ETHICS OPINION 080711

FACTS:
Attorney proposes using a fixed fee contract in the representation of defendants in criminal cases. The attorney requests the Committee's opinion on these types of contacts and the requirements that should be included in them.

QUESTION PRESENTED:
Are fixed fees or flat fees permitted under Montana's Rules of Professional Conduct?

SHORT ANSWER:
Yes, Montana Rule of Professional Conduct (MRPC 2004) Rule 1.5 permits a lawyer to charge a fixed or flat fee, provided that the agreement meets other obligations of professional conduct, including full disclosure to the client, reasonableness of fees, refund obligations, and depositing finds. The use of the terms "nonrefundable" and "earned on receipt" are discouraged.

DISCUSSION:
1. Governing Ethics Principles

A. Reasonableness of Fees and Refund Obligations
A lawyer may not make an agreement for, charge, or collect an unreasonable fee. MRPC 1.5 (a) states:

> (a) A lawyer shall not make an agreement for, charge or collect an unreasonable fee or an unreasonable amount for expenses. The factors to be considered in determining the reasonableness of a fee include the ollowing:
>
> > (1) the time and labor required, the novelty and difficulty of the questions involved and the skill requisite to perform the legal service properly;
> > (2) the likelihood, if apparent to the client, that the acceptance of the particular employment will preclude other employment by the lawyer;
> > (3) the fee customarily charged in the locality for similar legal services;
> > (4) the amount involved and the results obtained;
> > (5) the time limitations imposed by the client or by the circumstances;
> > (6) the nature and length of the professional relationship with the client;
> > (7) the experience, reputation and ability of the lawyer or lawyers performing the services; and
> > (8) whether the fee is fixed or contingent.

Because of the fiduciary relationship between an attorney and a client, contracts for legal services are not construed as are other commercial contracts. Cf. Morse v. Espeland (1985), 215 Mont. 148, 151, 696 P.2d 428, 430 ("Unquestionably, an attorney has a fiduciary relationship with a client on most matters pertaining to the representation . . . However, with respect to the negotiation of a fee, an attorney must necessarily deal at arms length with a client" [Citation omitted].)

> It is a misconception to attempt to force an agreement between an attorney and his client into the conventional modes of commercial contracts. While such a contract may have similar attributes, the agreement is, essentially, in a classification peculiar to itself. Such an agreement is permeated with the paramount relationship of attorney and client which necessarily affects the rights and duties of each.

Heinzman v. Fine, Fine, Legum & Fine, 217 Va. 958, 962 (1977).

Consequently, contracts between clients and lawyers are construed from the standpoint of a reasonable person in the client's circumstances, and the lawyer bears the burden of ensuring that the contract states any terms, including fee terms, diverging from a reasonable client's expectations. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS ("RESTATEMENT") §18(2), cmt. h (2000). In entering into fee agreements with clients, lawyers must communicate honestly about billing and collection issues. See MRPC 8.4(c) (it is professional misconduct for a lawyer to engage in conduct involving dishonesty, fraud, deceit, or misrepresentation); MRPC 7.1 ("A lawyer shall not make a false or misleading communication about the lawyer or the lawyer's services.") See also RESTATEMENT §§16(3), 49 (lawyer's failure to deal
honestly with the client in matters within the scope of the representation actionable as a breach of fiduciary duty).

While reasonableness is ordinarily determined when the agreement between the client and the lawyer is made, in some circumstances the reasonableness of a fee agreement must be reevaluated because subsequent unforeseen events have so altered the relationship between the lawyer and the client that a fee agreement that was reasonable at the time the agreement was made is no longer reasonable. WSBA Informal Ethics Opinion No. 2034 (2004). Examples of such subsequent events include, but are not limited to, death of the client or lawyer, lawyer's loss of his license, or failure of lawyer to perform the contracted services. *Id.*

The Rules may create fee refund obligations. Thus, a violation of the MRPC 1.5(a) reasonableness requirement may result in denial or disgorgement of fees. In addition, a client retains the absolute right to discharge the lawyer at any time for any reason or without reason. MRPC 1.16(a) imposes no restriction or condition on the client's right to discharge his lawyer. At the end of a representation, including discharge for no good cause by the client, lawyers are required by MRPC 1.16(d) to refund advance payments that have not been earned. *See* Minnesota Formal Ethics Op. 15 (1991), Ohio Informal Ethics Op. 90 8 (1990), Virginia Ethics Op. 1322 (1990), and Washington Ethics Op. 186 (1990) (explaining difference between general retainer, which is earned upon receipt, and advance fee payment, which isn't).

B. Depositing Funds

All funds of clients paid to a lawyer or law firm, including advances of costs and expenses, must be deposited in a trust account. With limited exceptions, no funds belonging to the lawyer may be deposited or retained in a trust account. MRPC 1.15(a) and 1.18. See also *In the Matter of Joseph Engel, III*, 2007 MT 172, ¶¶ 40-41. One of the exceptions to this general rule is that if a lawyer is in "possession of property in which both the lawyer and another person claim interests, the property shall be kept separate by the lawyer until there is an accounting and severance of

their interests. If a dispute arises concerning their respective interests, the portion in dispute shall be kept separate by the lawyer until the dispute is resolved." MRPC 1.15(a)(2).

2. Treatment of General Retainer Fees and Advance Payments.

A. General Retainer Fees

A general retainer, also commonly called a true retainer, engagement retainer, classic retainer, or a retainer for availability, is "a fee paid, apart from any other compensation, to ensure that a lawyer will be available for the client if required." RESTATEMENT § 34, cmt. e. A fee is a general retainer only if the lawyer is to be additionally compensated for actual work to be performed (if any). RESTATEMENT §34, cmt. e. See *Ryan v. Butera, Beausang, Cohen & Brennan*, 193 F.3d 210, 15 Law. Man. Prof. Conduct 501 (3d Cir. 1999).

As with all fees, a general retainer fee must be reasonable under MRPC 1.5(a). As explained in the Restatement, it will be considered reasonable

> if it bears a reasonable relationship to the income the lawyer sacrifices or expense the lawyer incurs by accepting it, including such costs as turning away other clients (for reasons of time or due to conflicts of interest), hiring new associates so as to be able to take the client's matter, keeping up with the relevant field, and the like. When a client experienced in retaining and compensating lawyers agrees to pay an engagement retainer fee, the fee will almost invariably be found to fall within the range of reasonableness. Engagement retainer fees agreed to by clients not so experienced should be more closely scrutinized to ensure that they are no greater than is reasonable and that the engagement retainer fee is not being used to evade the rules requiring a lawyer to return unearned fees . . .

Id.; see also MRPC 1. 5(a)(2) (a factor in determining the reasonableness of a fee is "the likelihood, if apparent to the client, that the acceptance of the particular employment will preclude other employment by the lawyer.")

Moreover, full disclosure of the general retainer arrangement is required. See RESTATEMENT § 38, cmt. g ("Clients who pay a fee without receiving an explanation ordinarily will assume that they are paying for services, not readiness.") At a minimum, the lawyer should inform the client, preferably in writing, of the time period of the lawyer's availability, that the client will be separately billed for any services subsequently provided, and that the lawyer will treat the payment as the lawyer's property upon receipt.

If a lawyer and client agree upon the payment of a general retainer fee that meets the reasonableness requirement of MRPC 1.5(a), it is property owned by the lawyer when received and, under MRPC 1.15(a), it must not be deposited into a trust account. As with all fees, and regardless of the descriptive words used by the parties in their fee agreement, a general retainer fee is subject to a continuing requirement of reasonableness.

B. Advance Payments

Advance payments may also be made to lawyers for services to be rendered in the future. Such

arrangements present an attractive option for both the client and the lawyer. They allow clients to secure their choice of counsel, and in some forms (e.g., lump sum/flat fee arrangements, discussed below), they cap the amount of fees the client must pay, allowing the client to budget for a fixed sum and avoid escalating hourly fees. For lawyers, these arrangements eliminate the risk of non payment after the work is completed. The ethics rules permit advance fee arrangements if they are reasonable.

In the absence of an agreement between the lawyer and client to the contrary, advance payments are presumed to be deposits against future services. See RESTATEMENT §38(3)(c) & cmt. g. Also absent an agreement to the contrary, an advance payment for services to be rendered belongs to the client until earned by the lawyer. For example, a lawyer may collect an amount from the client in advance of any work and then deduct from the amount based on the actual hours worked or mutually agreed upon "milestones" reached during representation. Advance payments for services that belong to the client until earned must initially be deposited in the lawyer's trust account and may be withdrawn when due unless the right of the lawyer or law firm to receive it is disputed by the client. MRPC 1.15 (a) and (c).

In the Matter of Joseph Engel, III, 2007 MT 172, ¶¶ 40-41, the Montana Supreme Court held that:

> Rule 1.18, MRPC, when read in its entirety, affords a lawyer a certain amount of discretion in determining whether a client's funds must be placed in an IOLTA account or a client trust fund. Thus, Engel might have faced a legitimate choice between whether to deposit the retainers in an IOLTA account or a client trust account. The rule does not give the lawyer the option, however, of placing the client's funds in the lawyer's operating account. In fact, Rule 1.15, MRPC, forbids the commingling of such funds. The rule requires a lawyer to hold his client's property in connection with representation separate from the lawyer's own property.
>
> Engel deposited the $20,000 and $50,000 retainers into his operating account rather than depositing the funds in an IOLTA account or a client trust account. This act violates Rules 1.15 and 1.18, MRPC. We cannot accept, and the rules do not condone, Engel's explanation that he soon would earn the funds, and thereby justify his decision to place the client funds in his operating account.

The Rules and the Engel case do not, however, clearly prohibit a lawyer and client from ***agreeing*** that advance payments are property of the lawyer that need not be initially deposited in a client's trust account. Such fees, if they are reasonable under MRPC 1.5(a) (taking into account the lawyer's disclosure duties discussed below), must remain subject to (1) the continuing requirement that fees be reasonable under MRPC 1.5(a), and (2) the lawyer's obligation to refund unearned fees upon termination of the representation under MRPC 1.16(d).

As noted above, it is the lawyer's duty to ensure that the agreement between the lawyer and client states any fee terms diverging from a reasonable client's expectation. See *In re Schwartz*, 686 P.2d 1236, 1243 (Ariz. 1984)) (because a fee agreement between lawyer and client is not an ordinary business contract, "[t]he profession has both an obligation of public service and duties

to clients which transcend ordinary business relationships and prohibit the lawyer from taking advantage of the client"). The reasonable client's expectation is that advance payments belong to the client until they are earned by the lawyer and will be initially deposited in trust and withdrawn by the lawyer as they are earned. If an agreement diverges from this expectation, therefore, the lawyer must disclose those fee terms fully and in a manner that can be reasonably understood by the client. See MRPC1.5(b).

In determining the appropriate disclosure to the client, lawyers must also keep in mind their legal and ethical duty to communicate with clients accurately and honestly, a principle that applies with full force in the context of lawyer client fee arrangements. Labels such as "earned upon receipt" or "nonrefundable," by themselves, are far more likely to mislead clients than to render such arrangements reasonable or the communications about them honest or accurate. This is because advance payments of fees are not "earned" until the lawyer performs the service or otherwise confers a benefit on the client, and the requirement to refund unearned fees upon termination of the representation under RPC 1.16(d) applies even if the fees are labeled "nonrefundable."

In short, the ethical propriety of a fee arrangement depends on the substance of the transaction and its accompanying disclosure, not on the label used to describe it.

The disclosure required when advance payments are treated as the lawyer's property upon receipt depends on all the circumstances, including the nature of the fee arrangement, the client's sophistication and experience in dealing with fee issues, and the history of the relationship between the lawyer and the client. At a minimum, and unless circumstances dictate otherwise, the client should be informed of the following
matters, preferably in writing:

- The specific services that will be provided in exchange for the advance fee payment;
- That the lawyer will treat the advance payment as the lawyer's property upon receipt;
- That the advance payment arrangement has no effect on the client's right to terminate the lawyer client relationship; and
- That the lawyer will have an ethical obligation to refund advance payments to the extent they become unreasonable.

Differing arrangements will require differing disclosures.

The term "fixed fee" is used to designate a sum certain charged by a lawyer to complete a specific legal task. A fixed fee is an advanced legal fee. Unless the lawyer and client agree otherwise, a fixed fee remains the property of the client until it is actually earned and must be deposited in the attorney's trust account. If the client ends the representation, even if such termination is without cause and constitutes a breach of the contract, the client is entitled to a refund of that portion of the fee that has not been earned by the lawyer at the time of the termination.

A written fixed fee agreement should clearly inform the client: 1) what portion of the retainer is considered to be fixed; 2) that earning the fixed fee is conditioned on the absence of default by

the lawyer; and 3) what circumstances may entitle the client to a disgorgement of all or part of the "fixed" amount. Since the fixed fee may be agreed to be earned upon payment, it should be deposited into the attorney's general operating
account rather than in his trust account. The unearned portion must go into the trust account. However, the attorney may be required to return a portion of the fixed fee if the fee is clearly excessived under Rule 1.5; e.g., as a result of changed circumstances, failure to perform the requested services, failure to convey any benefit to the client, or the lawyer suffered no lost employment from the engagement.

The Montana Supreme Court has not addressed whether an attorney may under any circumstances have a "nonrefundable" fee. Other states have addressed this issue and reached varying conclusions.

For example, *In Re Sather*, 3 P.3d 403 (Colo. 2000) involved an attorney who collected $20,000 as a "non refundable" advanced fee for a civil case and then failed to place the funds into his trust account. The Court held that because Mr. Sather treated the advance fee as his own property before earning the fee, his conduct violated Colo. RPC 1.15(a). However, he was not disciplined for this violation. The Court also found that Mr. Sather's labeling the $20,000 fee as "non refundable," even though he knew the fee was subject to refund under certain circumstances, violated Colo. RPC 8.4(c). After being discharged by his client, Mr. Sather failed to return the unearned portion of the $20,000 fee promptly, thereby violating Colo. RPC 1.16(d).

In *Bain v. Weiffenbach*, 590 So. 2d 544 (Fla. App. 1991), another court came to a different conclusion. In that case, a client filed suit to recover a portion of a $10,000 "nonrefundable" retainer paid to his attorney for representation in a criminal case. Relying heavily on Ethics Opinion 76 27 of the Florida State Bar, the Court analyzed the entire fee on whether it was reasonable, accepting that non refundable retainers are not per se prohibited. The Florida Court of Appeals posed the question as follows:

> If a substantial 'nonrefundable retainer' which is in part a prepaid fee is paid to an attorney and, before the attorney performs any service under the contract, the client dies, or fires the attorney, or the services called for by the contract are no longer needed for some other reason, would the attorney be guilty of charging a clearly excessive fee under DR 2 106(A) if he refused to refund any of the 'nonrefundable retainer'?

The Court went on to analyze the question and concluded that such a fee was neither automatically prohibited nor automatically permitted.

> Such a lawyer might, but would not necessarily be, guilty of charging an excessive fee . . . We interpret the question as referring to a payment by a client to a lawyer of a sum of money designated as 'nonrefundable
> retainer,' part of which is intended to compensate the lawyer for being available but not for specific services, and part of which is intended as a present payment for legal services to be performed in the future. If the

> lawyer performs no legal services, obtains no benefits for the client and has not lost other employment opportunities as a result of agreeing to represent the client, we believe he might well be guilty of charging an excessive fee if he refused to refund part of it . . . On the other hand, a lawyer of towering reputation, just by agreeing to represent a client, may cause a threatened lawsuit to vanish and thereby obtain a substantial benefit for the client and be entitled to keep the entire amount paid to him, particularly if he had lost or declined other employment in order to represent that particular client . . . We do not believe that, by designating a retainer as 'nonrefundable,' a lawyer automatically insulates himself from a claim that the fee is excessive. Whether the fee is excessive is governed by DR 2 106 rather than use of the description 'nonrefundable retainer.'

Other courts and ethics opinions have split on the issue. *AFLAC, Inc. v. Williams*, 1994 Ga. LEXIS 466 (Ga. 1994); *County of Campbell v. Howard*, 133 Va. 19 (1922) (quantum meruit recovery); *In the Matter of Edward M. Cooperman*, 83 N.Y.2d 465, 633 N.E.2d 1069, 611 N.Y.S.2d 465 (N.Y. 1994) (A non refundable fee compromises the client's unqualified right to terminate the attorney client relationship); *Heinzman v. Fine, Fine, Legum& Fine*, 217 Va. 958 (1977) (Contracts for legal services are not construed as are other commercial contracts); *Mullins v. Richlands National Bank*, 241 Va. 447 (1991) (reasonableness factors); *Tazwell Oil Co. v. United Virginia Bank*, 243 Va. 94 (1992) (reasonableness factors); *Wong v. Kennedy*, 1994 U.S. Dist. LEXIS 6875 (E.D.N.Y. 1994) (Using the term "retainer" to describe what is, in reality, an advanced legal fee does not change the true nature of the fee, nor does it allow the fee to be considered non refundable); *Wood v. Carwile*, 231 Va. 320 (1986) (quantum meruit recovery); *Jacobson v. Sassower*, 483 N.Y.S.2d 711 (N.Y. App. Div., 1st Dept. 1985) (Whether a non refundable retainer has a "chilling effect" on a client's right to discharge the attorney depends on a "full exploration of all the facts and circumstances of a particular case, including the intent of the parties and whether the fee demanded is out of proportion to the value of the attorney's services"); *In re Cook*, 526 N.E.2d 703 (Ind. 1988) (review of reasonableness and whether any portion is nonrefundable); *Jennings v. Backmeyer*, 569 N.E.2d 689 (Ind. App. 1991) (same); *Smith v. Binder*, 477 N.E.2d 606 (Mass. App. 1985) (same); *Brandes v. Zingmond*, 573 N.Y.S.2d 579 (Sup. Ct. N.Y. 1991) (same); Alabama Ethics Op. 93 21 (1993) (lawyer may not characterize fee as nonrefundable); Iowa Ethics Op. 95 32 (1996) (lawyer may not use retainer agreement that provides for nonrefundable minimum fee that must be paid once "substantial work" is done for client); *In re Kendall*, 804 N.E.2d 1152, 20 Law. Man. Prof. Conduct 174 (Ind. 2004) (lawyer may not declare advance fee payments to be "nonrefundable"); *In re Dawson*, 8 P.3d 856, 16 Law. Man. Prof. Conduct 546 (N.M. 2000) (nonrefundable unearned fees are not reasonable as required by rules).

Nonrefundable fees are not forbidden by the RESTATEMENT, but comment 9 to Section 38(3)(c) indicates that lump sum fee payments are presumed to be a deposit against future services and not an "engagement retainer." The Reporter's Note to Section 38 indicates that nonrefundable retainer arrangements have been rejected by a number of courts and commentators, and cautions that nonrefundable retainers may violate ethics rules that call for lawyers to return all unearned fees.

Even the authorities that do not wholly disapprove of nonrefundable retainers are careful to point out that the facts of any particular representation may render such a fee unreasonable or excessive, warranting much caution in their use. Opinions generally approving limited use of nonrefundable fees include Arizona Ethics Op. 99 02 (1999); Maryland Ethics Op. 87 9; Michigan Informal Ethics Op. RI l0 (1989); Nevada Ethics Op. 15 (1993); Pennsylvania Ethics Op. 93 201 (1994); Texas Ethics Op. 431 (1986); and Wisconsin Formal Ethics Op. E 93 4 (1993). See also Stalls v. Pounders, 2005 Tenn. App. LEXIS 42, 21 Law. Man. Prof. Conduct 53 (Tenn. Ct. App. 2005) (nonrefundable fee agreement enforceable if client fully understood contract, attorney and client had same understanding, and terms are "just and reasonable.")

Based upon the above ethics principles, and for the following reasons, the Committee discourages the use of descriptive labels such as "nonrefundable" or "earned upon receipt" for advance payment arrangements:

1. A non refundable fee may compromise the client's unqualified right to terminate the attorney client relationship under MRPC 1.16(a). See, e.g., In the Matter of Edward M. Cooperman, supra. The client's absolute right to discharge a lawyer retained would be of little value if the client must risk paying for services not rendered. Such a situation could force the client to continue the services of an attorney in whose integrity, judgment or capacity the client had lost confidence.

2. If the client discharges the lawyer prior to the fee being earned, the retention of a nonrefundable fee would violate the attorney's responsibility to refund to a client any advanced fee that had not been earned under MRPC 1.16(d).

3. A fee that is not earned is per se an unreasonable fee. Thus the retention of an unearned non refundable fee would result in the lawyer collecting an unreasonable fee in violation of MRPC 1.5(a).

If such terms are used, the language should be qualified and explained to ensure that clients are not misled about the lawyer's potential refund obligations under the ethics rules. For all advance payment arrangements where funds are treated as belonging to the lawyer, the touchstone is whether the disclosure is reasonable from the standpoint of the particular client under the particular circumstances.

Finally, it bears emphasizing that these disclosure principles apply to all advance payment and so called "special retainer" arrangements, including any form of lump sum, flat, or prepaid fee, fee deposits," regardless of their form or label. Because a fee is an engagement retainer only if the lawyer is to be additionally compensated for actual work performed, the disclosure principles in this section also apply to payments denominated as a general retainer (i.e., a payment for the lawyer's availability) that will be applied, in whole or in part, to the billing for services to be rendered.

CONCLUSION:
Montana Rule of Professional Conduct (MRPC 2004) Rule 1.5 permits a lawyer to charge a fixed or flat fee, provided that the agreement meets other obligations of professional conduct, including full disclosure to the client, reasonableness of fees, refund obligations, and depositing funds.

THIS OPINION IS ADVISORY ONLY