

Why Lawyers Shouldn't Accept Fees In Cryptocurrency: Part 1

By **John Reed Stark** (June 13, 2018, 12:54 PM EDT)

Law firms are increasingly accepting cryptocurrency as payment for services. While this might seem innovative and forward-thinking, ironically it is much more of a throwback.

Given that the IRS does not yet classify cryptocurrencies as legal tender, cryptocurrency is instead "property." This means that lawyers accepting cryptocurrency are more akin to famed lawyer (albeit fictional) Atticus Finch than famed bitcoin creator (albeit quasi-fictional) Satoshi Nakamoto.

Much like today's law firms who accept cryptocurrency from clients, Atticus Finch, the country lawyer of Harper Lee's "To Kill a Mockingbird," was very creative with his fee arrangements. For instance, in exchange for providing legal counsel regarding an entailment on the farm of his "down-and-out farmer neighbor" Walter Cunningham, Finch accepted as fees a load of stove wood, a sack of hickory nuts, a crate of smilax and holly, and (of course) a croker sack full of turnip greens. Finch was pleased with the transaction, as was Cunningham (except later on in the novel, when Cunningham threatened to shoot Finch, but that was a different situation, and I digress.)



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Would Atticus Finch go so far today as to accept cryptocurrency from a client? Perhaps. But law firms should think twice about the notion, and consider the comprehensive analysis of this two-part series, which discusses the broad range of significant risks law firms will confront when concocting cryptocurrency fee agreements with their clients.

Part one of the series provides some background and then focuses on the logistical and ethical issues law firms will encounter should they opt to accept cryptocurrency as fees. Part two of the series will focus on the statutory, regulatory and reputational implications of law firm cryptocurrency fee arrangements and conclude with some final thoughts looking ahead.

Some Background

That law firms are now accepting cryptocurrency in fee arrangements should really come as no surprise. In a highly competitive legal marketplace, where pressure is mounting for lawyers to attract clients, adding cryptocurrency into the mix of alternative fee arrangements seems enticing.

Concurrently, the legal and regulatory world is being upended by technological advances, from cryptocurrencies and blockchain to peer-to-peer lending and enhanced mobile financing, capturing the attention of Wall Street investors and industry regulators alike. The potential for financial and economic disruption is immense in the short and long term, particularly where blockchain is concerned — and the need for wise legal and compliance counsel to manage that disruption and growth is growing at an astronomical rate.

Hence the genesis of a new era of legal counseling quarterbacked by so-called fintech (short for "financial technology") lawyers and their respective fintech legal and compliance practice groups. Comprised of a hodgepodge of lawyers from existing and related disciplines, fintech law practice groups include:

- Privacy, data security, intellectual property and other cyber-related legal practitioners;
- Former regulators, prosecutors and other government attorneys who specialize in technology-related investigations and enforcement proceedings;
- Former congressional staffers and current congressional lobbyists, who concentrated their efforts toward technology-related legislation and rule-making and can navigate the hidden passages of Capitol Hill;
- Random technologists and information security specialists who can understand and “speak the language” of coding, engineering, cryptography and the myriad of other categories of circuitry-narrated know-how; and
- Any other designated tech-savvy lawyer who enjoys or appreciates the complex challenges associated with futuristic and game-changing technological advances.

What better way to attract the business of fintech than to create a financially friendly environment where a client's cryptocurrency fanaticism is not only inventively crafted and philosophically championed — but also enthusiastically embraced as consideration for legal services rendered. In fact, crafting cryptocurrency fee arrangements for legal services seems like a no-brainer, falling squarely within a slew of classic and basic legal marketing principles, including:

- Sharing the excitement of cryptocurrency offers a unique chance to become the trusted adviser of a client. The ultimate business development goal of attorneys is to become the trusted adviser of their clients. Accepting cryptocurrency is pioneering, risky and dangerous — which means a lawyer is leaping down into a foxhole with a client, the best of all places to build a genuine and ironclad relationship of trust and confidence;
- The medium can become the message. By accepting cryptocurrency as payment, a law firm is demonstrating its commitment to creativity, modernization and originality — traits that clients might appreciate and find compelling;
- Payment flexibility can attract business in and of itself. Given that accepting debit and credit cards online can make a law firm more appealing to current and potential clients, so too can accepting other forms of payment, including cryptocurrencies;
- Accepting cryptocurrency can serve as an alternative means of continuing legal education. Warehousing, trading and handling cryptocurrency allows for the exercise of “learning by doing,” always a preference for legal experts; and
- Lawyers can take advantage of the chance to demonstrate tangible support for a client’s enterprise. By “putting your money where your mouth is,” fintech legal practitioners in particular can prove themselves true believers in the future of technology-driven digital currency, setting themselves apart from their scribe competitors who remain content to observe the crypto revolution from the safety and shelter of the sidelines.

But having said all of the above, the risks for a law firm that accepts cryptocurrency run a perilous gamut of legal, regulatory, financial, ethical and reputational dangers. Simply stated, accepting cryptocurrency as a fee payment in today’s crypto-maniac environment is, despite all of the bus dev allure, just not worth it.

Cryptocurrency Conversion Concerns: Costly, Complicated and Risky

The logistics of accepting cryptocurrency are unique, complicated and problematic. It is not as if a law firm’s controller can stroll across the street and convert cryptocurrency to U.S. dollars, record the data in a firm's accounting software, and be back in time for a partnership meeting. First, the law firm must identify a reliable and trustworthy financial institution to safeguard the cryptocurrency (some sort of digital wallet) and to convert the cryptocurrency upon demand.

Where can a law firm find this kind of honorable, respected and U.S.-registered financial institution? Not among Wall Street's traditional ranks for sure. The institutions servicing cryptocurrency clients are barely in their infancy. There is no central regulatory authority; no state or federal team of bank auditors and compliance experts monitoring transactions; no proven licensure for any of the participants at the cryptocurrency institutions — it's not just the Wild West, it's global anarchy.

Furthermore, even if a law firm could identify a respectable institution to convert its cryptocurrency to cash, there remain other problems. For instance, by registering and interacting with the cryptocurrency institution, the law firm is inviting not just possible identity theft but also exposing its operations to a potential cyberattack.

Unlike Fed-insured banks and U.S. Securities and Exchange Commission-registered broker-dealers, cryptocurrency platforms and operators might not abide by a rigorous regime of cybersecurity rules and requirements, and likely lack not only appropriate cybersecurity practices, policies and procedures, but also skilled data security personnel and hardened cyberinfrastructure. This creates vulnerabilities not just to external threats but threats from their own internal employees, customers, contractors and operators.

A law firm must also maintain the proper record-keeping and accounting requirements of the cryptocurrency. This allows for audit, reporting and cash management — not just for the due diligence of the transaction but also for paying the partners, shareholders and other employees of the law firm. Even when a law firm becomes satisfied by the process, the law firm must establish rigid internal controls so that the cryptocurrency is not somehow stolen or wrongfully depleted by hackers or insiders. The more technical the cryptocurrency process the more easily manipulated or hijacked by the few internal experts schooled on its remittance.

Even the simple issue of decimal points can cause problems. For example, most accounting systems do not process more than two decimal places, because most regular currencies do not fall below cents. Cryptocurrencies, on the other hand, can go down to 18 decimal places. Law firm accounting systems cannot handle this conflict and until software packages develop for managing multiple decimal points, any cryptocurrency accounting will have to be done manually (and painstakingly).

Cryptocurrency Valuation Concerns: Wild Price Fluctuations

From a practical standpoint, accepting cryptocurrency also carries with it risks relating to its extraordinary price fluctuations. For example, bitcoin has had an exceptionally volatile price history. At around this time last year, bitcoin was trading at a price slightly higher than \$2,000, according to CoinMarketCap. By the end of 2017, it had reached its all-time high of around \$20,000 and a market cap of more than \$325 billion, marking an unprecedented surge.





Yet, the first quarter of 2018 has not been nearly as euphoric for the largest cryptocurrency, either in terms of market capitalization or price. As of the end of May, bitcoin was trading at around \$8,400 with a market cap of just over \$143 billion — a loss of more than 50 percent of its December 2017 value.

Navigating this financial rollercoaster ride during the typical timeline of law firm engagement (such as the negotiating phase, estimating phase, pricing phase, contract phase, invoice phase and payment phase) is laden with extraordinary financial risk to say the least.

Merely pinpointing the appropriate price for a cryptocurrency is challenging. For example, different payment processors convert bitcoin at different prices because there exists no single market price for bitcoin. Markups and manipulations can thrive and the customer may have nowhere else to turn but a crooked, irresponsible or incompetent payment transmitter.

Relatedly, aside from rabid price fluctuations, there are also unsightly, unreasonable and hefty commissions and other transaction fees that cryptocurrency exchanges typically charge when converting cryptocurrency into cash. Determining who bears the burden of these unpredictable and sizable costs is challenging. Likewise, if a client insists, or a law firm requires, that the law firm hold a retainer in cryptocurrency to draw fee payments from, who receives the windfall if the cryptocurrency increases and who must endure the loss if the cryptocurrency value craters?

Cryptocurrency Ethical Concerns: Complex and Far-Reaching

Accepting cryptocurrency as payment prompts an odd assortment of ethical issues for lawyers, many of which raise more questions than answers.

First off and above all else, a lawyer has certain obligations that arise from the essential ethics of the legal profession (as an officer of the court), including and especially an obligation not to support or facilitate criminal activity.

Thus, lawyers accepting cryptocurrency as payment must have reasonable policies, practices and procedures in place to ensure fee arrangements are not somehow facilitating criminal activity. Awareness, vigilance, recognizing red-flag indicators and caution are a lawyer's best tools in assessing situations that might give rise to concerns of money laundering, terrorist financing or other similar conduct.

Know Your Client Responsibilities

Lawyers who take cryptocurrencies as payment from a third party for legal services to a client should use standard "know your client" procedures to identify the payer. For instance, a law firm must ensure that whoever is paying a client's fees does not interfere with the law firm's independence or relationship with their client. Along these lines, this step is also critical to enable lawyers to comply with the ethics rules on third-party fee arrangements, conflicts of interest, and lawyer-client confidentiality.

But confirming the identity of a cryptocurrency payor is not easy — especially given that the *raison d'être* of cryptocurrency is to provide anonymity. In fact, when it comes to the origins of cryptocurrency payments, lawyers might have an easier time verifying the bonafides of a gym bag filled with cash and loose change.

The mere investigation of the identifiers within cryptocurrency payment trails poses immediate problems. Within the cryptocurrency world, there exist few traditional financial institutions

involved and scant licensed professionals performing any sort of gatekeeper function. In short, there is no simple path of due diligence — like a phone call or even a Google or Lexis search — that can instantaneously ease identification concerns.

Almost by definition, the world of cryptocurrency is cloaked and fortified by a shroud of mystery, circuitry and shadowy figures. To exacerbate matters, cryptocurrency patrons and promoters rarely break ranks, circling their sacred wagons of secrecy, anonymity and universal propriety.

Overpayment Concerns

Cryptocurrency pricing can be wildly volatile, and given that lawyers are prohibited from charging unreasonable fees for legal services, lawyers accepting cryptocurrency risk possible unconscionable overpayment for services, especially given the typical billing and payment cycle and delays for legal invoices.

With such rapidly changing cryptocurrency prices, a law firm cannot ensure that they are charging their client a consistent price. For instance, given this volatility, a billable fee of one bitcoin could cost a client wildly different prices based on the market's behavior that day. Cryptocurrencies also raise particular concerns for determining the appropriate value and whether the client is truly informed as to the nature of a fee. Although law firms are working around cryptocurrency volatility by quickly exchanging cryptocurrencies into fiat, delays could still distort transactions between them and their clients.

Safeguarding Cryptocurrency

Lawyer has very specific ethical obligations with respect to the safeguarding, care and protection of client funds such as retainers, advances, settlements and the like — another area that is strictly regulated, aggressively policed by every state, and of increasing concern to state bar associations.

With respect to warehousing cryptocurrencies in any kind of trust account, lawyers will face an array of challenging issues. For instance, cryptocurrencies cannot simply be deposited into a bank account like traditional currency and would need to be handled as property instead, where its handling requires not just financial competence but technological expertise as well. Not only do most law firms typically lack the technological sophistication to manage and properly execute inherently intricate cryptocurrency transactions, but also no state regulatory bar association is currently equipped to audit properly cryptocurrency transactions and storage.

Any sort of technological mishap can be fatal to a cryptocurrency payment, and, once lost or stolen, cryptocurrencies can be gone forever. Whether by mishap or cyberattack, once a cryptocurrency is pilfered, depleted, absconded with or compromised, there are no banks and there is no Federal Deposit Insurance Corp. insurance to reimburse a cryptocurrency owner.

Given that lawyers must employ reasonable methods to protect the cryptocurrency that they are handling, managing and trading, just the task of conjuring up a reliable and acceptable set of cryptocurrency practices and procedures could be overwhelming (and by necessity, must remain in a constant state of flux). Unfortunately, safeguarding cryptocurrency is not yet a course offered by any law school, so most lawyers will have to wing it — not a preferred modus operandi when it comes to issues of finance, taxes and compensation.

Nebraska, Lawyers and Cryptocurrency

The first (and apparently the only) state to officially weigh in on the ethics of whether a law firm can receive cryptocurrency as payment is Nebraska, which held, in a Sept. 11, 2017, opinion,^[1] that lawyers may accept payment in digital currencies but must immediately convert the money into U.S. dollars.

Although law firms across the country have announced that they accept cryptocurrency for payment, Opinion 17-03 is the first state bar opinion on whether attorneys can do so in compliance with the Model Rules of Professional Conduct, the most widely adopted system of legal ethical rules.

Nebraska noted that lawyers who receive payment in digital currencies should take three steps

Nebraska noted that lawyers who receive payment in digital currencies should take three steps. First, the lawyer should notify the client that the payment will be immediately converted to U.S. dollars. Second, the lawyer should make the conversion through a payment processor. Third, the lawyer should credit the client's account at the time of payment.

The opinion also says that:

[Lawyers who accept virtual currency] must be careful to see that this property they accept as payment is not contraband, does not reveal client secrets, and is not used in a money-laundering or tax avoidance scheme; because convertible virtual currencies can be associated with such mischief.

With respect to client trust accounts, Nebraska lawyers may only hold digital currencies in trust for clients after advising that the currency will be converted to U.S. dollars, but the currency must be held separate from the lawyer's property and must be properly safeguarded. The Nebraska opinion also admonishes lawyers that they should take safeguarding precautions such as encryption or use of more than one private key for access.

The committee said lawyers must take reasonable security precautions when they receive client payments in cryptocurrency or share them on behalf of clients. The opinion suggested that reasonable methods could include:

- Encrypting the private key required to send the cryptocurrency;
- Using more than one private key for access to the cryptocurrency; and
- Maintaining the wallet in a computer or other storage device that's disconnected from the internet, which would also allow for offline storage of private keys.

The Nebraska opinion seems to assume that an escrow involving lawyers and clients would occur in the same way as an ordinary escrow arrangement (even though cryptocurrency is property and not currency), in which the client gives complete control of the funds over to the lawyer. Therefore, if a cryptocurrency payment is intended to serve as a retainer that will be drawn on for future fees, Nebraska requires that the lawyer must immediately convert the cryptocurrency to U.S. dollars before the deposit into the trust account.

Although Nebraska Opinion 17-03 addresses only the conduct of attorneys licensed to practice law in the state of Nebraska, other states that have adopted, or used iterations of, the Model Rules of Professional Conduct may see the opinion as a guide for their own judicial systems or bar associations.

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[1] <https://supremecourt.nebraska.gov/sites/default/files/ethics-opinions/Lawyer/17-03.pdf>