Enduring Status of Ethics Opinion #81 (11/4/87)
Contingent Fee in Case in Which Fee Award is Permitted by Statute

Enduring Opinion #81 addressed three questions:

(1)  Does [former] Bar Rule 8(c) prohibit the taking of a contingent fee in an action brought under a statute providing for the award of attorneys’ fees to the prevailing party?

(b)  If a court-awarded fee is sought, is the attorney seeking the fee obligated to disclose to the Court the existence of the contingent fee agreement?

(c)  If [former] Rule 8(c) does not prohibit the taking of a contingent fee in such cases, are the Bar Rules violated if the contingent fee agreement provides that the attorney will receive a percentage of the gross recovery and gross recovery is defined to include the attorney’s fees as well as the judgment?

The framework of the opinion rested in part on then applicable Maine Bar Rule 8(c)(3), which prohibited the use of a contingent fee agreement “in connection with any proceeding where the method of determination of attorneys’ fees is otherwise expressly provided by statute or administrative regulations.” The current Maine Rules of Professional Conduct contain no provision expressly corresponding to former Maine Bar Rule 8(c)(3), probably because none is necessary. A statute or administrative rule that expressly provides for an award of attorney’s fees to a prevailing party by method other than contingent fee would always prevail over the parties’ contractual arrangement. Accordingly, Ethics Opinion #81 remains valid, although the rationale for the opinion is somewhat different.

As the Commission previously determined, the attorney must disclose any contingent agreement in all instances. The Commission reasoned, “In making its determination regarding fees, the Court is entitled to be informed as
to what the parties themselves considered to be reasonable. ¹ Moreover, as a practical matter, the plaintiff’s attorney may want to demonstrate the risk factor involved to support a demand for a multiplier.”

Complications arise under the third issue: whether an attorney may receive a percentage of the gross recovery; i.e., the judgment and fee award combined. As the Commission previously advised, the question cannot be answered in the abstract. The overall fee must be reasonable under the standards of M.R. Prof. Conduct 1.5(a). The reasonableness of legal fees is fact-dependent -- a function of infinite variables.

Two caveats should be underscored.

First, every fee agreement, whether or not contingent, in every case involving a potential award of legal fees to a successful client, should address the consequence; i.e. whether, or the extent to which, the attorney will share in the award. Between the attorney and client, there should be no surprises.

Second, every fee agreement involving a taxable recovery, whether or not contingent, should inform the client about the probability that the client may pay a tax on the fee paid to the attorney. ⁶⁶⁸⁸⁹⁰⁰, ⁵⁴⁴ U.S.

¹ There appears to be no current fee-shifting statute that limits recovery to a prescribed amount or formula; rather, all such statutes permit recovery of “reasonable attorneys’ fees” and costs. See 8 M.R.S. §416-A (involving award of prizes); 12 M.R.S. §6958 (damages for furnishing false information leading to search and rescue efforts); 14 M.R.S. §1218 (protection of jurors’ employment rights); 14 M.R.S. §6101 (mortgage foreclosures); 15 M.R.S. §711 (civil remedy for interception of certain communications); 20 M.R.S. §709 (right of access to criminal records); 23 M.R.S. §157 (certain unsuccessful appeals by the Department of Transportation); 24-A M.R.S. §§2436, 2108 (certain insurance-related claims); 26 M.R.S. §§625-B, 626, 626-A, 631, 670, 630, 631 (employee rights); 32 M.R.S. §11054.1.D (violations of Maine’s Fair Debt Collection Practices Act); and 33 M.R.S. §163.3 (involving prohibited private transfer fees in real estate transactions).
If an attorney were to share in the award of a statutory fee, the adverse tax consequence to the client could be enhanced. M.R. Prof. Conduct 1.4(b) requires attorneys to “explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation.” Neither the client nor the attorney can make “informed decisions regarding the representation” if the taxation of an award or settlement is not considered until it is too late.

In *Commission v. Banks* the Court held that the portion of a money judgment or settlement payable to the taxpayer’s attorney under a contingent fee agreement is included within the taxpayer’s gross income. Legal fees may be an itemized deduction, but subject to the 2% limitation on miscellaneous deductions or loss of the deduction for calculating the Alternative Minimum Tax with larger awards. The result may be double taxation – once to the client and again to the attorney. The impact of the decision was diminished somewhat by enactment of I.R.C. §62(a)(20) and (21), as part of the American Jobs Act of 2004, which excludes “attorney fees and court costs paid by, or on behalf of, the taxpayer in connection with any action involving a claim of unlawful discrimination,” certain Social Security claims, and certain whistleblower actions. However, *Commissioner v. Banks* still governs the taxation of recoveries in other contingent fee cases, such as defamation, tortious interference with contractual rights, and invasion of privacy. See generally I.R. S. Publication 529.