"Reasonablefees.com" - Expect Special Scrutiny

by
Eric T. Cooperstein, Senior Assistant Director
Minnesota Office of Lawyers Professional Responsibility

Reprinted from *Minnesota Lawyer* (September 4, 2000)

Collecting fees from cash-poor clients may be the bane of the private lawyer's existence. When clients cannot pay cash, lawyers accept an unusual array of in-kind payments: snowmobiles, tractors, radio advertising, and even re-roofing the lawyer's house.

But over the past few years, the proliferation of "dot.com" companies and other high-tech ventures has made some lawyers eager to accept assets other than cash from current and prospective clients, especially if that asset consists of corporate stock, warrants, or options that may skyrocket in value. American Bar Association Formal Opinion 00-418, issued this past summer, lays out the guidelines for lawyers to invest in their clients' corporations.

Certain assumptions form the basis for the ABA opinion. In all jurisdictions, a lawyer's fee must be reasonable. Rule 1.5(a) of the Minnesota Rules of Professional Conduct (MRPC) provides various factors of risk and experience that a lawyer should consider in setting a fee. The rule assumes that fees will be paid in cash but the comment anticipates "A lawyer may accept property in payment for services . . . . However, a fee paid in property instead of money may be subject to special scrutiny because it involves questions concerning both the value of the services and the lawyer's special knowledge of the value of the property."

Most payments-in-kind to lawyers raise no special concerns because the parties can reasonably ascertain the value of the property. Consumers and dealers routinely value used cars using the Blue Book. Sporting and farm equipment can be valued through similar arm's-length transactions reflected in classified ads and by dealers of such used products. Services such as roofing or landscaping can be assessed by comparison to bids for similar work.Ftn 1 Publicly traded stock prices can be obtained in real time minute-by-minute during the trading day.

In contrast, newly issued stock in a client's company or a share of a client's limited partnership immediately raises red flags. First, there may be no easy way to assess the property's value. Second, the lawyer's investment introduces an element of potential adversity not present in other in-kind payments. Finally, the lawyer may have expertise in valuing the investment that the client lacks, creating an imbalance of negotiating ability. For these reasons, the ABA decided that such investments or fee payments must meet all of the requirements of Rule 1.8(a), concerning business transactions with clients.

Until 1999, Minnesota's Rule 1.8(a) mirrored the ABA Model Rule upon which Opinion 418 is based. The model rule has three components: the transaction must be fair and reasonable to the client, the client must have an opportunity to consult with independent counsel regarding the transaction, and the client must give written consent to the transaction. When considering a stock or other ownership interest in start-up entities, agreeing to terms that are fair and reasonable to the client takes priority.

ABA Opinion 418 provides lawyers with guidelines for these transactions. For starters, a lawyer should assess the fairness and reasonableness of a transaction with a client based on "only the circumstances reasonably ascertainable at the time of the transaction."Ftn 2 Lawyers should endeavor to first establish the reasonable cash fee for the lawyer's services based on the Rule 1.5(a) factors and then determine the value of stock in the client's corporation. If the business entity is so new that the lawyer and client cannot accurately value the lawyer's investment, the parties may try to assess the value that the legal services will contribute to the potential success of the new company. In these situations, the lawyer's fee may essentially become contingent on the success of the client's business, which the rules permit just like any other contingent fee.Ftn 3

Both the model rule and Minnesota's Rule 1.8(a) require that the terms of the transaction with the client be reduced to writing. As Opinion 00-418 points out, disclosures are a crucial part of any lawyer investment in a client's business. Some of these disclosure requirements have already been incorporated into Minnesota's revised Rule 1.8(a)(3). In Minnesota, the document reflecting the client's consent must be separate from the documents for the transaction. In addition, the consent must disclose whether the lawyer represents the client's interests in the transaction, describe any of the lawyer's currently conflicting interests, and identify any reasonably foreseeable conflicts that may arise. This may include personal conflicts of interest caused by a tremendous increase in the value of the lawyer's stock.Ftn 4 Finally, full disclosure should also include a description of the services the lawyer will perform in return for the stock or the opportunity to invest.

Lawyers who fail to comply with the strict provisions of Rule 1.8(a) may pay a high price. A court may void the lawyer's interest, even if the transaction was otherwise economically fair.Ftn 5 Also, if a lawyer acquires an investment in a business which has a contested license, patent, or other property right as its only substantial asset, and the lawyer represents the business in that dispute, the lawyer's investment might run afoul of Rule 1.8(j), which prohibits lawyers from obtaining a proprietary interest in the subject matter of litigation.

For some lucky lawyers, acquiring stock in a client's business may be a lucrative way to collect fees and benefit from the latest e-commerce or genomics revolution. On the other hand, if a lawyer does not carefully comply with Rule 1.8(a), she might be better off with the client's old pickup truck.

1 Readers should note that such agreements for services, depending on the timing and length of the project, may invoke the provisions of Rule 1.8(a) for reasons beyond the scope of this article.

2 Accord Restatement (Third) of the Law Governing Lawyers (Proposed Official Draft 1998) § 207 Comment E (explaining that facts that develop after the transaction are not relative to determine fairness unless they relate to the differing ability of the lawyer and the client to foresee how the facts might develop in the future). But see *In re Davis*, 585 N.W.2d 373 (Minn. 1998) (memorandum signed by client purporting to retroactively approve transaction between lawyer and client void in part because value of transaction had tripled and constituted overreaching by lawyer).

3 See e.g. ABA Formal Opinion 94-389 (1994) (considering ethical boundaries of contingent fee arrangements).

4 See Formal Opinion 00-418 at p. 6. See also Rule 1.7(b), MRPC.

5 See *DiLuglio v. Providence Auto Body, Inc.*, 2000 WL 941134 (R.I. Jun. 30, 2000); *Schlanger v. Flaton*, 631 N.Y.S.2d 293 (App. Div. 1995) (upholding forfeiture under DR 5-104, New York Code of Professional Conduct).