

CLASP REGULATORY-POLICY MEMORANDUM

2010-2

TO: CLASP Subscribers
FROM: Linda E. Perle
DATE: April 29, 2010
RE: Updates on Attorneys' Fees

Attorneys' Fee Restriction Update

On April 17, 2010, the newly installed LSC board met in Tucson for its first quarterly committee and board meetings. A major piece of the board's business was to consider whether to adopt a Final Rule eliminating the restrictions contained in 45 CFR 1642 on the claiming of, and the collection and retention of, attorneys' fees pursuant to Federal or State law permitting or requiring the awarding of such fees. On January 20, 2010, the prior board had adopted an Interim Final Rule that eliminated the attorneys' fees restrictions from Part 1642, moved the provisions dealing with accounting for and use of attorneys' fees and acceptance of reimbursement of costs from Part 1942 to Part 1609, and made several technical changes to Parts 1609 and 1610. The Interim Final Rule was published in the Federal Register on February 11, 2010, and became effective on March 15, 2010, although LSC had announced it would suspend enforcement of the restriction until the Interim Final Rule became effective. The proposed Final Rule is identical in all respects to the Interim Final Rule except for the name and the effective date. After brief consideration of the LSC staff recommendation and the ten public comments submitted in response to publication of the Interim Final Rule, all of which supported the adoption of the Interim Final Rule as the Final Rule, the Board unanimously adopted the Final Rule and directed the LSC staff to publish it. The Final Rule was published in the Federal Register on April 16, 2010, and became effective upon publication. You can read the Final Rule and the accompanying Supplementary Material on the LSC website at http://www.lsc.gov/lscgov4/AttorneysFeesFinalRule4_26_10.pdf.

As was true under the Interim Final Rule, the Final Rule eliminated the Part 1642 restriction on attorneys' fees in its entirety, and transferred to Part 1609 the two provisions from Part 1642 unrelated to the restriction, one dealing with accounting and use of attorneys' fees, and the other dealing with acceptance or reimbursement of out-of-pocket costs and expenses from a client. It also makes several conforming changes to Part 1609 and 1610, removing references to Part 1642 and the attorneys' fees restriction.

The effect of the adoption of the Final Rule is to continue to permit LSC grantees to seek ("claim, or collect and retain") attorneys' fees in any case for which such fees

would be available absent the appropriations act restriction in Part 1642 that was imposed in April, 1996 and eliminated in December, 2009. Grantees are now permitted to seek attorneys' fees in new cases filed subsequent to the effective date of the rule as well as fees in any case filed prior to the effective date of the rule, regardless of whether the case is still pending on the effective date and when the work for which fees are being claimed was done. Grantees may use claims for attorneys' fees strategically in settlement negotiations or may actually seek awards of fees from the appropriate court.

The elimination of the attorneys' fees restriction does not create any new substantive right to be awarded attorneys' fees, but removes the prohibition on the act of claiming, and collecting and retaining such fees. As such, the elimination of the restriction restores to LSC grantees and their clients the same right to claim, collect and retain those fees as other litigants in cases where attorneys' fees are permitted or mandated to be awarded under state and Federal law. Whether the LSC grantee or client actually receives attorneys' fees in a particular case remains an issue for the court to decide under the provisions of federal and state law that govern attorneys' fees in the case. However, the LSC appropriations act provision that restricted attorneys' fees should no longer be a consideration for a grantee in any determination of whether or not to seek attorneys' fees. As has always been true, the court should not consider the former attorneys' fees restriction in determining whether or not to award attorneys' fees. Interpretation of Part 1642 has always been the prerogative of LSC, and not the court in any particular case where an award of attorneys' fees was permitted or mandated.

As was discussed at length in the [previous CLASP memo](#) (CLASP Regulatory-Policy Memorandum 2010-1, Feb. 12, 2010, p 3), before undertaking any case in which attorneys' fees may be awarded, LSC grantees should consider Part 1609 (Fee-Generating Cases) and make sure that the requirements of that regulation have been met.

Grantees that plan to seek attorneys' fees should review and, if necessary, revise their retainer agreements to address issues raised by the elimination of the attorneys' fees restriction and the issues raised by the IRS ruling discussed below. CLASP requests any program that has revised its retainer agreement in response to the new LSC rules to submit a copy of its new retainer to Linda Perle at lperle@clasp.org. We will collect these retainer agreements and share them with other programs that are considering making revisions. We also plan to use these revised retainers to prepare a sample attorneys' fee retainer that can serve as a model for other programs.

IRS Ruling on Attorneys' Fees

On April 14, 2010, the Internal Revenue Service released a private letter ruling in a case involving a taxpayer who had been represented on a pro bono basis in a class action lawsuit by two legal aid organizations and a private law firm ([No. 2010150160](#)) that addressed the issue of whether attorneys' fees awarded directly to one of the legal aid organizations and the private law firm was taxable income to the taxpayer.

The taxpayer had entered into a retainer agreement with one of the legal aid organizations which provided that the legal aid organization would not charge the taxpayer a fee for its services. The law firm joined the legal aid organization as co-counsel and also agreed to represent the taxpayer at no charge. The second legal aid organization also agreed to represent the taxpayer at no charge, so the taxpayer had no obligation to pay any fees or other costs to the legal aid organizations or the private law firm. The taxpayer and its co-plaintiffs prevailed in the lawsuit, and one of the legal aid organizations and the law firm filed a motion for attorneys' fees and costs. The court awarded attorneys' fees and other costs directly to the legal aid organization and the private law firm. The question is whether these attorneys' fees are includible in the taxpayer's gross income for federal income tax purposes.

The IRS concluded that under the specific circumstances of this case, where the litigant had no obligation to pay attorneys' fees and the fees were not sought on behalf of the taxpayer, but directly by the legal aid organization and the private lawyer on their own behalf, the award of attorneys' fees is not includible as part of the taxpayer's gross income. The letter makes it clear that the ruling only applies to the taxpayer requesting it and only under the specific circumstances of the particular case. However, it does suggest the approach that IRS would likely take in other cases where there is a retainer agreement that makes it clear that a legal aid organization is not charging its client a fee and where the award of attorneys' fees is made directly to the program.

Grantees that intend to seek attorneys' fees should make sure that they have reviewed and, if necessary, revised their retainer agreements to take into account the concerns addressed in this letter ruling. Please send Linda Perle a copy of your revised retainer agreement provisions at lperle@clasp.org.

Supreme Court Ruling on Attorneys' Fees

The following article appeared in the New York Times on Thursday, April 11.

Supreme Court backs bonuses for lawyers' public interest work

By Robert Barnes
Thursday, April 22, 2010; A04

A group of public interest lawyers learned Wednesday that the Supreme Court giveth, and the Supreme Court taketh away.

On the one hand, all nine members of the court decided that civil rights lawyers who achieve extraordinary results on behalf of the dispossessed are entitled to a bonus for their good work.

On the other hand, five of the justices were not convinced that a children's rights group and a private law firm, which together won a transformation of Georgia's dysfunctional foster-care system, deserved the \$4.5 million bonus they received from the federal judge who oversaw the case. The majority sent the case back for another review of whether the lawyers should get that much.

The Supreme Court often reviews the work of lawyers who have done their job poorly. But in this case, the question was how to encourage public interest lawyers and private law firms to take on poor clients or those pressing civil rights claims, and how to reward those who do.

Federal law allows lawyers who prevail in such cases to recover their fees. U.S. District Judge Marvin H. Shoob calculated the work done by the group Children's Rights and Atlanta's Bondurant, Mixson & Elmore law firm over the eight years of the suit and ordered the state of Georgia to pay them \$6 million. He also awarded them a bonus of 75 percent, bringing the total to \$10.5 million.

Shoob said the lawyers displayed a "higher degree of skill, commitment, dedication and professionalism" than he had seen in decades on the bench. He added that, in "58 years as a practicing attorney and federal judge, the court is unaware of any other case in which a plaintiff class has achieved such a favorable result on such a comprehensive scale."

Georgia balked at paying the multimillion-dollar bonus and appealed, saying neither federal law nor Supreme Court precedent allowed such "enhancements."

The winning lawyers in the case were supported at the Supreme Court by an array of liberal and conservative public interest groups, but Wednesday's decision divided the justices into familiar ideological camps.

The conservative majority said in an [opinion](#) written by Justice Samuel A. Alito Jr. that Shoob "did not provide proper justification for the large enhancement that [he] awarded." Alito said Shoob's decision to increase the fee by 75 percent was "essentially arbitrary" and called his judgment that the lawyers deserved a bonus "impressionistic."

Alito said it should be presumed that the base rate is adequate compensation. In the "rare" cases in which it is not, it is up to the lawyers asking for extra money to justify the request, and up to judges to meet specific guidelines in awarding the bonus.

Alito said the federal law that requires reimbursement makes it "possible for persons without means to bring suit to vindicate their rights. But unjustified enhancements that serve only to enrich attorneys are not consistent with the [statute's](#) aim." He was joined by Chief Justice John G. Roberts Jr. and Justices Antonin Scalia, Anthony M. Kennedy and Clarence Thomas.

Justice Stephen G. Breyer complained that the majority should have decided only the question that prompted the case -- are enhancements allowed? -- and left it up to Shoob to pass judgment on how the lawyers had performed.

Breyer noted the years of work spent on the case, the complexity of the litigation and the reforms implemented by the state because of the suit.

"If the facts and circumstances that I have described are even roughly correct, then it is fair to ask: If this is not an exceptional case, what is?" Breyer wrote. He was joined by the court's liberals, Justices John Paul Stevens, Ruth Bader Ginsburg and Sonia Sotomayor.

The case is [Perdue v. Kenny A.](#)

If you have any questions about the status of the attorneys' fee restriction, please contact Linda Perle at CLASP at lperle@clasp.org or 202-906-8002. Also, please send

copies of any revisions you have made to your retainer agreements in light of the changes to the restriction and/or the IRS ruling discussed above.

Please note that CLASP has moved. Its new address is 1200 18th Street, NW, Suite 200, Washington, DC 20036. Linda's phone number and email address remain the same as before (lperle@clasp.org and 202-906-8002), but she has a new fax number which is 202-842-1174.