roots, linda

From: Marcy Glenn [MGlenn@hollandhart.com]

Sent: Thursday, February 25, 2010 11:59 AM

To: Alexander Rothrock; Anthony van Westrum; Boston Stanton; Cecil Morris; Cynthia Covell; David Little; David Stark; Eli Wald; Federico Alvarez; Gary B. Blum; Helen E. Raabe; Henry Reeve; webb, john; bender, michael; coats, nathan; gleason, john; John M. Haried; roots, linda; Lisa Podsiadlik; Lisa Wayne; Marcus L. Squarrell; Marcy Glenn; Michael Berger; Nancy Cohen; Neeti Pawar; Ruthanne Polidori; Tammy Bailey (Administrator to Judge Lucero); Thomas E. Downey, Jr.; Tuck Young; dewey, valerie; lucero, william

Subject: Additional materials for February 26, 2010 meeting of the Supreme Court Standing Committee on the CRPC

Attachments: 10-02-23 Majority Report.doc.pdf; Ancillary Changes--Redline.doc

I'm attaching two additional documents for our meeting tomorrow. Both relate to Agenda Item 3(a), concerning the proposed amendments to Rule 1.5(b) that the Committee approved at the August 2009 meeting.

1. The document identified above at 10-02-23 Majority Report is the February 23, 2010 draft Majority Report prepared by Alec Rothrock, concerning the approved proposed changes to Rule 1.5 (b). The draft Minority Report, which I authored some months ago, is in the previously distributed meeting materials. Because the Minority Report was drafted before the Majority Report, the Minority Report probably has a lot of background information that can now be removed.

2. Alec brought to my attention this week the document identified above as "Ancillary Changes--Redline.doc." It shows some additional changes to Comment [2] to Rule 1.5 and Comment [1] to Rule 1.8, which should have been considered and voted upon in connection with the other Rule 1.5 (b) amendments. The attached redline is a little confusing to read -- Comment [2] to Rule 1.5 is formatted as centered text, and what should have been a centered caption stating "Rule 1.8" before Comment [1] to that rule instead appears as text at the end of the prior comment. Alec or I will bring corrected copies of this attachment to the meeting. Alec and I believe that these changes are both necessary and non-controversial, but they were inadvertently forgotten when the Committee voted to approve the other Rule 1.5(b) amendments at the August meeting.

I look forward to seeing you tomorrow,
Marcy

MEMORANDUM

TO: The Colorado Supreme Court

FROM: Alec Rothrock, Chair of Rule 1.5(b) Subcommittee Alec

DATE: February 23, 2010

SUBJECT: "Majority Report": Proposed Revision of Colo. RPC 1.5(b) and Comment [3A]

A majority of the Standing Committee on the Rules of Professional Conduct recommends the attached proposed revision to Colo. RPC 1.5(b) and related Comment [3A] to address a perceived ambiguity in the existing versions of that rule and comment. *See* Exhibit A. The majority holds the view that the proposed changes (a) clarify the perceived ambiguity concerning the applicability of the "business transactions with a client" standards of Colo. RPC 1.8(a) to certain "midstream" changes to fee agreements (sometimes called "midstream modifications"), and (b) are greatly preferable to abandoning this language altogether.

Certain midstream modifications present a need for client protection that Colo. RPC 1.8(a) reasonably satisfies, and there is a corresponding need to notify lawyers about the applicability of Colo. RPC 1.8(a). The majority believes that the minority position does not provide sufficient protection to clients and that it fails to warn lawyers that, whether or not Colo. RPC 1.5(b) states that Colo. RPC 1.8(a) is applicable to certain midstream modifications, the Office of Attorney Regulation Counsel (OARC) requires and expects lawyers to comply with Colo. RPC 1.8(a) in these circumstances.

(The Court should Maintain the Applicability of Rule 1.8(a) To Certain Midstream Modifications)

When a lawyer and a client bargain to change the fee arrangement during the course of the representation, after the lawyer has assumed fiduciary duties to the client, a need for client protection arises. The need is greatest when the client's options, and therefore bargaining power, are limited. The lawyer's bargaining power in these circumstances cannot be underestimated.

A common example is the change from an hourly fee to a contingent fee on the eve of trial, after the client has run out of money, and hiring substitute counsel is not feasible.[1] A client can be equally vulnerable in other circumstances. The same pressures may exist

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[1] *E.g., In re Hefron,* 771 N.E.2d 1157 (Ind. 2002).

before the closing of a transaction. There are also numerous types of fee modifications that may unfairly compensate the lawyer, including a change to a higher rate of contingent fee,[2] payment of a lucrative flat fee,[3] and a change to a lower hourly fee coupled with the addition of a contingent fee.

In these situations, Colo. RPC 1.8(a) provides a measure of protection for the client.[4] The prescribed Colo. RPC 1.8(a) protocol--including the recommendation to seek the advice of independent counsel--serves as a sort of Miranda warning that the client cannot depend on the lawyer to protect his interests in the matter. Most importantly, the lawyer has an ethical obligation to ensure that the transaction is fair and reasonable to the client.

The Rule 1.8(a) protocol most commonly applies when a lawyer wishes to enter into a business transaction with a client (other than a client's sale of products or services in his or her own trade or profession[5]), or when a lawyer "knowingly acquire[s] an ownership, possessory, security or other pecuniary interest adverse to a client."[6] *See, e.g., In re Fisher,* 202 P.3d 1186, 1195-96 (Colo. 2009) (lawyer who accepted deed of trust on marital residence to secure outstanding legal fees violated Colo. RPC 1.8(a) for failing to comply with requirements of rule). Although a lawyer-client relationship is a type of business relationship, Rule 1.8(a) does not apply to "ordinary fee agreements between client and lawyer,"[7] which do not include midstream modifications. Rule 1.8(a) does not apply to initial fee agreements for practical reasons,[8] and perhaps also because, prior to forming an attorney-client relationship, the lawyer does not occupy a fiduciary relationship to the client

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[2] *E.g., In re Thayer*, 745 N.E.2d 207 (Ind. 2001).
[3] *E.g., In re Stephens,* 851 N.E.2 1256 (Ind. 2006).
[4] Colo. RPC 1.8(a) provides as follows:

> (a) A lawyer shall not enter into a business transaction with a client or knowingly acquire an ownership, possessory, security or other pecuniary interest adverse to a client unless:
> (1) the transaction and terms on which the lawyer acquires the interest are fair and reasonable to the client and are fully disclosed and transmitted in writing in a manner that can be reasonably understood by the client;
> (2) the client is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of independent legal counsel on the transaction; and
> (3) the client gives informed consent, in a writing signed by the client, to the essential terms of the transaction and the lawyer's role in the transaction, including whether the lawyer is representing the client in the transaction.

[5] Cmt. [1], Colo. RPC 1.8.
[6] Colo. RPC 1.8(a).
[7] Cmt. [1], Colo. 1.8(a).
[8] "If fee agreements were covered by the rule [governing business transactions with a client], then a lawyer would have to advise every client to obtain independent counsel before entering into a fee agreement. If the client retained independent counsel, that lawyer would also have to advise the client to obtain independent counsel before entering into a fee agreement — so on down the line." Ass'n of the Bar of the City of New York Opinion 2000-3 (2000) (*quoting* Simon's Code of Prof'l Resp. Ann., DR 5-104(A), Commentary at 310 (West 2000)).

and their negotiations are ostensibly at arms' length.[9] Neither rationale is pertinent to midstream modifications, when the lawyer acts as a fiduciary and the client may have so much time, knowledge and money invested in the lawyer that switching counsel may be difficult if not out of the question.

Legal support for the applicability of Rule 1.8(a) to midstream modifications (other than periodic hourly rate increases contemplated in writing) derives from two principal sources. First, for all the same reasons that support the applicability of Rule 1.8(a) in this context, there is broad agreement among the states, including Colorado, that modified fee agreements are subject to special scrutiny in civil cases.[10] Second, although there is vague authority elsewhere,[11] Indiana has, for several years, held Rule 1.8(a) to be applicable in this setting. *E.g., In re Hefron*, 771 N.E.2d 1157 (Ind. 2002). Indiana even tailored its version of the Rule 1.8(a) Comment to state that the rule applies "when a lawyer seeks to renegotiate the terms of the fee arrangement with the client after representation begins in order to reach a new agreement that is more advantageous to the lawyer than the initial fee arrangement."[12]

There is also a practical danger to removing all Colo. RPC 1.8(a) language from Colo. RPC 1.5(b). The Office of Attorney Regulation Counsel (OARC) may apply Colo. RPC 1.8(a) anyway. Its policy, as expressed to the Committee, is to expect compliance with Colo. RPC 1.8(a) for at least some midstream modifications. There is no published decision of this Court or of a disciplinary hearing board applying Colo. RPC 1.8(a) in these circumstances, or even a Colorado Bar Association Ethics Committee opinion. The net effect of removing compliance with Colo. RPC 1.8(a) from Colo. RPC 1.5(b) would be that, absent clear direction to the contrary from the Court, lawyers could be disciplined for violating Colo. RPC 1.8(a) without knowing it applied.

(The Proposed Changes to Rule 1.5(b) and Comment [3A] Fix the Perceived Ambiguity)

Leaving aside OARC's prosecutorial policy, the fact that it has proven difficult to draft a rule to provide the required protection is not a sound reason to abandon the principle

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[9] *Compare Ramirez v. Sturdevant,* 26 Cal. Rptr. 2d 554, 558 (Cal. App. 1994) ("in general, the negotiation of a fee agreement is an arms-length transaction"), *with Alioto v. Hoiles,* Civil Action No. 04-cv-00438-JLK-MEH, 2007 WL 4557838 * 2 (D. Colo. Dec. 20, 2007) ("attorney fee agreements are not considered ordinary, arms-length contracts") (construing California law) (Kane, J.).

[10] *E.g., Rupp v. Cool,* 362 P.2d 396, 398 (Colo. 1961). *See generally* Annot., "Validity and effect of contract for attorney's compensation made after inception of attorney-client relationship," 13 A.L.R.3d 701 (1967).

[11] One commentator states that "[m]ost courts that consider the propriety of changes to lawyers' fee agreements during the course of representations also look to ethics rules governing lawyers' business transactions with clients." D. Richmond, "Changing Fee Agreements During Representations: What are the Rules?," 15 No. 3 *The Professional Lawyer* 2, 16 (2004). The authorities cited in support of this statement consisted of Indiana cases and cases from other jurisdictions that did not clearly support the proposition.

[12] Indiana Comment [1], Rule 1.8. The Indiana comment also refers to the inapplicability of Rule 1.8(a) to "initial" fee agreements, not "ordinary" fee agreements as in the Colorado and ABA versions.

altogether. The controversy lies with the language, not the principle. The Court chose to adopt this principle over two years ago, and lawyers have been required to follow it since January 1, 2008. The current proposal, while not perfect (no rule is), provides the needed protection.

The chief complaint about existing Colo. RPC 1.5(b) and related Comment [3A]—from a handful of lawyers—is a perceived ambiguity about whether it subjects periodic increases in hourly rates to Rule 1.8(a). As the minority report states, "The Committee intended CRPC 1.5(b) to permit lawyers to avoid the application of CRPC 1.8(a) by advising clients at the time of the initial fee agreement that the lawyer could periodically make reasonable upward fee adjustments. To convey that concept, the rule stated that [Colo. RPC] 1.8(a) would apply to material midstream modifications '[e]xcept as provided in a written fee agreement[.]'" The thrust of this prefatory clause was to provide that no change expressly contemplated in a written fee agreement—including but not limited to periodic hourly rate increases—would constitute a material change (as defined in Comment [3A]) subject to Rule 1.8(a).

It is not clear what is ambiguous about current Rule 1.5(b). Some members of the Committee expressed the view that it was not ambiguous and that no change was required. In any event, the majority's proposal clarifies the inapplicability of Rule 1.8(a) to periodic hourly rate increases by revising the prefatory clause of the second sentence to state, "Except as agreed by a lawyer and a client regarding reasonable periodic increases in the fee or expenses. . . ." In addition, proposed Comment [3A] states, "Reasonable periodic increases in the fee or expenses to which the client expressly or impliedly agrees are not subject to Rule 1.8(a)."

The minority argues that, notwithstanding these changes, maintaining the concept in Rule 1.5(b) that "material changes" to the fee trigger Rule 1.8(a) will not eliminate the confusion and indeed will create even greater confusion. The minority explains that proposed Comment [3A]'s last sentence, which states that a change "reasonably likely to benefit the client" is not a material change, "yields the negative inference that a change in the fee that benefits the lawyer and not the client *is* material and Rule 1.8(a) *does* apply." (Emphasis in minority report.) This negative inference, so the theory goes, is at odds with the majority's proposed clarifying language quoted in the preceding paragraph. The majority believes it is not reasonable to draw the negative inference inferred by the minority, especially when it conflicts with clear language in both Rule 1.5(b) and Comment [3A].

The minority also takes issue with the majority's proposed revision of Rule 1.5(b) and Comment [3A] to expand the types of lawyer-client agreements that would except rate increases from Rule 1.8(a). The Committee as a whole recognizes that the prefatory phrase, "[e]xcept as provided in a written fee agreement," is too narrow, because the first sentence of Rule 1.5(b) permits a lawyer to communicate the basis or rate of a fee with a new client in a writing *other than* a "written fee agreement." To remedy this shortcoming, the majority proposal replaces the phrase "[e]xcept as provided in a written fee agreement," in the second

sentence of Rule 1.5(b), with the phrase, "[e]xcept as agreed by a lawyer and a client." The majority proposal also includes a sentence in proposed Comment [3A] stating that a client's agreement to periodic hourly rate increases "may be manifested by a provision for such increases in any written fee agreement, any communication required by the first sentence of Rule 1.5(b) to which the client assents, or a course of dealing between the lawyer and client."

The minority takes issue in various respects with the wording used in this sentence in the majority's proposed Comment [3A]. The majority stands by the wording. Substantively, the minority objects to the majority's recognition in proposed Comment [3A] that a client may have agreed to periodic hourly rate increases through a "course of dealing" between the lawyer and the client. For example, some lawyers are fortunate enough to have longstanding clients who are perfectly content to pay fees based on invoices showing hourly rates periodically adjusted. Their financial relationship may have evolved well beyond the original written fee agreement or written communication compliant with Rule 1.5(b).

The minority argues that it is "unwise to introduce the contract principle of course of dealing" and that this concept will "create confusion, less protection for clients, and increased exposure to violations for lawyers." Again, the majority disagrees. A "course of dealing" may be a "contract principle," but it is also a common phrase. A lawyer who cannot prove a course of dealing runs a disciplinary risk. More importantly, the minority's solution is to abandon the applicability of Rule 1.8(a) altogether in favor of the allowing lawyers to do nothing more than to communicate changes in the fee to the client in writing.

To be sure, the majority and minority agree that this communication requirement should be added to Rule 1.5(b). The crux of the disagreement between the majority and the minority is over the minority's view that the combination of this written communication requirement with the requirement in Colo. RPC 1.5(a) that fees (and expenses) be "reasonable" offers roughly equivalent protection to clients to that afforded by Rule 1.8(a).

The majority does not believe it does. "Reasonableness" is an objective standard. It is the appropriate standard when the lawyer and the client are more or less at equal bargaining power at the inception of the relationship. The balance changes when the lawyer is already in the process of representing the client; here, because of the vastly superior power the lawyer usually possesses in these circumstances, the standard should include "fairness," which is an element of Colo. RPC 1.8(a) but not Rule 1.5(a). A fee arrangement that is objectively reasonable may not be subjectively fair to a client. *See Hicks ex rel. Saus v. Jones,* 617 S.E.2d 457, 465 (W. Va. 2005) ("fair" is subjective term).

Fairness is a critical missing element in the minority's proposal. So too are the requirements that the lawyer (a) advise the client in writing about the desirability of consulting independent counsel (and give the client time to do so); (b) obtain the client's informed consent, in a writing signed by the client, to the essential terms of the transaction;

and (c) comply with various ancillary procedures designed to warn the client about the lawyer's inherently conflicted interests.[13]

There simply is no comparison between the protections afforded by Rule 1.8(a) and those afforded by Colo. RPC 1.5(a) and a lawyer's written communication to a client confirming a midstream modification. The Rule 1.8(a) protections are necessary and justified in the anxious and sometimes desperate setting of a midstream modification other than a standard hourly rate increase. Moreover, if OARC holds Colorado lawyers to that standard anyway, Colo. RPC 1.5(b) *must* warn lawyers about the applicability of Rule 1.8(a) to midstream modifications or they will have insufficient notice of what is expected of them. *E.g., In re Sather,* 3 P.3d 403, 414-15 (Colo. 2000) (declining to discipline lawyer for failing to deposit advance fee into trust account where court had not previously made ethical obligation clear).

[13] *See* Cmt. [2], Colo. RPC 1.8 ("When necessary, the lawyer should discuss both the material risks of the proposed transaction, including any risk presented by the lawyer's involvement, and the existence of reasonably available alternatives and should explain why the advice of independent legal counsel is desirable."); Cmt. [3], Colo. RPC ("when the lawyer's financial interest . . . poses a significant risk that the lawyer's representation of the client will be materially limited by the lawyer's financial interest in the transaction. . . the lawyer's role requires that the lawyer must comply, not only with the requirements of [Colo. RPC 1.8](a), but also with the requirements of Rule 1.7").

Rule 1.5

(b) When the lawyer has not regularly represented the client, the basis or rate of the fee and expenses shall be communicated to the client, in writing, before or within a reasonable time after commencing the representation. The lawyer also shall communicate in writing to the client any change to the basis or rate of the fee or expenses. Except as agreed by a lawyer and a client regarding reasonable periodic increases in the fee or expenses, any material changes to the basis or rate of the fee or expenses are subject to the provisions of Rule 1.8(a).

Comment

[3A]Reasonable periodic increases in the fee or expenses to which the client expressly or impliedly agrees are not subject to Rule 1.8(a). The client's agreement to such periodic increases may be manifested by a provision for such increases in any written fee agreement, any communication required by the first sentence of Rule 1.5(b) to which the client assents, or a course of dealing between the lawyer and client. The reasonableness requirement of Rule 1.5(a) applies to increases in the fee or expenses. When a change in the basis or the rate of the fee or expenses is reasonably likely to benefit the client, such as a reduction in the hourly rate or a cap on the fees or expenses that previously did not exist, the change is not material and Rule 1.8(a) does not apply.

EXHIBIT A

Rule 1.5

Comment

[2] When the lawyer has regularly represented a client, they ordinarily will have evolved an understanding concerning the basis or rate of the fee and the expenses for which the client will be responsible. . . . When developments occur during the representation that render an earlier communication~~disclosure~~ substantially inaccurate, a revised written communication~~disclosure~~ should be provided to the client.

Rule 1.8

Comment

[1] A lawyer's legal skill and training, together with the relationship of trust and confidence between lawyer and client, create the possibility of overreaching when the lawyer participates in a business, property or financial transaction with a client, for example, a loan or sales transaction or a lawyer investment on behalf of a client. . . . "Except as stated in the last sentence of Rule 1.5(b), i~~I~~t does not apply to ordinary fee arrangements between client and lawyer, which are governed by Rule 1.5, although its requirements must be met when the lawyer accepts an interest in the client's business or other nonmonetary property as payment of all or part of a fee. . . .