



THE RISK MANAGER

A QUARTERLY NEWSLETTER BY LAWYERS MUTUAL INSURANCE COMPANY OF KENTUCKY

KENTUCKY SUPREME COURT SPELLS OUT WHEN A LAWYER WHO IS DISCHARGED OR WITHDRAWS FROM A CONTINGENCY FEE CASE IS ENTITLED TO A QUANTUM MERUIT FEE

One of a lawyer’s biggest nightmares is to do considerable work on a contingency fee case only to be discharged by the client prior to trying or settling the matter. The lawyer then learns the former client promptly settled the case for a substantial sum seemingly finessing the lawyer out of the contingency fee. This is what happened in *Hughes & Coleman, PLLC v. Chambers*, 526 S.W. 3d 70 (Ky. 2017).

CASE HISTORY

Hughes was retained by Underwood to represent him for injuries sustained in a car crash. This agreement provided for Hughes to be paid on a contingency fee basis and, among other terms, provided that the firm would “assist the client in submitting medical bills for payment to any responsible insurance carrier or agency.”

Hughes then requested and received from Underwood’s PIP insurer Underwood’s remaining PIP benefits of \$18,812.94. These funds were deposited in Hughes’ client trust account. Hughes repeatedly requested Underwood to provide wage verification documents and physician statements to verify entitlement to further lost wage payments. None were ever sent to Hughes.

Hughes made two disbursements from these funds – one to Underwood and the other in full satisfaction of a hospital bill. The remaining funds in the client trust account were \$14,344.06.

Hughes then filed suit and began settlement negotiations with the tortfeasor’s insurer.

The insurer offered \$145,000, but Hughes valued the case at \$200,000 and recommended against settling for the insurer’s

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CRYPTOCURRENCY IS ALIVE AND WELL IN KENTUCKY.

Should You Accept It as a Retainer or Fee Payment?

INTRODUCTION

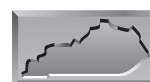
The purpose of this article is to alert Kentucky lawyers to the risk management and professional responsibility considerations of dealing with cryptocurrency or virtual currency. It is beyond the scope of this article to explain the intricacies of how cryptocurrency transactions take place. We urge all Kentucky lawyers and judges to inform themselves on these details because even if you have no intention of using cryptocurrencies, clients may seek advice on their use and cryptocurrencies have already been the subject of litigation in Kentucky.

As a frame of reference what follows is the IRS definition of virtual currency:

Virtual currency is a digital representation of value that functions as a medium of exchange, a unit of account, and/or a store of value. In some environments, it operates like “real” currency – i.e., the coin and paper money of the United States or of any other country that is designated as legal tender, circulates, and is customarily used and accepted as a medium of exchange in the

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QUANTUM MERUIT FEE

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offer. Shortly thereafter Hughes and Underwood fell out because Hughes refused to send Underwood the remaining \$14,344.06. Underwood then discharged the firm alleging that he had been misled about the need to keep the funds in Hughes' client trust account and asked that his file and the remaining funds be sent to him. Hughes promptly complied.

Underwood hired Chambers who quickly negotiated a settlement of \$200,000 with the tortfeasor's insurer. Chambers received a contingency fee of \$66,660. Hughes then asserted an attorney's lien claiming a *quantum meruit* share of the fee in payment for the work it did for Underwood prior to being discharged.

Chambers denied Hughes was entitled to any part of the fee arguing the discharge was "for cause" and so barred its *quantum meruit* claim. The justifiable cause was alleged to be Hughes' mishandling of Underwood's no-fault (PIP) benefits that was both unethical and illegal.

The trial court heard expert testimony that it was common practice to handle a client's no fault benefits as Hughes had. The expert "opined that the firm had provided diligent service, that Underwood's case appeared to have been progressing well, and that there was nothing about the representation that he considered good cause for discharging the firm." The court also considered the 503-page case file that Hughes had compiled from its case-management system. The court found the file to be "extremely detailed and meticulous."

The trial court concluded that Hughes was discharged without cause and on a *quantum meruit* basis apportioned 75% (\$49,995) of the fee to Hughes and 25% (\$16,665) to Chambers. Chambers appealed only on the issue whether Hughes' discharge was for cause. The Court of Appeals reversed ruling that "in its handling of Underwood's no-fault benefits, Hughes had maintained a position unsupported by law and adverse to its client, which constituted valid cause for Underwood's terminating its services." The Supreme Court granted Hughes petition for discretionary review.

SUPREME COURT ANALYSIS

The Supreme Court's opinion is a clinic on when a lawyer is entitled to a *quantum meruit* fee. It teaches that there are different standards for determining whether *quantum meruit* is warranted depending on whether the client discharged the lawyer; or the lawyer withdrew from the representation.

TOO OFTEN
LAWYERS FAIL
 TO THOROUGHLY DOCUMENT
A CONTINGENCY FEE
CASE AS THEY WOULD AN
HOURLY FEE MATTER.



What follows is a break down of the Court's guidance for each situation.

CLIENT DISCHARGES THE LAWYER

In *Baker v. Shapero*, 203 S.W.3d 697 (Ky. 2006), the Court established the rule that "when an attorney employed under a contingency fee contract is discharged without cause before completion of the contract, he or she is entitled to fee recovery on a *quantum meruit* basis only, and not on the terms of the contract."

What is for cause?

- ◆ The Court held "that an attorney's discharge should be deemed for cause – so as to bar the fired attorney from recovering a fee in *quantum meruit* – only where the reason for the discharge is some sort of culpable conduct by the attorney."
- ◆ "[T]he 'cause' of the discharge must involve some sort of wrongful conduct by the attorney, resulting in an irreconcilable breakdown in the attorney-client relationship."
- ◆ "[A] complete forfeiture of attorney's fees will be warranted only when the attorney's 'clear' violation of a duty is found to have so destroyed the attorney-client

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“IF YOU BOARD THE WRONG TRAIN, IT IS NO USE
RUNNING ALONG THE CORRIDOR IN THE OTHER DIRECTION.” *Dietrich Bonhoeffer*

QUANTUM MERUIT FEE

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relationship that the attorney is considered to no longer have a right to compensation for services rendered prior to the point of his or her discharge.”

LAWYER WITHDRAWS FROM THE REPRESENTATION

Whether a withdrawing lawyer may recover a *quantum meruit* fee on the former client's ultimate recovery turns on whether the lawyer's reason for withdrawing constituted “good (or just) cause.”

What is good (or just) cause?

- ◆ “When the lawyer withdraws, the ethical and contractual duties and obligations owed to the client are paramount to the analysis. Broadly speaking, attorneys must, among other things, competently represent and zealously advocate their clients' best interests.”
- ◆ “[N]either simple disagreements with clients over claim values, nor latent fears that the representation will somehow jeopardize the lawyer's relationships with third-parties, [will] justify lawyers' casting aside their clients and the duties otherwise owed to them.”
- ◆ Absent sufficient justification in the ilk of an irretrievable breakdown of the lawyer-client relationship, ...a lawyer who voluntarily withdraws from the representation will not be permitted to later insist on receiving a fee on the former client's ultimate recovery.

The Supreme Court found that the trial court's ruling was correct that Underwood's dissatisfaction with the handling of PIP benefits was not a sufficient cause to bar Hughes from being paid for the work they performed. The judgment awarding Hughes a *quantum meruit* fee was reinstated.

MANAGING THE RISK

Document the File!: Too often lawyers fail to thoroughly document a contingency fee case as they would an hourly fee matter. When a fee dispute arises the court is presented with a sparse file apparently showing the lawyer had done little work on the case. Thorough documentation of a contingency fee dispute is the surest way of proving the value of legal services when a dispute arises. A significant factor in Hughes prevailing on its *quantum meruit* claim was its 503-page case file compiled from its case-management system. Both the trial

court and the Supreme Court considered this file substantial evidence. The trial court described the file as “extremely detailed and meticulous.”

Cover Fee Payments in Detail in the Contingency Fee Agreement:


While not stipulated in Kentucky Rule of Professional Conduct SCR 3.130 [1.5, Fees], recommended additional matters to cover in contingency fee agreements to avoid disputes are:

- How the lawyer is paid if the client rejects a reasonable settlement offer and the lawyer withdraws.
- How the lawyer is paid if the lawyer is terminated by mutual agreement or if the client unilaterally discharges the lawyer without cause.
- Whether the lawyer is obligated to pursue an appeal if there is an adverse judgment.

Be Sure to Use the Correct Standard in Determining Whether You are Withdrawing for Good or Just Cause and Will be Entitled to a Quantum Meruit Fee:

The distinction between withdrawing in compliance with the Kentucky Rules of Professional Conduct and with a judge's permission to withdraw and withdrawing for good and just cause warranting a *quantum meruit* fee is explained in *Hughes* and *Lofton*.

Hughes: Whether a *quantum meruit* fee is forfeited is not governed by the ethics rules and standards – guided perhaps, but not governed. *Cf Lofton*, 367 S.W.3d at 596 (differentiating “good cause” for withdrawing as counsel with court's leave under SCR 3.130-1.16(b), from the higher standard for withdrawing and receiving *quantum meruit* compensation). Even if Hughes & Coleman neglected to fully explain to Underwood, in clear and understandable terms, his PIP benefits and their handling by them, that does not amount to the sort of culpable conduct that forfeits a discharged lawyer's right to be paid for services rendered.

Lofton: However, we find that the “good faith” or “good cause” or a comparable basis for withdrawing as counsel under SCR 1.16(b) does not translate into a comparable justification or “good cause” to be entitled to *quantum meruit* compensation for past services. They are two entirely different standards, with a much lower threshold to withdraw from the case than to withdraw with *quantum meruit* compensation. 

“THE RULE IN CARVING HOLDS GOOD AS TO CRITICISM; NEVER CUT WITH A KNIFE WHAT YOU CAN CUT WITH A SPOON.”

Charles
Buxton

CRYPTOCURRENCY

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country of issuance – but it does not have legal tender status in any jurisdiction.

Virtual currency that has an equivalent value in real currency, or that acts as a substitute for real currency, is referred to as “convertible” virtual currency. Bitcoin is one example of a convertible virtual currency. Bitcoin can be digitally traded between users and can be purchased for, or exchanged into, U.S. dollars, Euros, and other real or virtual currencies. (IRS Notice 2014)

NEBRASKA LEADS THE WAY

The only significant ethics opinion at this writing dealing with cryptocurrency is Nebraska Ethics Advisory Opinion for Lawyers No. 17-03 (9/11/2017). The opinion considered and answered three questions.

A. May an attorney receive digital currencies such as bitcoin as payment for legal services?

“An attorney may receive and accept digital currencies such as bitcoin as payment for legal services. In order to assure that the fee charged remains reasonable under Neb.Ct. R. Prof. Cond. § 3-501.5(a), which prohibits charging unreasonable fees the attorney should mitigate the risk of volatility and possible unconscionable overpayment for services by (1) notifying the client that the attorney will not retain the digital currency units but instead will convert them into U.S. dollars immediately upon receipt; (2) converting the digital currencies into U.S. dollars at objective market rates immediately upon receipt through the use of a payment processor; and (3) crediting the client’s account accordingly at the time of payment.” (Editor’s note: *The Nebraska and Kentucky Rule 1.5 (a) are identical.*)

B. May an attorney receive digital currencies from third parties as payment for the benefit of a client’s account?

“An attorney may receive digital currencies as payment from third-party payors so long as the payment prevents possible interference with the attorney’s independent relationship with the client pursuant to Neb. Ct. R. of Prof. Cond. §3-501.7(a) or the client’s confidential information pursuant to Neb. Ct. R. of Prof. Cond. §3-501.6 by implementing basic know-your-client (“KYC”) procedures to identify any third-party payor

AN ATTORNEY MAY HOLD BITCOINS AND OTHER DIGITAL CURRENCIES IN ESCROW OR TRUST FOR CLIENTS OR THIRD PARTIES...



prior to acceptance of payments made with digital currencies.” (Editor’s note: *The Nebraska and Kentucky Rule 1.7 (a) are identical. The Nebraska and Kentucky Rule 1.6 are identical with one exception not significant to this question.*)

C. May an attorney hold digital currencies in trust or escrow for clients?

“An attorney may hold bitcoins and other digital currencies in escrow or trust for clients or third parties pursuant to Neb. Ct. R. of Prof. Cond. §3-501.15(a) so long as the attorney holds the units of such currencies separate from the lawyer’s property, kept with commercially reasonable safeguards and records are kept by the lawyer of the property so held for five (5) years after termination of the relationship. Because bitcoins are property rather than actual currency, bitcoins cannot be deposited into a client trust account created pursuant to Neb. Ct. R. §§ 3-901 to 3-907 (Trust Fund Requirements for Lawyers).” (Editor’s note: *The Nebraska and Kentucky Rule 1.15 (a) are identical for all practical purposes. Kentucky does not have a rule comparable to Nebraska 3-901 to 3-907. Currently most authorities consider cryptocurrency an asset or commodity meaning that bitcoins cannot be deposited in a client trust account.*)

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“REMEMBER, YOU ARE JUST AN EXTRA
IN EVERYONE ELSE’S PLAY.”

Franklin
Delano
Roosevelt

CRYPTOCURRENCY

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MANAGING THE RISK

We are in the early phase of the use of cryptocurrencies in the practice of law. The paramount risk management consideration is that lawyers must know what they are doing when dealing with them. Do not accept cryptocurrencies for any purpose until you have thoroughly researched how they operate with special emphasis on client confidentiality and the security of the system. Understand that the cryptocurrency market is constantly changing in the number of currencies available, how these currencies function, and the value of the currency. The big unknown is how the government might choose to control them. This fluid situation requires cryptocurrency continuing education. What follows are our preliminary risk management ideas.

Firm Cryptocurrency Policy:

- ◆ Even if a firm has no current intention of dealing in cryptocurrencies, it should now develop a policy on cryptocurrencies; *i.e.*,
 - Whether the firm will or will not accept cryptocurrencies;
 - Who the firm will accept them from – only corporate clients or all clients and third parties.
 - Whether cryptocurrency will be accepted for all payments, only for legal services rendered and retainers, or only for legal services rendered.
 - What payments will be immediately converted to dollars.
 - Whether the firm will or will not advise clients on cryptocurrency matters.
 - How the firm will gain competence in cryptocurrency systems and maintain it by continuing study of the cryptocurrency market.
 - Whether the firm should include in its standard letter of engagement a paragraph covering cryptocurrency.
 - What records of cryptocurrency transactions should be maintained to comply with Kentucky Rule of Professional Conduct 1.15(a), Safekeeping property.

Avoiding Illegal Transactions:

- ◆ A firm must assure that any cryptocurrency they accept is not contraband, does not violate client confidentiality, and is not part of a money-laundering or tax avoidance scheme.

Price Volatility:

- ◆ The fact that cryptocurrencies can fluctuate widely in value in a short period of time creates the risk that fee agreements that are couched in terms of bitcoins or other virtual currencies can lead to a client paying \$300 an hour in one month and \$500 an hour the next month. This could easily be seen as an unreasonable fee as prohibited by Kentucky Rule of Professional Conduct 1.5(a), Fees. To avoid this risk fee agreements should be in dollars. To risk manage currency volatility, arrange to convert bitcoins and other digital currencies received for services rendered and retainers into U.S. dollars immediately upon receipt.

Third-Party Payers:

- ◆ When a lawyer is asked to accept payment of fees by a third-party payer, the lawyer must consider SCR 3.130(1.8)(f) Conflict of interest: current clients; specific rules:
 - (f) A lawyer shall not accept compensation for representing a client from one other than the client unless:
 - the client gives informed consent;
 - there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship; and
 - information relating to representation of a client is protected as required by Rule 1.6

Because use of cryptocurrency is pseudonymous and virtually anonymous, to comply with Rule 1.8 a lawyer should use Know Your Client ("KYC") procedures. For more information on KYC go to Google where you will find a full range of articles on KYC.

Cryptocurrency Payments for other than Retainers and Fees, e.g., Settlements and Judgments

- ◆ The Nebraska opinion only addresses cryptocurrency payments for legal services. It does not consider other cryptocurrency payments in which clients have an interest such as settlement and judgment payments. It seems obvious, however, that cryptocurrency a lawyer receives for a client's account should immediately be converted to dollars to avoid any risk of currency fluctuations. There are cryptocurrency payment processors available that will

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“HUMOR IS THE SHOCK ABSORBER OF LIFE;
IT HELPS TAKE THE BLOWS.”

Peggy
Noonan

ARE YOU READY FOR AN E-DEVICE U.S. BORDER SEARCH – AKA A DIGITAL STRIP SEARCH?

The recent ABA Center for Professional Responsibility Conference included the panel program *Prying Eyes: Think Confidential and Privileged Client Information is Safe at the Border? Guess Again*. The panelists pointed out that lawyers crossing international borders are at an increasing risk that border control officers will seek to search smart phones, portable hard drives, USB thumb drives, and laptops. The panel stressed the ethical duty lawyers have when crossing a border with e-devices to protect privileged or confidential information. This ethical duty is complicated by the fact that the U.S. Customs and Border Protection Agency asserts the authority to conduct routine searches without probable cause to review any information on e-devices of U.S. citizens when crossing the U.S. border. Lawyers are not exempt. This necessitates that lawyers carefully plan what e-devices they will travel with and what information is on them.

There are two good sources for guidance for lawyers crossing the U.S. border with e-devices. Both are readily available via Google:

- ◆ The Association of the Bar of The City of New York Committee on Professional Ethics Formal Opinion 2017-5: *An Attorney's Ethical Duties Regarding U.S. Border Searches of Electronic Devices Containing Clients' Confidential Information*
- ◆ *Digital Privacy at the U.S. Border: Protecting The Data on Your Devices and in the Cloud* (Electronic Frontier Foundation, March 8, 2017).

A lawyer's ethical duties when crossing the U.S. border with e-devices is summed up in Formal Opinion 2017-5 as follows:

Before crossing the U.S. border, an attorney must make reasonable efforts to protect [e-devices] against the disclosure of clients' confidential information in response to a demand by border agents. Because "reasonable efforts" depend on the circumstances, no particular safeguards are invariably required. However, attorneys should generally (i) evaluate the risks of traveling with confidential information and (ii) consider what safeguards to implement to avoid or reduce the risk that confidential information will be accessed or disclosed in the event of a search. At the border, if government agents seek to search the attorney's electronic device pursuant

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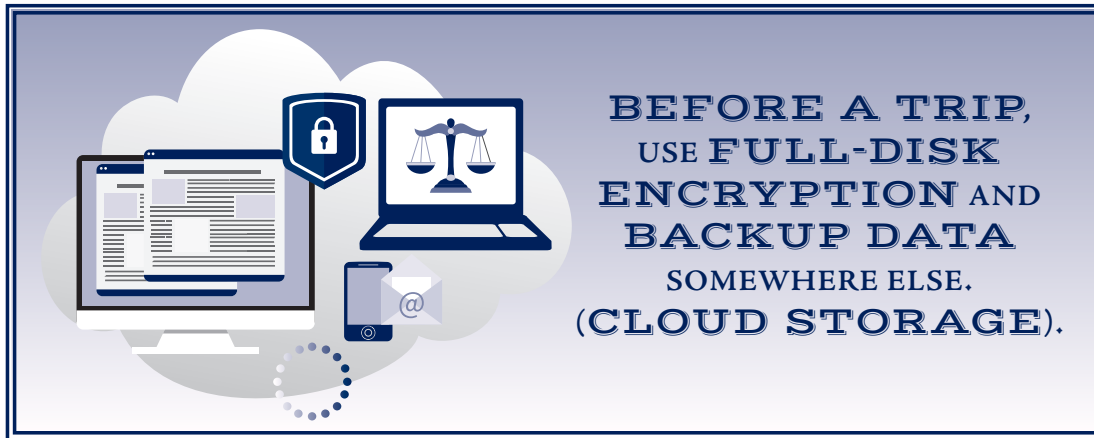
to a claim of lawful authority, and the device contains clients' confidential information, the attorney may not comply until first making reasonable efforts to assert the attorney-client privilege and to otherwise avert or limit the disclosure of confidential information, e.g., by asking to speak to a superior officer. To add credence to the claim of attorney-client privilege, an attorney should carry attorney identification and be familiar with the customs agency's policies or guidelines regarding searches of privileged information. Finally, if the attorney discloses clients' confidential information to a third party during a border search, the attorney must inform affected clients about such disclosures.

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**“I LOVE DEADLINES. I LOVE THE WHOOSHING NOISE
THEY MAKE AS THEY GO BY.”**

*Douglas Adams
Not recommended
for lawyers*

DIGITAL STRIP SEARCH



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DIGITAL PRIVACY

Digital Privacy at the U.S. Border is an excellent practical consideration of the whole range of ethics issues and risk management options bearing on crossing the U.S. border with e-devices. It is divided into three parts:

PART 1: DIGITAL PRIVACY GUIDE FOR TRAVELERS

- ◆ Covers risk assessment factors including immigration status, travel history, and the data stored on an e-device.
- ◆ Reviews risk management actions to protect confidentiality:

“Before your trip. Travelers should decide whether they can reduce the amount of digital information that they carry across the border. For example, they may leave certain devices at home, use temporary devices, delete content from their devices, or shift content to the cloud. Travelers should protect the information they do carry over the border. Most importantly, they should use full-disk encryption and backup their data somewhere else. Also, shortly before arriving at the border, travelers should power off their devices, which will resist a variety of high-tech attacks against encryption. Travelers should not rely solely on fingerprint locks, which are less secure than passwords.”


PART 2: CONSTITUTIONAL RIGHTS, GOVERNMENT POLICIES, AND PRIVACY AT THE BORDER

Covers individual rights at the border and government policies and practices at the border.

PART 3: THE TECHNOLOGY OF PRIVACY PROTECTION

Covers a variety of tools to protect privacy. These include:

- ◆ Encryption
- ◆ Understanding Weaker Screen-Lock or User Account Passwords
- ◆ Strong Full-Disk Storage Encryption
- ◆ Activating Encryption
- ◆ Secure Deletion and Forensics
- ◆ Overview of Secure Deletion.
- ◆ Wiping Hard Drives and Removable Media
- ◆ Individual File Secure Deletion
- ◆ Clearing Free Space
- ◆ Encryption and Secure Deletion
- ◆ Cloud Storage

The foregoing only scratches the surface of the wealth of information on border crossings contained in *Digital Privacy at the U.S. Border*. We urge you to review it now as part of your professional reading even if you have no plans to cross the U.S. border. 

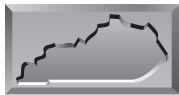
THE RISK MANAGER
PUBLISHED BY LAWYERS MUTUAL INSURANCE COMPANY OF KENTUCKY

DEL O'ROARK
Newsletter Editor

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IF YOU WANT TO GO FAR, GO TOGETHER.”** *African Proverb*



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CRYPTOCURRENCY

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immediately convert cryptocurrency into dollars upon receipt. Law firms dealing in cryptocurrency should make arrangements for immediate conversion of such payments.

Letters of Engagement and Cryptocurrency:

- ◆ It is important that clients be advised at the outset of a representation in a letter of engagement how cryptocurrency payments are managed. This information should include:
 - Which cryptocurrency payments will be converted into dollars immediately upon receipt.
 - That this conversion will be by a payment processor at current market rates.
 - That the client's account with the firm will be credited at the time of payment for the converted amount.

- That future fluctuations in the cryptocurrency will neither increase nor decrease the amount credited to the client's account.
- That any cryptocurrency the client requests be held in trust and not converted into dollars is solely the client's risk for currency value fluctuations and will be paid out in kind.

SUMMING UP

There is considerable disagreement over the legitimacy of cryptocurrencies. At this time it looks like they are here to stay and lawyers must be competent in dealing with them. We hope this article starts you thinking of what your firm needs to do. Always remember the KBA Ethics Hotline if you are in doubt about any aspect of cryptocurrencies. The Hotline has demonstrated its great value for Kentucky lawyers for a number of years. It is an ideal source for guidance on this new development in the practice of law. 