jurisdiction.

⁷ See N.Y. COMP. CODES R. & REGS. tit. 22 §§ 1215.1, 1215.2 (2002); California Business & Professions Code § 6147 and 6148 (West 2013).

3. Ask for a retainer

Where appropriate, obtaining an adequate retainer fee from the client in advance of performing any work can help avoid future disputes over unpaid fees. The initial retainer amount should be sufficient to cover the initial work in the case. The firm also should advise clients that they will need to replenish the retainer before it is exhausted or the firm may be compelled to withdraw from the representation. Taking such precautions initially will minimize the risk that a large unpaid receivable will accrue, and that the law firm will then face significant financial pressure to pursue a suit for unpaid fees later.

4. Efficiency through Technology

Many lawyers have already discovered the value of utilizing law practice management software or online services in their practices. These technologies provide a direct benefit to law firms by helping them to better operate as commercial enterprises. Unfortunately, a large number of legal malpractice claims each year are directly related to poor office management and administrative errors. Utilization of this type of software not only represents a sound risk control measure to protect against such potential exposure, but also facilitates better efficiency in the day-to-day practice of law. Today, most practice management software will provide a billing attorney direct access to the client's up-to-date accounts receivable and work in progress data. Therefore, when an attorney opens a file to work on a pending matter, the attorney immediately sees the balance of any outstanding bill before the attorney begins additional work on a matter. Such information will immediately alert the attorney to any emerging billing issues so the attorney can take the necessary action.

5. Use good billing "etiquette"

If law firms expect clients to timely pay their legal bills, they should lay the groundwork by using appropriate billing etiquette. Such sound billing practices may include:

- Ensuring that bills clearly and accurately describe the work performed;
- Billing clients monthly to enable clients to pay in smaller increments;
- Sending clients a status update contemporaneously with every bill sent, even if only to report that there have been no new developments;
- Reviewing pre-bills for any overcharges or other errors and making those corrections before mailing, rather than placing the burden on the client to bring errors to the firm's attention;
- Implementing a three tiered bill review process where the billing attorney, supervising partner and managing partner each review the bill before sending; and
- Marking time entries as non-billable, where appropriate (for example, when billing for a basic task).

By maintaining high billing and collections standards, law firms can avoid many non-payment problems altogether, and may be able to resolve any remaining payment issues before they become thornier collections issues.

6. Talk it Out

Once the bill becomes overdue, it is best not to give unpaid legal bills more time to increase before taking corrective action. Rather, the billing attorney should immediately initiate a personal discussion with the client after the account is slightly over 45 days delinquent to determine whether there is any issue with the representation. Not surprisingly, the attorney's direct client communication is usually more effective at resolving delinquencies than a form letter from the law firm's accounting department.

7. Take steps to resolve a dispute

If the client is not paying the bill due to a legitimate issue, the firm may wish to consider offering the client a slight fee reduction or a credit toward future legal fees. Writing off a small amount of fees is often a better strategy than pursuing collection proceedings against a client. Offering a compromise and a few gracious words can help preserve the attorney-client relationship and avoid potential claims of legal malpractice against the law firm. The law firm itself is best suited to determine whether a compromise would be in its best interest in a given situation, based upon the firm's history and experience with the client. However, if the client is avoiding the billing attorney's phone calls and fails to respond to letters and billings, the firm will then need to decide whether to write the account off, employ a collection agency or pursue a lawsuit against the client.

8. Withdraw!

If the firm is considering litigation against the client, the lawyer should take steps to withdraw from the representation as soon as possible. First, law firms must not sue current clients for unpaid fees, as that would constitute a conflict of interest pursuant to ABA Model Rule of Professional Conduct 1.7, as well as any relevant state equivalent to Model Rule 1.7. Therefore, the firm must withdraw from the attorney-client relationship, either by client consent or motion to withdraw, prior to filing suit against the client.⁸ Model Rule of Professional Conduct 1.16 (b) allows for permissive withdrawal from the representation where withdrawal can be accomplished without material adverse effect on the interests of the client, where the representation will result in an unreasonable financial burden on the lawyer or where the representation has been rendered unreasonably difficult by the client.⁹ Before withdrawing, the lawyer should comply with any applicable law requiring notice or permission of a tribunal and "shall take steps to the extent reasonably practicable to protect a client's interests."¹⁰ Ceasing work for the client will not only prevent the unpaid fees from accruing further, but may also trigger the statute of limitations to start running on any potential malpractice claim.

⁸ Several states have issued ethics opinions on this issue. See Arizona Ethics Op. 2000-03 (2000); Florida Ethics Op. 88-1 (1988); Los Angeles County Bar Ethics Op. 476 (1994); Philadelphia Ethics Op. 81-541.

⁹ ABA Model Rule of Professional Conduct 1.16(b)(1) and 1.16(b)(6). Comment [8] to this rule further provides that "a lawyer may withdraw if the client refuses to abide by the terms of an agreement relating to the representation, such as an agreement concerning fees or court costs or an agreement limiting the objectives of the representation."

¹⁰ Examples of reasonably practicable steps to protect the clients' best interests include giving reasonable notice to the client, allowing time for employment of other counsel, surrendering papers and property to which the client is entitled and refunding any advance payment of fee or expense that has not been earned or incurred. ABA Model Rule of Professional Conduct 1.16(c) and (d).

Weighing the Ethical and Practical Aspects of a Fee Suit

The collection of legal fees is primarily a business concern for law firms. Nonetheless, lawyers are responsible for managing collections in an ethical manner. While the Model Rules of Professional Conduct do not directly prohibit law firms from suing clients for fees, they discourage law firms from doing so and indicate that lawyers should use other means at their disposal to collect their fees. Comment [9] to ABA Model Rule of Professional Conduct 1.5 states that if a procedure has been established for the resolution of fee disputes, such as arbitration or mediation procedures established by the bar, lawyers must comply accordingly, where mandated. Even when such procedures are only voluntary, the lawyer should conscientiously consider submitting to a dispute resolution mechanism. Some states also have issued ethics opinions noting, as a general rule, that lawyers should not sue clients for nonpayment of fees.¹¹

As a practical matter, where the firm has exhausted all other remedies, a fee collection suit may become a necessary step to collect unpaid fees. However, a fee suit is not always in the firm's best interests. Therefore, law firms should thoroughly analyze the risks and benefits of pursuing a fee collection suit against a client prior to filing suit. The attached "Law Firm Checklist for Fee Collection Suits" is a helpful resource for law firms to assess whether or not to file a fee collection suit. Preferably, a law firm committee, excluding the attorney involved in the underlying representation, should be responsible for performing this risk/benefit analysis and for making the ultimate decision of whether or not to file suit against a client. After considering the various points in the checklist, the decision of whether or not to pursue a fee collection suit should become apparent.

Note that where the risk/ benefit calculus weighs clearly on the side of filing the fee suit, firms should confirm whether compliance with any relevant state or local laws is required prior to filing suit. For example, some states, such as New York, require an attorney to send the client a formal notice of its right to utilize fee arbitration before the attorney may institute a legal action to recover a fee.¹²

Solid internal risk management practices can aid firms not only with collection of legal fees, but also with avoiding disagreements with clients over fees that could eventually snowball into acrimonious litigation.

¹¹ See Pa. Eth. Op. 87-77 (1987)(citing ABA Code EC 2-23, which provides that the attorney should avoid litigation with client over unpaid fees "unless necessary to prevent fraud or gross imposition by the client." Instead, the use of arbitration or mediation for fee disputes is encouraged before the lawyer resorts to litigation.); see also Los Angeles Opinion No. 109.

¹² See *Herrick v. Lyon*, 7 A.D.3d 571 (N.Y. 2004) (dismissing fee suit where law firm failed to properly serve the defendant with written notice of his right to arbitrate the fee dispute and allege proper service of such notice in the complaint and did not file a timely request for arbitration).

Summary

Given the significant risks associated with fee collection suits against clients, law firms should consider litigation only as a last resort. By implementing effective internal risk management procedures, many, if not most, client collections issues can be avoided and resolved without resorting to costly litigation. For more difficult collections issues, the firm should engage in a thorough risk/benefit analysis to assess whether a suit would be in its best interest. While suits for unpaid fees may be appropriate in some cases, law firms should consider first taking risk management steps to reduce the likelihood of a legal malpractice counterclaim, such as awaiting the expiration of the statute of limitations on any potential legal malpractice counterclaim, as well as compliance with applicable state and local laws, rules of professional conduct and written agreements with the client. Taking such a multi-faceted approach will help the firm not only more effectively avoid and resolve current collections matters, but also prevent future collections issues from developing. Law firms will then be better able to weather the current economic climate, along with any future economic storms that may develop in the future.

Law Firm Checklist for Fee Collection Suits

This checklist is designed to help lawyers evaluate whether a fee collection suit is in the firm's best interests.

SELF ASSESSMENT TOPIC	YES	NO	RISK CONTROL ACTIONS NEEDED / TAKEN
Is the amount of fees owed a significant amount for the law firm?			
Does a fee collection suit have a high probability of success?			
<ul style="list-style-type: none"> Would an independent fact finder view the fees charged as fair and reasonable under the circumstances? 			
<ul style="list-style-type: none"> Does the firm have a written and executed fee agreement with the client? 			
<ul style="list-style-type: none"> Will the firm ultimately be able to enforce any judgment against the client? 			
<ul style="list-style-type: none"> Does the client have sufficient assets from which to collect the judgment against the client? 			
<ul style="list-style-type: none"> Has the firm complied with all other pre-suit requirements of the jurisdiction? 			
Will the client likely pursue a legal malpractice counterclaim against the firm in response to the fee collection suit?			
<ul style="list-style-type: none"> Has the firm reviewed the client's entire file, including any e-mails relating to the representation? 			
<ul style="list-style-type: none"> Do any harmful documents or e-mails exist that could be used against the firm in a legal malpractice action? 			
<ul style="list-style-type: none"> Has the client ever complained about the quality of the firm's representation? 			
<ul style="list-style-type: none"> Did the client arguably suffer any harm as a result of the law firm's representation? 			
<ul style="list-style-type: none"> Has the statute of limitations on any counterclaim for malpractice and/or other potential claims passed? 			
<ul style="list-style-type: none"> Does the client have a history of filing lawsuits? 			
Would a counterclaim for malpractice against the firm be costly, in terms of ...			
<ul style="list-style-type: none"> the legal fees and expenses incurred in defense of the matter? 			
<ul style="list-style-type: none"> the value of the firm's time spent pursuing the action and defending the counterclaim? 			
If the firm were to lose on the legal malpractice counterclaim, would the firm likely face a significant judgment?			
<ul style="list-style-type: none"> Would the firm's professional liability insurance policy likely provide coverage for such a claim against the firm? 			
<ul style="list-style-type: none"> Does the firm's insurance policy contain an exclusion for a legal malpractice counterclaim filed in response to a fee collection suit? 			
Has the firm considered the amount of time necessary to pursue the fee suit, obtain a judgment and enforce the judgment against the client?			
Would the firm's billable time be better expended on other clients who consistently pay their legal fees, rather than on pursuing a fee claim?			
Is the firm concerned about any potential negative impact on its reputation from a legal malpractice counterclaim?			



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