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## Success Fees: Unlocking the Future of Alternative Fee Arrangements

The concept of a “success fee” is rooted in the idea that a lawyer’s compensation is contingent on achieving a favorable result for the client. Originally, this type of fee, often referred to as a contingency fee, was a staple of certain areas of legal practice, particularly personal injury law, class actions, and other cases where clients may only be able to afford legal representation if they win or reach a settlement and have no financial responsibility if the case fails.

However, with the ever-changing legal landscape and emerging use of innovative alternative fee arrangements (AFAs), the concept of a “success fee” has morphed into an agreement whereby the client agrees in advance to pay a fee for “success,” and the client and lawyer or law firm define in advance what “success” means. The attorney typically charges a fee at the inception of the matter and also has an opportunity to earn an additional fee for a successful outcome. It might mean winning a trial or disposing of the case early by motion, or, in the transactional world, successfully closing a deal early or on time or reaching a settlement below a certain figure. In the event of an unsuccessful outcome, the attorney retains the original base fee but does not earn anything further at the conclusion of the matter. However, if the lawyer or law firm is successful, it can realize higher returns and gain a specific financial award for success (e.g., percentage above result). Because success is defined at the outset, i.e., a settlement, verdict, or arbitration award within a specific dollar range or timeframe; type of disposition; favorable ruling or decision, etc., the success fee causes more risk to be shared. Some examples may be (1) counsel and client agree on a budget for an initial phase (or the entire case), and in return, client agrees to pay law firm a success fee if the

fees are below budget (the success fee might be a percentage of the savings under budget); and (2) outside counsel gives client a volume discount in return for performance awards based on various criteria (fees below a specified target, early disposition, control of local counsel fees, etc.).

This article will explore the ethical concerns associated with lawyers charging success fees by examining a lawyer’s obligations under the American Bar Association’s Model Rules of Professional Conduct (“Model Rules”) and the interests at stake for both lawyers and clients. It will also look at how these fees can sometimes blur the line between advocacy and financial interest, creating conflicts that lawyers need to manage carefully. And lastly, it will consider some risk management strategies to employ in the law firm in order to effectively manage this billing structure in a practice setting.

### Why Use a Success Fee? – Benefits and Limitations

Success fees, and AFAs more generally, have been a growing trend in recent years for many reasons including, but not limited to the economic downturn causing clients to demand more value for their money; client distrust of the traditional hourly billing scheme while still demanding efficiency, competitive pricing, and predictability in legal fees; use of generative AI in legal practice; and competition for clients among lawyers and law firms to remain successful and profitable.

The use of a success fee has many benefits, some of which are the following:

- **Shared risk opportunities between lawyers and clients:** They create agreements requiring accountability for both the lawyer and client regarding the legal matter and are designed to pass on to the lawyer some of the risk that the client may not receive a positive outcome.
- **Predictability:** Clients can more accurately budget and plan for legal costs, and lawyers are encouraged to provide legal services more efficiently and focus on value-driven client services.
- **Cost-cutting and containment:** Law firms can increase profit and pursue ways to deliver more value and/or motivate extra effort by staff.
- **Relationship building:** Success fees require communication and a close working relationship to be established between the lawyer and client at the beginning of the representation. They reinforce the sense of shared commitment towards a client's goals and shared financial risk in obtaining those goals. They may help a lawyer establish his/her/their role as a trusted adviser, and focus on the client's needs and success.

While the potential benefits of success fees are readily apparent, there are potential risks. They can be costly to the client if the success criteria are met, and detrimental to the lawyer or firm if not. Lawyers and law firms face a plethora of potential ethical pitfalls when implementing a success fee, including potential conflicts of interest, reasonableness of the fee and the complexity of defining success.

### Ethical Implications of Success Fees

As with any fee agreement, success fees present certain ethical issues under the Model Rules of Professional Conduct. While the Model Rules do not specifically prohibit success fees, they do set clear guidelines regarding fees and conflicts of interest that are critical in assessing an attorney's obligations in the use of these fees.

Model Rule 1.5(a) addresses the reasonableness of fees. A lawyer's obligations under this rule provide that the fee must be "reasonable" based on eight non-exclusive factors. As a result, a success fee arrangement must be carefully scrutinized under these factors to ensure that it does not result in an excessive fee and is in compliance with the rule.<sup>1</sup> The provision allowing for success fees, however, is tempered by the requirement that these agreements be in writing and clearly explained to the client.<sup>2</sup>

Model Rule 1.7(a)(2) prohibits a lawyer from representing a client if there is a significant risk that the lawyer's representation will be materially limited by the lawyer's own interests. In addition, Comment 10 to Model Rule 1.7 states that "[t]he lawyer's own interests should not be permitted to have an adverse effect on representation of a client." These obligations prohibit lawyers from allowing their financial interests to interfere with or supersede their obligations to their clients. Success fees introduce such a risk, as the lawyer has a financial stake in the outcome of the case. Clients must be fully informed of how the fee is structured, the risks involved, and the alternatives available to them. Lawyers have an ethical duty to ensure that their clients fully understand the fee arrangement before signing it. Further, informed consent is essential because clients may not fully appreciate the implications of a success fee agreement. For example, a client may not realize that they could end up paying a substantial portion of their recovery to their lawyer, or that the lawyer's financial incentives may not always align with their own.<sup>3</sup>

Similarly, ethical considerations are a significant concern in any success-based fee arrangement, as attorneys typically are prohibited from sharing in a client's financial success. Specifically, under Model Rule 1.8(i), a lawyer "may not acquire a proprietary interest in the cause of action or subject matter of the litigation that the lawyer is conducting for a client..."<sup>4</sup> Such success fee arrangements may well be deemed sufficiently contingent on the outcome of the matter as to trigger the specific professional responsibility rules governing contingent fees. Attorneys must always be on the lookout for this trigger and ensure that these agreements are reasonable and clearly communicated to the client.

Lastly, Model Rules 1.1 and 1.3 require lawyers to act competently and diligently in representing their clients. Further, Comment 1 to Model Rule 1.3 states in relevant part as follows: "[a] lawyer should pursue a matter on behalf of a client despite opposition, obstruction, or personal inconvenience to the lawyer, and take whatever lawful and ethical measures are required to vindicate a client's cause or endeavor. A lawyer must also act with commitment and dedication to the interests of the client with zeal in advocacy upon the client's behalf."<sup>5</sup> This language has implications for the use of success fees. For example, lawyers need to prevent incentivizing undesirable or unethical behaviors, such as under or overworking a case or prioritizing speed over thoroughness.

<sup>1</sup> There are certain prohibitions against using contingency or success fees in criminal and family law cases due to concerns about conflicts of interest and the public policy implications of lawyers having a financial stake in the outcome. See Model Rule 1.5(d)(1) and (2).

<sup>2</sup> See Model Rule 1.5(c).

<sup>3</sup> See also Model Rule 1.4 – Communication.

<sup>4</sup> See Model Rule 1.8(i).

<sup>5</sup> See Model Rule 1.3.

### Best Practices for Implementing Success Fees

At the risk of stating the obvious, implementation of a success fee must work for both the client and the attorney or law firm to be successful. Some items to consider in using a success fee are the following:

- **Assessing Your Firm's Readiness:** Before jumping into the use of a success fee, it is crucial for a law firm to evaluate its readiness. This assessment involves analyzing the firm's current billing practices, understanding the financial implications and impact on resources the use of a success fee will have and gauging the firm's adaptability to a new billing structure. Firms should also consider their client base and market demands. Are clients seeking more flexible billing options? Additionally, internal systems and billing processes must be capable of handling the tracking and management complexities that success fees can create.
- **Identifying Suitable Cases or Services:** Not all legal services provided by the firm are ideal candidates for a success fee. Identifying the right clients, cases or services is a critical step in implementing these arrangements successfully. Typically, complex litigation, cases with uncertain durations or transactional work might be better suited for success fee models. The key is to match the fee arrangement with the nature of the legal work, considering factors like case complexity, duration, client expectations, and potential outcomes.
- **Knowledge:** Attorneys and law firms need to educate themselves about success fees, how they work, the benefits and risks, and the types of matters for which a success fee is best matched. It is also imperative that the attorney has an understanding of the client's business, its legal needs, and how the two fit together. At that point, the attorney should work with the client to select and craft a fee agreement and be able to advise the client on the pros and cons of the agreement for the particular matter at hand.
- **Engagement Agreement:** Lawyers should decide upon and implement a success fee in close collaboration and communication with the client. The first step is to work with the client to determine whether a success fee would be effective for the particular matter(s). This provides an opportunity to develop the client's trust regardless of whether a success fee is eventually achieved. The attorney has the opportunity to listen to the client and learn about his/her/their objectives and legal needs and to educate and advise the client on various fee agreement options. Trust between the attorney and client is essential for the success fee to work. As such, success fee agreements work best for matters where (1) the client is a sophisticated consumer of legal services; and (2) there is a pre-existing attorney-client or other relationship which has allowed the parties to develop a trust in one another. The second step is for the attorney to carefully draft a fee agreement in collaboration with the client. Like most attorney-client engagement agreements, the agreement should address the client's needs and goals. It must clearly define the scope of the representation, the details of the fee and how it is to be determined. It should clearly and accurately define when "success" is achieved, and that the total fees are reasonable. One sample clause to be considered is the following: "In addition to the base fee of [amount], a success fee of [percentage]% of [specified outcome] will be payable upon successful resolution of [matter]." After the representation has begun, the attorney should keep the client informed on the status of the matter and the budget. Attorneys should consider a provision in the fee agreement that allows the parties to reassess the agreement at specified points during the representation and to allow for alterations in certain specified instances. This provides both the attorney and the client with a "safety net" should the matter and the billing not play out as anticipated.<sup>6</sup>

Clients must be fully informed of how the fee is structured, the risks involved, and the alternatives available to them.

<sup>6</sup> One cautionary note is *X Corp. v. Wachtell, Lipton, Rosen & Katz* wherein Wachtell, Lipton, Rosen & Katz was sued by X Corp., the successor-in-interest to Twitter, for unjust enrichment, breach of fiduciary duty, and other claims relating to fees. Wachtell had agreed to represent Twitter in litigation on an hourly basis, but shortly before the Twitter acquisition closed, Wachtell pressured Twitter executives to sign a new agreement giving Wachtell an \$90 million total fee, including an unspecified "success fee," nearly six times its invoiced hourly fees. X Corp. is seeking to void the new agreement and disgorge excess fees, as Wachtell negotiated the new fee arrangement in violation of its fiduciary duties and California law regarding contingency fees.

- **Monitor and Evaluate:** Continuous monitoring and evaluation are essential to ensure the viability of success fee arrangements. Law firms should establish metrics and benchmarks to assess the performance of the success fee arrangements. This might include tracking client satisfaction, analyzing profitability, and monitoring the efficiency of legal work under this model against other forms of fee agreements. Further, this review allows firms to understand the impact of the success fee model on their business and make data-driven decisions. It is also important to solicit client feedback to gauge satisfaction and see if the arrangements meet their expectations. This ongoing evaluation helps to refine and optimize success fee strategies over time.
- **Adjusting Strategies Based on Feedback and Results:** Adaptability is crucial. Law firms need to be prepared to pivot and adjust their strategies based on client feedback and the performance results of different fee arrangements. If the success fee model is consistently underperforming or not meeting client needs, firms should analyze why and make necessary adjustments. This might involve tweaking the pricing models, redefining success, or even reverting to traditional billing methods where appropriate.

## Conclusion

Charging a success fee can be ethically permissible and financially lucrative under the right circumstances, but lawyers must navigate a complex web of ethical considerations. Under the Model Rules, lawyers are required to ensure that any success fee arrangement is reasonable, transparent, and that the attorney has obtained the informed consent of the client. By doing so, lawyers can balance their own financial interests with their ethical obligations to provide competent representation to their clients.

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