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Alternative Fee Arrangements: How Long Do the RPCs Apply?

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"Alternative fee arrangements" have become increasingly popular in recent years among both lawyers and clients. They range from variants on traditional hourly or contingent fees to taking stock or other business interests in lieu of fees. Although the "dot com bust" cooled the ardor for stock as a compensation tool, alternative fee arrangements are still being expanded into a wide variety of practice settings. If you're using—or thinking about using—alternative fee arrangements, the Washington Court of Appeals recently issued an opinion that may have far-reaching consequences. The Court of Appeals in *Holmes v. Loveless*, 122 Wn. App. 470, 94 P.3d 338 (2004), held that the requirement in the Rules of Professional Conduct that a lawyer's fee be "reasonable" extends over the life of the fee agreement involved.

Holmes arose under unusual circumstances. The plaintiffs were two retired partners of a law firm. The defendant was a real estate developer. The lawyers and their firm had entered into a fee agreement with the developer in 1972 to provide legal services during the start-up phase of a project. Under the agreement, the law firm heavily discounted its fees (charging no more than necessary to cover its overhead) during a two-year start-up period. After that initial period, the law firm's fees moved back to its regular rates. In return, the

law firm was to receive five percent of any cash distributions generated by the project. The project turned out to be very successful and over the next 30 years generated $380,000 for the firm. The fee discount the law firm had effectively offered, by contrast, was calculated at $8,000 before any adjustment for inflation.

By 2001, the two partners had retired and the firm had assigned its interest in the project to them. Around that same time, the developer notified the partners that it was terminating the fee agreement. The two partners then sued the developer to enforce the agreement and continue the distributions. The trial court enforced the agreement on summary judgment, but the Court of Appeals reversed.

The developer argued that the fee agreement violated the RPCs and, therefore, was unenforceable as a matter of public policy. The developer's position was rooted in two elements of the RPCs—RPC 1.8(a), which regulates lawyer-client business transactions, and RPC 1.5(a), which prohibits unreasonable fees. The Court of Appeals first agreed with the general proposition that "[a] fee agreement that violates the Rules of Professional Conduct . . . is against public policy and unenforceable." 122 Wn. App. at 475. The Court of Appeals also agreed that review of the agreement under both provisions was warranted and, because the fee agreement remained in effect, should be evaluated primarily under the current rules. Both RPC 1.8(a) and RPC 1.5(a) contain "reasonableness" criteria for evaluating fees. Under RPC

1.8(a)(1), a business transaction between a lawyer and a client must be "fair and reasonable to the client." RPC 1.5(a), in turn, contains a variety of criteria for assessing whether a lawyer's fee is "reasonable." The Court of Appeals found that the two are intertwined when a lawyer's compensation for services comes from an associated business transaction: "To some degree, the excessive fee and business transaction provisions overlap when attorneys and clients use business transactions as compensation for legal services. When the fee generated by a business transaction is not fair and reasonable, the business transaction is not fair and reasonable." 122 Wn. App. at 476-77.

The Court of Appeals relied on a recent fee disgorgement case that included a business transaction—*Cotton v. Kronenberg*, 111 Wn. App. 258, 44 P.3d 878 (2002), *rev. denied*, 148 Wn.2d 1011 (2003)—in holding that the obligation to ensure that a fee is reasonable continues throughout the duration of the agreement. *Cotton* involved a lawyer who took real estate as an element of a fee and who was later disqualified before the legal services were completed. The *Cotton* court found that RPC 1.8(a)'s "reasonableness" requirement continued over the life of the agreement and that the lawyer's disqualification before completing the services involved rendered the transaction unreasonable. Although *Cotton* did not address the corresponding provision in RPC 1.5(a), the Court of Appeals in *Holmes* concluded that it, too, continued over the life of the agreement.

The *Holmes* court then examined the changing nature of the fee over the life of the agreement. It conceded that although the arrangement may have been reasonable at the outset, the fee generated became unreasonable as time went by because the lawyer's risk diminished while the certainty and amount of the fee 30 years later became disproportionate. In line with this analysis, the Court of Appeals did not rescind the agreement or order disgorgement of the fees received. Rather, it refused to enforce the agreement going forward.

Although both *Holmes* and *Cotton* involved real estate deals, the Court of Appeals in each case used stock investments in high tech companies as an example. Therefore, in an era when investing in clients and "alternative fee arrangements" are more common with clients in a wide range of industries from high tech to project development, *Holmes*' temporal yardstick for reasonable fees may have far-reaching practical consequences. For lawyers looking for a roadmap, the ABA's formal ethics opinion on investing in clients—00-418 (2000)—remains essential reading as it, like *Holmes* and *Cotton*, discusses the intersection of RPCs 1.8 and 1.5 and offers practical suggestions for constructing alternative fee arrangements that will stand the test of time.

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