# THE ETHICS OF BILLING AND COLLECTING FEES AND EXPENSES

## Hypotheticals and Analyses*

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* These analyses primarily rely on the ABA Model Rules, which represent a voluntary organization's suggested guidelines. Every state has adopted its own unique set of mandatory ethics rules, and you should check those when seeking ethics guidance. For ease of use, these analyses and citations use the generic term "legal ethics opinion" rather than the formal categories of the ABA's and state authorities' opinions -- including advisory, formal and informal.

# TABLE OF CONTENTS

# "Retainer" Payments

## Hypothetical 1

You just moved to another law firm, and you are studying that law firm's policies and procedures. Among other things, the new firm requires that in nearly every case a lawyer insists that new clients send the law firm a "retainer" payment before the firm begins working for that client.

One of your firm's senior partners explains that a "retainer" represents the client's payment for the firm's availability, while another senior partner insists that a retainer is simply a deposit against which your firm will bill as it performs services. They also disagree about whether your firm can insist on a "nonrefundable" retainer from clients.

**(a)** Does a client's "retainer" payment represent an amount the client pays to assure your firm's availability?

**MAYBE**

**(b)** Can a lawyer insist that a client pay a "nonrefundable" retainer?

**NO (PROBABLY)**

## Analysis

Unfortunately, lawyers often use the term "retainer" without indicating exacting what that term means.

**(a)** States vary widely in their recognition of various types of "retainers" that lawyers may insist clients pay. To make matter even more complicated, states articulate these various possibilities in a variety of ways -- ethics rules, legal ethics opinions and case law.

Two states' analyses highlight the tremendous variation.

- **[E-1346]** North Carolina LEO 2008-10 (10/24/08) (in a compendium opinion about fees, explain the four existing types of fees paid in advance, and creating a new type of permissible fee to be paid in advance -- called a "minimum fee"; explaining the four different types of fees that can be paid in advance: (1) Advance Payment: a deposit by the client of money that will be

billed against, usually on an hourly basis, as legal services are provided; not earned until legal services are rendered; deposited in the trust account; unearned portion refunded upon the termination of the client-lawyer relationship; (2) General Retainer: consideration paid at the beginning of a representation to reserve the exclusive services of a lawyer but not used to pay for actual representation; generally used when corporate or business clients have a specific need to consult a lawyer on a regular basis; earned upon payment; paid to lawyer or deposited in firm operating account; some or all of the retainer is subject to refund if clearly excessive under the circumstances as determined upon the termination of the client-lawyer relationship; (3) Flat Fee or Prepaid Flat Fee: fee paid at the beginning of a representation for specified legal services on a discrete legal task or isolated transaction to be completed within a reasonable amount of time; fee pays for all legal services regardless of the amount of time the lawyer expends on the matter; if client consents, treated as earned immediately and paid to the lawyer or deposited in the firm operating account; some or all of the flat fee is subject to refund if clearly excessive under the circumstances as determined upon the termination of the client-lawyer relationship; (4) Hybrid Fee: fee paid at the beginning of a representation that is in part of a general retainer or a flat fee and in part an advance payment to secure the payment of fees yet to be earned; one portion of the fee is earned immediately and the other remains the client's property on deposit in the trust account; client must consent and agree to the portion that is a flat fee or a general retainer and earned immediately; unearned portion of the advance payment refunded upon termination of the client-lawyer relationship; flat fee/general retainer portion subject to refund if clearly excessive under the circumstances as determined upon the termination of the client-lawyer relationship.").

- **[E-843 N 1/10]** Smith v. United Salt Corp., Case No. 1:08cv00053, 2009 U.S. Dist. LEXIS 82685, at *27-28 (W.D. Va. Sept. 9, 2009) (analyzing privilege protection and work product protection for materials created during defendant's investigation of a plaintiff's allegation of sexual harassment; "The motion is specifically denied insofar as it seeks to compel United Salt to provide copies of any documents concerning an investigation by in-house legal counsel of Smith's and Clifton's allegation of sexual harassment, including Joseph Pribyl's memorandum to counsel concerning Michael Foster's termination. The court finds that these documents are protected from production under the attorney-client privilege. . . . The motion also is denied insofar as it seeks to compel United Salt to produce copies of notes created by Pribyl, United Salt's director of human resources, regarding workers' compensation and disability claims filed by Smith based on the court's finding that these notes are protected from production under the work-product doctrine.").

Thus, these and other states recognize a number of different types of "retainers" that clients might pay lawyers.

The two main types of "retainers" represent very different concepts. First, most states recognize what could be called "true" retainers -- payment that clients pay to assure a lawyer's availability during a certain period of time. The Restatement calls this type of retainer an "engagement-retainer fee."

> **[E-1360]** The term 'retainer' has been employed to describe different fee arrangements. As used in this Restatement, an 'engagement retainer fee' is a fee paid, apart from any other compensation, to ensure that a lawyer will be available for the client if required. An engagement retainer must be distinguished from a lump sum fee constituting the entire payment for a lawyer's service in a matter and from an advance payment from which fees will be subtracted . . . . A fee is an engagement retainer only if the lawyer is to be additionally compensated for actual work, if any, performed. In some jurisdictions, an engagement retainer is referred to as a 'general' or 'special' retainer.

Restatement (Third) of Law Governing Lawyers § 34 cmt. e (2000). Most states recognize this type of payment.

- **[E-1347]** North Carolina LEO 2008-10 (10/24/08) (in a compendium opinion about fees, explain the four existing types of fees paid in advance, and creating a new type of permissible fee to be paid in advance -- called a "minimum fee"; identifying five types of fees that can be paid in advance, and providing additional details about all five: advance payment; general retainers, flat fee or prepaid flat fee; hybrid fees and minimum fees; providing additional information about general retainers, defined as follows: "consideration paid at the beginning of a representation to reserve the exclusive services of a lawyer but not used to pay for actual representation; generally used when corporate or business clients have a specific need to consult a lawyer on a regular basis; earned upon payment; paid to lawyer or deposited in firm operating account; some or all of the retainer is subject to refund if clearly excessive under the circumstances as determined upon the termination of the client-lawyer relationship."; noting that an earlier opinion explains the nature of a "general retainer"; "RPC 50 holds that a lawyer may charge and collect a general retainer as consideration for the exclusive use of the lawyer's services in a particular matter. Such retainers are sometimes

referred to as 'true retainers' because the money is paid for nothing more than the reservation of the lawyer's time; the legal services provided by the lawyer are separately compensated."; offering the following as a proposed (but not mandatory) model fee provision dealing with the general retainer; "As a condition of the employment of Lawyer, Client agrees to pay $_____ to Lawyer. This money is a general retainer paid by Client to ensure that Lawyer is available to Client in the event that legal services are needed now or in the future and to insure that Lawyer will not represent anyone else relative to Client's legal matter without Client's consent."; "Client understands and specifically agrees that: (1) the general retainer is not payment for the legal work to be performed by Lawyer; (2) Client will be billed separately for the legal work performed by Lawyer and his/her staff. Legal work will be billed on an hourly basis [or other appropriate basis] according to the schedule attached to this agreement; (3) the general retainer will be earned by Lawyer immediately upon payment and will be deposited in Lawyer's business account rather than a client trust account; and (4) when Lawyer's representation ends, Client will not be entitled to a refund of any portion of the general retainer unless it can be demonstrated that the general retainer is clearly excessive under the circumstances.").

- Virginia LEO 1807 (9/20/04) (A lawyer who has not been paid may: (1) garnish any of the former client's money being held in the trust account of a successor lawyer (the money should not be called a "retainer" which involves the payment of money "to insure the attorney's availability for future legal services" and must therefore not be placed in a trust account because it is earned upon payment); (2) undertake discovery of documents relating to the client's payments to the successor lawyer, although the discovery "should not seek more confidential information from the new attorney than is necessary for collection.").

Only a few law firms nationally have the market power to insist that their clients pay this type of retainer. In essence, the clients are paying for a "veto power" that permits the clients to disqualify the law firm from representing the clients' adversary. Ironically, some of the law firms with the market power to insist on this type of retainer payment also insist that their clients sign a "prospective consent" allowing the law firm to represent the clients' adversary in all or some situations.

Second, some retainer payments represent a client's deposit of an amount against which the lawyer will eventually charge if the lawyer performs services. This is the far more common type of "retainer."

Not surprisingly, the Restatement explains that an ill-defined payment of this sort is presumed to be an advance deposit rather than an "engagement retainer."

> **[E-1376]** A fee payment that does not cover services already rendered and that is not otherwise identified is presumed to be a deposit against future services. The lawyer's fee for those services will be calculated according to any valid fee contract or, if there is none, under the fair-value standard of § 39. If that fee is less than the deposit, the lawyer must refund the surplus. . . . If the fee exceeds the deposit, the client owes the lawyer the difference. The deposit serves as security for the payment of the fee. . . . A client and lawyer might agree that a payment is an engagement-retainer fee . . . rather than a deposit. Clients who pay a fee without receiving an explanation ordinarily will assume that they are paying for services, not readiness. . . . A client and lawyer might also agree that an advance payment is neither a deposit nor an engagement retainer, but a lump-sum fee constituting complete payment for the lawyer's services. Again, the lawyer must adequately explain this to the client. In any event, an engagement-retainer or lump-sum fee must be reasonable. . . . If the lawyer withdraws or is discharged prematurely or for other misconduct, the contractual fee might be subject to reduction.

Restatement (Third) of Law Governing Lawyers § 38 cmt. g (2000).

Given the enormous variation in the type of "retainer" payments that various states' ethics rules, bars and courts recognize, lawyers obviously must define the type of "retainer" payment they seek from prospective clients or clients.

**(b)** Determining if a lawyer can charge a "nonrefundable" retainer depends both on the nature of the retainer and on the applicability of the general principle that lawyers can never charge unreasonable fees. See, e.g., ABA Model Rule 1.5(a).

Unless a retainer payment represented an acceptable fixed fee (in those states allowing nonrefundable fixed fees), lawyers cannot collect a nonrefundable retainer.

- **[E-574 N 6/09]** Cuyahoga County Bar Ass'n v. Cook, 901 N.E.2d 225, 227 (Ohio 2009) (imposing a six-month stayed suspension of a lawyer who charged a flat non-refundable retainer and a contingent fee in a foreclosure action; "We have cautioned against charging nonrefundable fees because former DR 2-110(A)(3) and successor Rule 1.16(e) of the Rules of Professional Conduct require in all but narrow circumstances that upon withdrawal from representation, a lawyer must return fees that the client has paid in advance and that the lawyer has not earned.").

- **[E-639 N 12/09]** **[TOM E 639 and E 1273 (see below) seem to be the same with additional words at end of E 1273]** Alaska LEO 2009-1 (5/5/09) ("Every fee must be reasonable and is subject to the standards of Rule 1.5 of the Alaska Rules of Professional Conduct as well as to review by fee arbitration. For that reason, it is misleading to describe a fee or retainer in any way as 'non-refundable.'"; "Regardless of how a fee is characterized, e.g., 'a nonrefundable retainer,' 'a fee earned upon receipt,' a 'flat fee,' a 'minimum fee,' etc., these factors continue to apply to the lawyer's fee. If unreasonable, the fee is improper. It is for that reason that a lawyer's characterization of amounts paid to the lawyer as being 'nonrefundable' is fundamentally misleading." (footnote omitted); "Upon termination of representation, Rule 1.16(d) requires 'refunding any advance payment of fee that has not been earned.' Again, regardless of how a fee is characterized, this requirement applies to the lawyer's fee. Even if characterized as nonrefundable, an unearned fee must be refunded. Because characterizing the fee as nonrefundable incorrectly suggests that a client has no recourse against the lawyer, this practice is fundamentally misleading.").

- **[E-1273 N 9/11]** Alaska LEO 2009-1 (5/5/09) (modification of Op. 87-1, 9/3/87) ("Every fee must be reasonable and is subject to the standards of Rule 1.5 of the Alaska Rules of Professional Conduct as well as to review by fee arbitration. For that reason, it is misleading to describe a fee or retainer in any way as 'non-refundable.'"; "Regardless of how a fee is characterized, e.g., 'a nonrefundable retainer,' 'a fee earned upon receipt,' a 'flat fee,' a 'minimum fee,' etc., these factors continue to apply to the lawyer's fee. If unreasonable, the fee is improper. It is for that reason that a lawyer's characterization of amounts paid to the lawyer as being 'nonrefundable' is fundamentally misleading." (footnote omitted); "Upon termination of representation, Rule 1.16(d) requires 'refunding any advance payment of fee that has not been earned.' Again, regardless of how a fee is characterized, this requirement applies to the lawyer's fee. Even if characterized as nonrefundable, an unearned fee must be refunded. Because characterizing the fee as nonrefundable incorrectly suggests that a client has no recourse against the

lawyer, this practice is fundamentally misleading."; explaining that "the sole justification for a 'nonrefundable retainer,' considered earned immediately upon receipt appears to be a payment intended exclusively to ensure that the attorney is available to the client such that the attorney must refuse other employment and cannot represent an opposing side.").

- **[E-619 N 7/09; 2/10** will be reported in So. 2d] Ala. State Bar v. Hallett, Nos. 1071419 & 1071486, 2009 Ala. LEXIS 69 (Ala. Apr. 10, 2009) (amended Jan. 21, 2010) (finding that Alabama law prohibits "nonrefundable retainers").

- **[E-1344]** North Carolina LEO 2000-5 (7/21/00) (explaining that lawyers cannot describe a fee as "nonrefundable," because the lawyer might have to refund part of any fee that is considered reasonable large; also permitting a retainer agreement provision that calls for the client to forfeit some or all of the fee, under certain circumstances; "Although a flat fee may be deposited into an operating account at the beginning of the representation, when the client-lawyer relationship ends, if the fee is clearly excessive in light of the services actually rendered, the portion of the fee that makes the total payment clearly excessive must be returned to the client. . . ."; "The duty to refund any portion of a fee that is clearly excessive exists regardless of the type of fee that was paid. This means that there is always a possibility that a lawyer will have to refund some or all of any type of advance fee, if the client-lawyer relationship ends before the contemplated services are rendered. At the conclusion of the representation, the lawyer must review the entire representation and determine whether, in light of the circumstances, a refund is necessary to avoid a clearly excessive fee. . . ."; "The possibility that a refund to the client will be required means that no fee is truly 'nonrefundable.' To call such a payment a 'nonrefundable fee' is false and misleading in violation of Rule 7.1. Moreover, the designation of the fee is 'nonrefundable' in the fee agreement has a chilling effect on the client's right to terminate the representation at anytime. A lawyer may refer to such a fee as a 'prepaid flat fee.' The lawyer may also reach an agreement with the client that some or all of the fee may be forfeited under certain conditions but only if the amount so forfeited is not clearly excessive in light of the circumstances and all such conditions are reasonable and fair to the client."; explained in the North Carolina Bar's compendium opinion, North Carolina LEO 2008-10 (10/24/08)).

- **[E-1290 B 9/11]** Columbus Bar Ass'n v. Klos, 692 N.E.2d 565, 565, 567, 568 (Ohio 1998) (analyzing the following situation: "In April 1994, Klos agreed to represent Lilly Clay in a wrongful termination matter against her former employer. Klos charged Clay $500 for an investigation letter and then, when the letter did not resolve the situation, Klos and Clay entered into a 'Fee Agreement.' The agreement provided for 'a retainer of $4,000 and or $150 per hour' (with credit for the previously paid $500) 'and or a sum equal to 33 percent of any sum which may be received by a compromise settlement of said claim recovered through prosecution of said claim to judgment in any

> court."; noting that lawyer spent only 34.54 hours on the Clay matter; publicly reprimanding the lawyer; "[T]he fee agreement used by Klos in the Clay matter was deficient. The portion of the contract covering the investigative phase of the case involved a retainer that was nonrefundable should the attorney withdraw for any reason. It further provided that if the attorney withdrew because of the acts of the client, the attorney would be entitled to compensation at $150 per hour. The actual wording was, 'If the Attorney withdraws * * * without the fault or against the desire of the Client, * * * there shall be nothing due * * * to the Attorney for attorney's fees other than the retainer, court costs, and expenses * * *. If the withdrawal of the Attorney shall be due to the acts or conduct of the Client * * *, the attorney shall be reimbursed for services at an hourly rate of $150.00.'"; "The contingent fee portion of the contract covering the litigation phase of the Clay case was also flawed. It provided that should the attorneys be discharged or withdraw prior to settlement, they would be compensated at $150 per hour. . . . [A] liquidated hourly fee arrangement upon termination of a contingent fee contract precluded the application of DR 2-106(B), which sets out the elements to be considered in the calculation of a reasonable fee. We disapprove also of this portion of the Clay contract."; also finding the language ambiguous; "[T]he contract language provided for a $ 4,000 retainer, 'and or' $150 per hour, 'and or' a contingent fee equal to thirty-three percent of any settlement or judgment. This language is ambiguous. It is impossible to determine from the four corners of this document whether one, two, or all three methods of fee determination apply. In practice, Klos did not apply any of these methods. He applied the fee agreement of the Clay case by charging Clay the retainer and the to that sum adding one-third of the recovery after the recovery was reduced by the retainer. This method of application of the fee agreement was not clearly expressed at the outset of the representation and is certainly not apparent in the document.").

This is not to say that a "true retainer" is not refundable. Because all fees must be reasonable, a lawyer who either withdraws or is terminated by the client normally must return a portion of the "true retainer" if the lawyer has not been available for the specified amount of time.

Despite many possible types of retainers (and perhaps because of that fact), lawyers must always explain the exact nature of the retainer.

- See, e.g., **[E 1684]** In the Matter of Kenneth E. Lauter, 2010 Ind. LEXIS 539 (Ind. Sept. 17, 2010) (issuing a public reprimand of a lawyer who included a handwritten note on a retainer agreement that indicated that the lawyer might conduct additional work but did not explain the fees associated with that work; "[T]he Contract contained a handwritten notation in the bottom margin, initialed by the client, calling for an 'additional retainer fee payable if client and firm agree to file federal court litigation' ('additional retainer'). The client and Respondent agreed to leave the amount of the additional retainer undetermined until Respondent had completed his due diligence and decided whether to advise the client to proceed to federal court."; "In the client's case, the EEOC issued a finding of no probably cause in December 2003. Respondent then filed a FOIA request for the EEOC file. After receiving the file in February 2004, he contacted the client the next day to inform her that he believed the case had sufficient merit to proceed to federal court. He testified that he 'reminded her of the additional retainer that she had initialed and said it would be four thousand, two hundred and fifty dollars ($4,250,000).' This amount was not reduced to writing. Respondent did not advise the client that she might wish to consult independent counsel before agreeing to this amount."; "We do not suggest that Respondent is guilty of overreaching in his dealing his clients. There is no allegation that the fee he charged in this case was unreasonable, that he did not represent the client well, or that he did not achieve a good result for her. Respondent's structuring of his fees so clients whose claims are resolved at the administration level pay a lower fee than those whose cases must go to court appears intended to benefit his clients and is certainly not to be discouraged. The problem in this case is that Respondent gave no indication to the client of what the additional retainer would be or how it would be determined."; "In this case, the handwritten note in the Contract calls for an additional retainer if the case goes to court without stating how payment of the additional retainer will figure into the calculation of any contingent fee that might eventually be owing. In particular, the Contract does not state whether the additional retainer will applied toward the contingent fee or whether it is to be in addition to the contingent fee. The term 'retainer' might imply to a lawyer that it is to be in addition to the contingent fee, and this is way Respondent treated it. But one purpose of this rule is to protect the lay client who is unfamiliar with the legalese and industry standards regarding attorney fees. Because the Contract fails to disclose adequately the method by which the contingent fee was to be calculated, we conclude that Respondent violated Rule 1.5(c).").

Several Restatement provisions deal with retainer payments. One Restatement comment analyzes the reasonableness of a retainer fee, and the need to avoid the retainer requirement amounting to an improper "liquidated damages" clause.

> An engagement-retainer fee satisfies the requirements of this Section 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 . . . . In some circumstances, large engagement-retainer fees constitute unenforceable liquidated-damage clauses . . . or are subject to challenge in the client's bankruptcy proceeding.

Restatement (Third) of Law Governing Lawyers § 34 cmt. e (2000).

## Best Answer

The best answer to **(a)** is **MAYBE**; the best answer to **(b)** is **PROBABLY NO**.

# Nonrefundable Fixed Fees

## Hypothetical 2

You realize that the legal profession is moving away from hourly fees, and you do not want to be left behind. As you begin to focus on the possibility of charging "fixed" fees, one of your partners asks a question based on some articles she has read.

May a lawyer charge a "nonrefundable" fixed fee?

## MAYBE

## Analysis

The issue of "nonrefundable" retainers and "nonrefundable" fixed fees has generated a confusing series of legal ethics opinions and case law.

The bedrock principle guiding all fee issues is the prohibition on a lawyer charging an "unreasonable" fee. ABA Rule 1.5(a). Thus, any amount that a lawyer collects must reasonably relate to the services the lawyer has provided.

This basic principle translates into a prohibition on the lawyer retaining any amount that the lawyer has not yet earned. Thus, several cases have explained that lawyers may charge a "nonrefundable" retainer (at least one which represents an advance payment of fees which the lawyer will later earn) or a "nonrefundable" fixed fee for services that the lawyer does not render.

- **[E 574 n 6/09]** Cuyahoga County Bar Ass'n v. Cook, 901 N.E.2d 225, 227 (Ohio 2009) (imposing a six-month stayed suspension of a lawyer who charged a flat non-refundable retainer and a contingent fee in a foreclosure action; "We have cautioned against charging nonrefundable fees because former DR 2-110(A)(3) and successor Rule 1.16(e) of the Rules of Professional Conduct require in all but narrow circumstances that upon withdrawal from representation, a lawyer must return fees that the client has paid in advance and that the lawyer has not earned.").

- **[E 619 N 7/09; 2/10** will be reported in So. 2d**]** Ala. State Bar v. Hallett, Nos. 1071419 & 1071486, 2009 Ala. LEXIS 69 (Ala. Apr. 10, 2009) (amended Jan. 21, 2010) (finding that Alabama law prohibits "nonrefundable retainers").

- **[E 1290 B 9/11]** Columbus Bar Ass'n v. Klos, 692 N.E.2d 565, 565, 567, 568 (Ohio 1998) (analyzing the following situation: "In April 1994, Klos agreed to represent Lilly Clay in a wrongful termination matter against her former employer. Klos charged Clay $500 for an investigation letter and then, when the letter did not resolve the situation, Klos and Clay entered into a 'Fee Agreement.' The agreement provided for 'a retainer of $4,000 and or $150 per hour' (with credit for the previously paid $500) 'and or a sum equal to 33 percent of any sum which may be received by a compromise settlement of said claim recovered through prosecution of said claim to judgment in any court."; noting that lawyer spent only 34.54 hours on the Clay matter; publicly reprimanding the lawyer; "[T]he fee agreement used by Klos in the Clay matter was deficient. The portion of the contract covering the investigative phase of the case involved a retainer that was nonrefundable should the attorney withdraw for any reason. It further provided that if the attorney withdrew because of the acts of the client, the attorney would be entitled to compensation at $150 per hour. The actual wording was, 'If the Attorney withdraws * * * without the fault or against the desire of the Client, * * * there shall be nothing due * * * to the Attorney for attorney's fees other than the retainer, court costs, and expenses * * *. If the withdrawal of the Attorney shall be due to the acts or conduct of the Client * * *, the attorney shall be reimbursed for services at an hourly rate of $150.00.'"; "The contingent fee portion of the contract covering the litigation phase of the Clay case was also flawed. It provided that should the attorneys be discharged or withdraw prior to settlement, they would be compensated at $150 per hour. . . . [A] liquidated hourly fee arrangement upon termination of a contingent fee contract precluded the application of DR 2-106(B), which sets out the elements to be considered in the calculation of a reasonable fee. We disapprove also of this portion of the Clay contract."; also finding the language ambiguous; "[T]he contract language provided for a $ 4,000 retainer, 'and or' $150 per hour, 'and or' a contingent fee equal to thirty-three percent of any settlement or judgment. This language is ambiguous. It is impossible to determine from the four corners of this document whether one, two, or all three methods of fee determination apply. In practice, Klos did not apply any of these methods. He applied the fee agreement of the Clay case by charging Clay the retainer and the to that sum adding one-third of the recovery after the recovery was reduced by the retainer. This method of application of the fee agreement was not clearly expressed at the outset of the representation and is certainly not apparent in the document.").

Upon closer examination, however, the issue becomes more complicated.

Depending on the nature or the retainer of the fixed fee, several ethics opinions have

explained that simply calling such fees "nonrefundable" is misleading -- because it does not explain the nature of the payment.

- **[E 1273 B 9/11]** Alaska LEO 2009-1 (5/5/09) (modification of Op. 87-1, 9/3/87) ("Every fee must be reasonable and is subject to the standards of Rule 1.5 of the Alaska Rules of Professional Conduct as well as to review by fee arbitration. For that reason, it is misleading to describe a fee or retainer in any way as 'non-refundable.'"; "Regardless of how a fee is characterized, e.g., 'a nonrefundable retainer,' 'a fee earned upon receipt,' a 'flat fee,' a 'minimum fee,' etc., these factors continue to apply to the lawyer's fee. If unreasonable, the fee is improper. It is for that reason that a lawyer's characterization of amounts paid to the lawyer as being 'nonrefundable' is fundamentally misleading." (footnote omitted); "Upon termination of representation, Rule 1.16(d) requires 'refunding any advance payment of fee that has not been earned.' Again, regardless of how a fee is characterized, this requirement applies to the lawyer's fee. Even if characterized as nonrefundable, an unearned fee must be refunded. Because characterizing the fee as nonrefundable incorrectly suggests that a client has no recourse against the lawyer, this practice is fundamentally misleading."; explaining that "the sole justification for a 'nonrefundable retainer,' considered earned immediately upon receipt appears to be a payment intended exclusively to ensure that the attorney is available to the client such that the attorney must refuse other employment and cannot represent an opposing side.").

- **[E 1344]** North Carolina LEO 2000-5 (7/21/00) (explaining that lawyers cannot describe a fee as "nonrefundable," because the lawyer might have to refund part of any fee that is considered reasonable large; also permitting a retainer agreement provision that calls for the client to forfeit some or all of the fee, under certain circumstances; "Although a flat fee may be deposited into an operating account at the beginning of the representation, when the client-lawyer relationship ends, if the fee is clearly excessive in light of the services actually rendered, the portion of the fee that makes the total payment clearly excessive must be returned to the client. . . ."; "The duty to refund any portion of a fee that is clearly excessive exists regardless of the type of fee that was paid. This means that there is always a possibility that a lawyer will have to refund some or all of any type of advance fee, if the client-lawyer relationship ends before the contemplated services are rendered. At the conclusion of the representation, the lawyer must review the entire representation and determine whether, in light of the circumstances, a refund is necessary to avoid a clearly excessive fee. . . ."; "The possibility that a refund to the client will be required means that no fee is truly 'nonrefundable.' To call such a payment a 'nonrefundable fee' is false and misleading in violation of Rule 7.1. Moreover, the designation of the fee is 'nonrefundable' in the fee agreement has a chilling effect on the client's right to terminate the representation at anytime. A lawyer may refer to such a fee as a 'prepaid flat

> fee.' The lawyer may also reach an agreement with the client that some or all of the fee may be forfeited under certain conditions but only if the amount so forfeited is not clearly excessive in light of the circumstances and all such conditions are reasonable and fair to the client."; explained in the North Carolina Bar's compendium opinion, North Carolina LEO 2008-10 (10/24/08)).

The lesson of these legal ethics opinions is that a lawyer properly explaining the nature of a retainer or a fixed fee might be able to charge a "nonrefundable" fee -- although the lawyer might have to call it something else. The best example of such a fee is a "true" retainer, which the client pays the lawyer to be available for a certain period of time (and implicitly off-limits to any adversaries for that time). That type of retainer/fee is "nonrefundable" in the sense that the lawyer earns it without performing any services, but rather simply by being available during the period time. If the client wants that amount back at the end of the time period, the lawyer presumably does not have to return the money, because the lawyer has earned it. On the other hand, a client presumably can seek return of that amount the day after paying the lawyer that amount -- because the lawyer has not yet earned that amount by making himself or herself available to the client.

A 2010 Missouri legal ethics opinion does an excellent job of explaining all of this. The opinion first provides examples of the impermissible fees that lawyers cannot describe as "nonrefundable."

> **[E 1627]** Two types of cases provide good examples of situations in which supposedly nonrefundable fees are involved. The first example is the domestic relations case where the client pays a flat fee or makes an advance deposit on fees against which the attorney will bill on an hourly basis. Sometimes the attorney will describe all or part of the flat fee or initial payment as a 'nonrefundable' or 'minimum' fee. The second example is the criminal case in which the attorney charges a flat fee and describes the entire fee as

> nonrefundable. . . . In these situations and others, the description of a fee as 'nonrefundable' is misleading.

Missouri LEO 128 (5/18/10).[1] The opinion then describes an example of a fee that the client might describe as "nonrefundable" but which is actually earned -- and therefore not returnable to the client as long as the total fee is "reasonable."

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[1] **[E 1627]** Missouri LEO 128 (5/18/10) (analyzing "nonrefundable" fees; "In many instances, attorneys receive payment before the attorney has completed the services for which the payment is made. In some instances, attorneys refer to these payments as 'nonrefundable.' These 'nonrefundable' fees are often the subject of disciplinary complaints and fee disputes."; "Two types of cases provide good examples of situations in which supposedly nonrefundable fees are involved. The first example is the domestic relations case where the client pays a flat fee or makes an advance deposit on fees against which the attorney will bill on an hourly basis. Sometimes the attorney will describe all or part of the flat fee or initial payment as a 'nonrefundable' or 'minimum' fee. The second example is the criminal case in which the attorney charges a flat fee and describes the entire fee as nonrefundable."; "In these situations and others, the description of a fee as 'nonrefundable' is misleading."; "If the representation was completed, the attorney will not be required to refund any of the advance deposit or flat fee, assuming the amount charged was reasonable. However, if the representation ended before the representation was completed, the attorney must analyze the factors set out in Rule 4-1.5(a) to determine the extent to which the attorney must refund all or a portion of the fees paid in advance. In addition, because an attorney may not charge or collect an unreasonable fee, the attorney must determine that the fee was reasonable, even if the representation was complete. Regardless of the terminology used to describe the fee, if the ultimate fee is unreasonable, taking into consideration the eight factors listed under Rule 4-1.5(a), the unreasonable portion must be refunded."; "In other words, an attorney may charge a fee for initially intaking a prospective consent or accepting a case, to the extent that it creates a conflict in a situation in which the attorney may have to decline representation of others involved in the case. If the representation terminates after that point, that fee is not accurately described as 'nonrefundable,' it is earned. In light of the duty to explain the basis for the fee to the client, the attorney should explain that the fee is earned because of the attorney's inability to represent anyone else in the matter, rather than describing it as nonrefundable. The fee is only earned to the extent that the fee is reasonable in light of all of the circumstances."; "Representation in a criminal case may terminate early because the attorney withdraws, the client discharges the attorney or the prosecution dismisses the charges. In any of these situations, the attorney may owe a refund. The amount of the refund should be based on the reasonable value of the legal services actually provided, taking into account all of the factors listed in Rule 4-1.15(a)."; "Unless a mixed or hybrid fee arrangement it used, the flat fee should cover the entire representation on the matter. If not, the representation involves limited scope representation under Rule 4-1.2. In that event, the fee agreement must be in writing and must clearly spell out what is and is not covered. For example, if the fee only covers representation of a criminal defendant for negotiating a plea but not for trial, it would involve limited representation. Similarly, representation in a dissolution case that only covers a 'noncontested' dissolution involves limited scope representation. Representation, in any type of case, that excludes appeal is limited scope representation."; "Part of the confusion surrounding this topic may stem from the historical view that a flat fee is earned upon receipt for trust account purposes. However, in the course of reviewing that approach, we have determined that it is not consistent with the current Rules of Professional Conduct. Rule 4-1.15(f) states: 'A lawyer shall deposit into a client trust account legal fees and expenses that have been paid in advance, to be withdrawn by the lawyer only as fees are earned or expenses incurred.' We believe that all flat fees must be deposited into a lawyer trust account and promptly removed when actually earned, similar to removal of earned hourly fees. Flat fees could be removed based upon reaching a particular stage of a case or based on some other reasonable criteria, depending on the nature and circumstances of the representation."; "We have used the word 'fee'

> **[E 1627]** [A]n attorney may charge a fee for initially intaking a prospective consent or accepting a case, to the extent that it creates a conflict in a situation in which the attorney may have to decline representation of others involved in the case. If the representation terminates after that point, that fee is not accurately described as 'nonrefundable,' it is earned. In light of the duty to explain the basis for the fee to the client, the attorney should explain that the fee is earned because of the attorney's inability to represent anyone else in the matter, rather than describing it as nonrefundable. The fee is only earned to the extent that the fee is reasonable in light of all of the circumstances.

Id.

At about the same time, an Arizona legal ethics opinion acknowledged that certain fees can acceptably be nonrefundable.

> **[E 1658 B 4/11]** A flat fee may or may not be paid in advance and be non-refundable. The agreement between the lawyer and the client determines these additional matters. The agreement could provide, for example, that the fee would be paid in advance and then 'earned' at an hourly rate until exhausted. When treated in that fashion, the amount tendered is no different from an advance fee drawn on at an hourly rate, except that the fee establishes an upper limit on the client's liability. A flat fee also may be paid in advance and then deemed earned in part upon the completion of specified portions of the task or the occurrence of specified events in the representation. The fee could be paid and earned in installments triggered by the specified events or task. Or, the fee could be paid in advance and treated as 'earned on receipt' or non-refundable. Id. at 4. Opinion 99-02 continues by explaining that, in addition, a

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rather than 'retainer' in this opinion. Historically, a 'retainer' was a fee paid for the attorney to maintain availability to a client. Currently, the term has taken on many meanings which are inconsistent with one another and which are confusing to clients. We encourage attorneys to avoid using the term retainer when the attorney actually means an advance for deposit, flat fee, initial deposit, etc. Attorneys best fulfill their duty of communication about fees under Rules 4-1.4 and 4-1.5 when they use plain language that clients are likely to clearly understand.").

> non-refundable flat-fee agreement may appropriately reflect a negotiated element of risk sharing between lawyer and client. The lawyer takes the risk that he or she will do more work than planned, without additional compensation, and the client, in return, agrees that the lawyer will earn the agreed-upon amount, even if that amount would exceed the lawyer's usual hourly rate, assuming the total fee is reasonable.

Arizona LEO 10-03 (6/2010).[2]

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[2] **[E 1658 B 4/11]** Arizona LEO 10-03 (6/2010) ("Inquiring lawyers wish to know whether a lawyer may charge a 'non-refundable fee' for a set number of hours of work, which may or may not result in completion of a specific task. The lawyers propose, by way of example, that a lawyer whose billing rate is $200 an hour offers to charge a non-refundable fee of $2,000 that would pay for 10 hours of legal work or completion of the matter, whichever occurs first. In other words, the client is told in the fee agreement that the lawyer either will complete the matter for the $2,000 non-refundable fee, or the lawyer will provide 10 hours of work toward completion of that matter. The agreement would further provide that, if facts or circumstances change that require additional time, the lawyer may then bill for the additional time at his or her specified hourly rate."; "Provided that the overall fee is reasonable, it is ethically permissible to charge a minimum fee that may be designated 'earned upon receipt' or 'non-refundable' with the language required by ER 1.5(d), for a specified number of hours or through completion of the matter, whichever occurs first, and also to include a provision that, under certain reasonably defined changed circumstances, the lawyer reserves the right to charge the client on an hourly basis for the remainder of the matter."; citing an earlier Arizona LEO explaining the nature of "flat fees"; "Opinion 99-02 explained that a 'non-refundable fee' is not synonymous with a 'flat fee.' A 'flat fee' describes an agreement whereby the lawyer renders a specific legal service for an amount that is fixed at the start of the representation. Typically, the specified legal service is a self-contained task that can be described from start to finish, such as drafting a will, obtaining a divorce decree, documenting a real estate transaction, or handling a litigation from complaint to judgment. According to Opinion 99-02, in setting the amount of the flat fee, the lawyer assumes the risk of accurately estimating the probable time required to complete the service. In that respect, a flat fee is analogous to a contingency fee. Like a contingency fee (as with all fees), a flat fee is always subject to a reasonableness analysis."; explaining that a "flat fee" may or may not be non-refundable; "A flat fee may or may not be paid in advance and be non-refundable. The agreement between the lawyer and the client determines these additional matters. The agreement could provide, for example, that the fee would be paid in advance and then 'earned' at an hourly rate until exhausted. When treated in that fashion, the amount tendered is no different from an advance fee drawn on at an hourly rate, except that the fee establishes an upper limit on the client's liability. A flat fee also may be paid in advance and then deemed earned in part upon the completion of specified portions of the task or the occurrence of specified events in the representation. The fee could be paid and earned in installments triggered by the specified events or task. Or, the fee could be paid in advance and treated as 'earned on receipt' or non-refundable. Id. at 4. Opinion 99-02 continues by explaining that, in addition, a non-refundable flat-fee agreement may appropriately reflect a negotiated element of risk sharing between lawyer and client. The lawyer takes the risk that he or she will do more work than planned, without additional compensation, and the client, in return, agrees that the lawyer will earn the agreed-upon amount, even if that amount would exceed the lawyer's usual hourly rate, assuming the total fee is reasonable."; explaining how non-refundable fees must be handled in connection with a lawyer's trust account: "A non-refundable fee becomes the property of the lawyer when paid. Such funds should not be placed in a trust account where they will commingle with client funds. ER 1.15(a). On the other hand, the client retains ownership of, or at least an equitable claim to, funds representing an advance payment of fees. Accordingly, those funds must be deposited in the lawyer's trust account. ER 1.15(c). The lawyer may withdraw the advanced fee from the trust account only when, and to the extent that, he or

In 2009, a District of Columbia court explained that a "true" retainer can be "nonrefundable" once the lawyer has fulfilled the conditions of making himself or herself available.

- **[E 853 N 1/10, 4/10]** In re Mance, 980 A.2d 1196, 1200, 1202, 1203, 1204, 1206, 1207 (D.C. 2009) (analyzing the following situation: "Respondent told Mr. Saunders [father of a son who needed representation because he was a murder suspect] that his fee would be $ 15,000 -- with the initial installment of $ 7,500 to be paid up-front -- and possibly an additional $ 5,000 for investigative services 'depending on what was involved.' The second installment of $ 7,500 was to be paid after Saunders's son turned himself in to the police. Without any further discussion about the fee, Mr. Saunders agreed and paid respondent [lawyer] the initial $ 7,500. Although they did not discuss how the money would be kept, respondent placed most of it, $ 6,010, in a client escrow account, and the rest in his operating account."; noting that eventually Saunders terminated the lawyer and received his initial $ 7,500 payment back from the lawyer; explaining the nature of a flat fee; "We begin our analysis by describing the nature of a flat fee. A flat fee is one that 'embraces all work to be done, whether it be relatively simple and of short duration, or complex and protracted. . . . A flat fee is different from an engagement retainer, which 'is a fee paid, apart from any other compensation, to ensure that a lawyer will be available for the client if required.' RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 38 cmt. g (2000). . . . D.C. Legal Ethics Op. 264 (February 14, 2006) (an engagement retainer is a nonrefundable payment to assure the availability of the attorney whether services are performed or not). Engagement retainers are earned when received, but it may become necessary to refund even a

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she earns the fee by the criteria specified in the fee agreement. In the case of the type of 'hybrid' fee at issue here -- in part non-refundable, and in part earned on an hourly or other basis -- prepaid funds advanced to secure the hourly fee would go into the trust account, but funds earned on receipt would not."; ultimately finding that the non-refundable fee as not unethical; "The Committee believes that the fee arrangement at issue is not on its face unethical, if the total fee is reasonable. The Committee's concern centers around use of the term 'flat fee' for the proposed arrangement, because of the traditional understanding by clients of what the term 'flat fee' entails. The proposed arrangement would not pose this problem of confusion if the fee paid for the specified number of hours was termed a 'minimum fee.' In reality, the proposed fee arrangement is calling for the payment of a minimum fee, not what has been traditionally terms a 'flat fee.'"; "This minimum fee could be designated as 'earned on receipt' and 'non-refundable,' in which case the funds should be placed n the lawyer's operating account. If the minimum fee is not so designated, the funds should be placed in the trust account and transferred to the operating account when the funds have been earned." (footnote omitted)).

portion of a retainer if the lawyer withdraws or is discharged prematurely. See RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 38 cmt. g (2000) ('A fee payment that does not cover services already rendered and that is not otherwise identified is presumed to be a deposit against future services.')."; "In sum, a flat fee is an advance of unearned fees because it is money paid up-front for legal services that are yet to be performed."; "[W]hen Mr. Saunders terminated the representation before the first milestone was met (before the client turned himself in to the police), respondent was obligated to return the initial payment -- or the portion that he had not earned -- because a lawyer 'cannot earn a fee for doing nothing.'" (citation omitted); "A corollary to the rule that a flat fee is an advance of unearned fees, is that the fee must be held as client funds in a client's trust or escrow account until they are earned by the lawyer's performance of legal services."; "Another important benefit to placing flat fees in a trust or escrow account is preservation of the client's right to choose his or her counsel, including the right to discharge an attorney."; "But we also note that, consistent with the general requirement that a lawyer must entrust flat fees in a trust or escrow account until earned, the client may consent otherwise . . . and the fee agreement may specify how and when the attorney is deemed to earn the flat fee or specified portions of the fee."; "Although the default rule is that an attorney must hold flat fees in a client trust or escrow account until earned, we note that an attorney may obtain informed consent from the client to deposit all of the money in the lawyer's operating account or to deposit some of the money in the lawyer's operating account as it is earned, per their agreement."; "Where there is no discussion regarding the fee arrangement besides merely stating the overall fee, and no mention of the escrow account option, a client cannot be said to have a sufficient basis to give informed consent to waive the requirements of a rule designed to protect the client's interests."; agreeing that a public sanction was the appropriate punishment because of the uncertainty of the rule until this opinion).

- DC LEO 264 (2/14/06). **[FIND]**

At least one state recognizes the permissibility of a hybrid true retainer/minimum fee. In North Carolina LEO 2008-10 (10/24/08), the North Carolina Bar even suggested language a lawyer could use in describing a fee which at least in part is nonrefundable.

> **[E 1351]** As a condition of the employment of Lawyer, Client agrees to pay $_____ to Lawyer. This money is a minimum fee for the reservation of Lawyer's services; to

> insure that Lawyer will not represent anyone else relative to Client's legal matter without Client's consent; and for legal work to be performed for Client."; "Client understands and specifically agrees that: the minimum fee will be earned by Lawyer immediately upon payment and will be deposited in Lawyer's business account rather than a client trust account; Lawyer will provide legal services for Client on an hourly basis [or other appropriate basis] according to the schedule attached to this agreement until the value of those services is equivalent to the minimum fee; thereafter, Client will be billed for the legal work performed by Lawyer and his/her staff on an hourly basis [or other appropriate basis] according to the schedule attached to this agreement; and when Lawyer's representation ends, Client will not be entitled to a refund of any portion of the minimum fee, even if the representation ends before Lawyer has provided legal services equivalent in value to the minimum fee, unless it can be demonstrated that the minimum fee is clearly excessive fee under the circumstances.

North Carolina LEO 2008-10 (10/24/08).[3]

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[3] **[E 1351]** North Carolina LEO 2008-10 (10/24/08) (in a compendium opinion about fees, explain the four existing types of fees paid in advance, and creating a new type of permissible fee to be paid in advance -- called a "minimum fee"; identifying five types of fees that can be paid in advance, and providing additional details about all five: advance payment; general retainers, flat fee or prepaid flat fee; hybrid fees and minimum fees; providing further explanation about a new fee that the bar calls a "minimum fee," which the bar defines as follows: "consideration paid at the beginning of a representation to reserve the exclusive services of a lawyer; lawyer provides legal services up to the value of the minimum fee; earned upon payment; paid to lawyer or deposited in firm operating account; some or all of the minimum fee is subject to refund if clearly excessive under the circumstances as determined upon the termination of the client-lawyer relationship."; explaining that "[i]f there is a seeming inconsistency in the ethics opinions it arises from the strict formulation of the general retainer. A lawyer is allowed to charge a general retainer as consideration for the reservation of the lawyer's services and to treat the money as earned immediately. But the client is not given a credit for future legal services up to the value of the retainer. This strikes many lawyers as detrimental to the client's interests and it has lead to the creation of hybrid fees. The strict formulation of the general retainer has been maintained by the Ethics Committee for three important reasons. It avoids the client confusion that is engendered if a client is told that a payment both reserves the lawyer's services and pays for future representation. In addition, requiring general retainers to be separate and distinct from advance fees means that, if an advance fee is charged for future legal services, there is no penalty to the client for deciding to change legal counsel before the advance fee is exhausted and, if a refund is owed to the client because expected services have not been performed, the money is readily available in the trust account."; "Upon further reflection, the Ethics Committee has, nevertheless, determined that it is in the client's interest to receive legal services up to the value of a general retainer provided the client fully understands and agrees that the payment the client makes at the beginning of the representation is earned by the lawyer when paid, will not be deposited in a trust account, and is only subject to refund if the charge for reserving the lawyer's services (as opposed to the charge for the legal services performed) is clearly excessive under the circumstances. This newly acknowledged form of fee payment made by a client at the beginning of a representation will be referred to as a minimum fee. . . ."; offering the following proposed (but not

Finally, some courts seem to acknowledge the possibility of more traditional fixed fees that are nonrefundable.

- **[E 550 B 3/09]** Grievance Adm'r v. Cooper, 757 N.W.2d 867, 867 (Mich. 2008) (upholding a fee agreement in a domestic relations matter providing that a $4,000 payment was a nonrefundable "minimum fee"; "The Attorney Discipline Board erred in holding that the July 29, 2002 fee agreement was ambiguous as to whether the $4,000 minimum fee was nonrefundable. As written, the agreement clearly and unambiguously provided that the respondent was retained to represent the client and that the minimum fee was incurred upon execution of the agreement, regardless of whether the representation was terminated by the client before the billings at the stated hourly rate exceeded the minimum. So understood, neither the agreement nor the respondent's retention of the minimum fee after the client terminated the representation violated existing MRPC 1.5(a), MRPC 1.15(b) or MRPC 1.16(d).").

In addition to the substantive issues involving such retainers and fixed fees, lawyers must also wrestle with how they treat such payments for trust account purposes.

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mandatory) model fee provision dealing with such a fee: "As a condition of the employment of Lawyer, Client agrees to pay $_____ to Lawyer. This money is a minimum fee for the reservation of Lawyer's services; to insure that Lawyer will not represent anyone else relative to Client's legal matter without Client's consent; and for legal work to be performed for Client."; "Client understands and specifically agrees that: the minimum fee will be earned by Lawyer immediately upon payment and will be deposited in Lawyer's business account rather than a client trust account; Lawyer will provide legal services for Client on an hourly basis [or other appropriate basis] according to the schedule attached to this agreement until the value of those services is equivalent to the minimum fee; thereafter, Client will be billed for the legal work performed by Lawyer and his/her staff on an hourly basis [or other appropriate basis] according to the schedule attached to this agreement; and when Lawyer's representation ends, Client will not be entitled to a refund of any portion of the minimum fee, even if the representation ends before Lawyer has provided legal services equivalent in value to the minimum fee, unless it can be demonstrated that the minimum fee is clearly excessive fee under the circumstances.").

## Best Answer

The best answer to this hypothetical is **MAYBE**.

# Determining the Reasonableness of a Fee

## Hypothetical 3

Your firm has been moving away from the billable hour as the main way to bill clients. However, you have some questions about how to judge the reasonableness of fees that are not calculated by the hour. In one recent incident, one of your healthcare lawyers signed a retainer agreement with a new client to handle a certificate of need for a fixed fee of $25,000. The process went much more smoothly than anyone anticipated, and your lawyers only spent time handling the certificate of need process that would amount to $10,000 if billed by the hour. The client must have realized that process was easier than anticipated, because it has asked for $10,000 back from your firm.

**(a)** Can you rely on the written retainer agreement as a defense to this client's effort to seek the return of $10,000 from the agreed-upon fixed fee of $25,000?

**NO**

**(b)** Is the client likely to succeed in seeking the reimbursement of $10,000?

**MAYBE**

## Analysis

As in other contexts, normal contract rules do not apply when judging the reasonableness of a fee arrangement.

### Introduction

The one constant principle every state bar recognizes in the _____ text is the impermissibility of a lawyer charging an unreasonable fee.

> (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 following:
>
> (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.

ABA Model Rule 1.5(a). A comment provides some additional explanation.

> Paragraph (a) requires that lawyers charge fees that are reasonable under the circumstances. The factors specified in (1) through (8) are not exclusive. Nor will each factor be relevant in each instance. Paragraph (a) also requires that expenses for which the client will be charged must be reasonable. A lawyer may seek reimbursement for the cost of services performed in-house, such as copying, or for other expenses incurred in-house, such as telephone charges, either by charging a reasonable amount to which the client has agreed in advance or by charging an amount that reasonably reflects the cost incurred by the lawyer.

ABA Model Rule 1.5 cmt [1].

The Restatement takes essentially the same approach.

> **[E 1355]** A lawyer may not charge a fee larger than is reasonable in the circumstances or that is prohibited by law.

Restatement (Third) of Law Governing Lawyers § 34 (2000). A Restatement illustration provides an example of an unreasonable fee.

> **[E 1359]** Bank Clerk is charged with criminal embezzlement and retains Lawyer to defend against the charges for a

> $15,000 flat fee. The next day another employee confesses to having taken the money, and the prosecutor (not knowing of Lawyer's retention by Bank Clerk) immediately drops the charges against Bank Clerk. Lawyer has done nothing on the case beyond speaking with Bank Clerk. In the absence of special circumstances, such as prior discussion of this possibility or the lawyer having rejected another representation offering a comparable fee in reliance on this engagement, it would be unreasonable for Lawyer to be paid $15,000 for doing so little. Client must pay the fair value of Lawyer's services . . . but more than that is not due and the lawyer must refund the excess if already paid . . . . If, however, the prosecutor dropped the charges as the result of a plea bargain negotiated by Lawyer, the rapid disposition would not render unreasonable an otherwise proper $15,000 flat fee. A negotiated disposition without trial is a common event that parties are assumed to contemplate when they agree that the lawyer will receive a flat fee.

Restatement (Third) of Law Governing Lawyers § 34 cmt. c, illus. 1 (2000).

Surprisingly, courts sometimes find that a lawyer's fee is unreasonably large.

- See, e.g., **[E 600 -- cite checkers highlighting and comment]** Landry v. Haartz, Civ. A. No. 04-4760 (Mass. Super. Ct. Apr. 3, 2009) (finding that a lawyer seeking to recover $300,000 in fees had overcharged the client; "Mr. Landry did little work on the Repurchase Agreement. He spoke with Ms. Haartz and Mr. Davis a handful of times, engaged in little or no correspondence, drafted 2-3 pages and satisfied himself with the valuation of Ms. Haartz's and Mr. Davis' stock as conveyed by the accountants for the Haartz Corporation. Mr. Landry conversed with Mr. Concannon but raised few issues. He reviewed red-lined versions of the drafts he received from Bingham and did minimal research. He attended a meeting at Bingham McCutchen on January 8, 2002 and the closing the following day. Mr. Landry did little and accomplished almost nothing -- and none of the issues involved in his representation were novel or difficult." (Motion for Directed Verdict at 10 (filed Oct. 2008)); "Mr. Landry kept no time records and while his memory of the extent of his efforts is spotty, clearly his efforts were not taxing. Yet for those efforts, Mr. Landry seeks a total of more than $300,000 in legal fees." (Motion for Directed Verdict at 10 (filed Oct. 2008)); ultimately ordering the plaintiff to return $121,000 he had already been paid, and denying his effort to be paid an additional $180,000). **This is not ready. I am still looking for this case, but quotes are from a motion filed, NOT the judge, and I have that, but not the opinion.**

Courts and bars have also dealt with the permissibility of lawyers charging for certain types of activities. For instance, one court held that lawyers generally may not charge clients for time the lawyer spends preparing the bills.[1] While the North Carolina Bar indicated that lawyers may bill for intracorporate communications.[2]

## The Nature of Fee Contracts

Courts and bars agree that fee agreements will not be assessed in the same way as other contracts. In essence, the ethics rules require that fee contracts face scrutiny both when a client and a lawyer enter into them, and when the lawyer wants to enforce them.

> Under § 18, a contract between a client and lawyer is to be construed as a reasonable client would have construed it, considering the contract in the circumstances in which it was made . . . .

Restatement (Third) of Law Governing Lawyers § 38 cmt. d (2000).

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1 **[E 423 N 9/08]** Attorney Grievance Comm'n v. Kreamer, 946 A.2d 500 (Md. 2008) (in a lengthy opinion affirming a Maryland lawyer's disbarment, holding that lawyers generally may not charge clients for time spent preparing their billing statements).

2 **[E 1343]** North Carolina LEO 2007-13 (1/25/08) (explaining that lawyer may bill for intra-office communications; "A lawyer may bill for intra-office communications about a client's matter. For example, a lawyer and a paralegal (or two or more lawyers) who meet to discuss a client's case may both bill for the time expended in the meeting provided the meeting advances the representation of the client and the participation of both billing staff members is necessary. Email communications to instruct, update, or confer with other members of the firm is no different and, on occasion, may involve the expenditure of less time by the participants than an in-person meeting (and, therefore, be less expensive for the client). Nevertheless, to insure honest billing predicated on hourly charges, the lawyer must establish a reasonable hourly rate for his services and for the services of his staff; disclose the basis for the amounts to be charged; avoid wasteful, unnecessary, or redundant procedures; and make certain that the total cost to the client is not clearly excessive.").

Some states even consider a lawyer to be acting in a fiduciary capacity when entering into a fee contract with a client. See, e.g., Virginia LEO 1707 (1/12/98) (a "lawyer's fiduciary duties extend to preliminary consultation by a prospective client with a view to engagement"). Not all states take this strict approach.

- McGuire, Cornwell & Blakey v. Grider, 765 F. Supp. 1048, 1051 (D. Colo. 1991) (finding that "there was no fiduciary relationship between the parties until [the client] signed the fee agreement . . . . [B]ecause there was no fiduciary relationship between the parties when [client] entered into the fee agreement, there was no breach of fiduciary duty concerning the arbitration clause.").

- See, e.g., In re Timpone, 804 N.E.2d 560, 56374 (Ill. 2004) (suspending an Illinois lawyer for 42 months because he borrowed money from a client for whom the lawyer had just completed some work; noting that the lawyer had "violated his fiduciary duty to his client by, among other things: (1) failing to advise [client] that there were limits on the types of transactions an attorney could enter into with a client; (2) failing to advise him to consult independent counsel before making the loan; and (3) providing no collateral for the loan and giving [client] no promissory note evidencing the loan or the interest rate until five years after the transaction").

Recognizing that lawyers have fiduciary duties when entering into fee arrangements shifts the analysis considerably. Fiduciaries generally are presumed to have defrauded or otherwise taken advantage of their beneficiary in any contract in which the fiduciary gains a benefit. See, e.g., Thomas v. Turner's Administrator, 87 Va. 1, 12 S.E. 149 (1890).

Thus, bars everywhere recognize that, as the Virginia Bar put it, fee contracts "are not construed as are other commercial contracts." Virginia LEO 1606 (11/22/94).[3]

Not surprisingly, the Restatement devotes considerable attention to determining the reasonableness of a lawyer's fee. One comment describes the role of this analysis in various contexts.

> This Section forbids unlawful fees and unreasonably large fees, while leaving clients and lawyers free to negotiate a broad range of compensation terms. It does not forbid lawyers to serve for low fees or without charge; such service is often in the public interest . . . . Nor does the Section render unenforceable all fee arrangements that might be considered objectionable by some persons, for example, a lawyer's insistence that a needy client pay for the lawyer's services at the lawyer's usual rates. The prohibition on unreasonable payment arrangements is not limited to fees in a narrow sense. It applies also to excessive disbursement or interest charges or improper security interests . . . .
>
> The Section applies in two different contexts. First, in fee disputes between lawyer and client, a fee will not be approved to the extent that it violates this Section even though the parties had agreed to the fee. This Section thus applies in proceedings such as suits by lawyers for fees, suits by clients to recover fees already paid, and fee-arbitration proceedings . . . . If the parties have not agreed (whether before, during, or after the representation; . . . to the basis or amount of the fee, the tribunal will set a fee compensating the lawyer for the fair value of services rendered . . . . The fair-value fee will usually be at the lower range of reasonable fees and thus less than a fee for the same services that would be upheld as reasonable if the parties had agreed upon it.

[3] Most recently the Virginia Bar again highlighted the unique nature of fee agreements, emphasizing that fee agreements are "unique and not governed solely by principles that govern ordinary commercial contracts." Virginia LEO 1812 (10/31/05).

> Second, this Section applies when courts or other disciplinary authorities seek to discipline a lawyer for charging unreasonably high fees . . . . In many jurisdictions, authorities have been reluctant to discipline lawyers on such grounds. For a variety of reasons, discipline might be withheld for charging a fee that would nevertheless be set aside as unreasonable in a fee-dispute proceeding. It is therefore important to distinguish between applying this Section in fee disputes . . . and applying it in disciplinary proceedings . . . .

Restatement (Third) of Law Governing Lawyers § 34 cmt. a (2000).

A later provision discusses the analysis that bars undertake in the disciplinary context.

> The standards that apply when fees are challenged as unreasonable in fee disputes are also relevant in the discipline of lawyers for charging unreasonably high fees. If a fee would not be set aside in a fee dispute, disciplinary authorities can be expected to find that receiving or charging such a fee does not warrant sanctions for unreasonableness. Disciplinary authorities likewise rely on the list of factors . . . that tribunals refer to in fee disputes. Discipline is also appropriate if the lawyer overreached by deceiving the client, failed to provide all the services in question, or unjustifiably demanded a fee larger than the contract provided. Discipline may also be appropriate if the clear unreasonableness of the fee is demonstrated by other circumstances, including what other lawyers handling such matters charge, the facial unreasonableness of any express fee agreement, limits imposed by statutes, rules, and judicial precedents, previous warnings to the lawyer, evidence that the fee is uniformly deemed to be clearly excessive by responsible practitioners, or other evidence demonstrating the lawyer's gross insensitivity to broadly accepted billing standards.
>
> A lawyer can be disciplined for unreasonably making a large fee claim even though the fee was not collected. In a fee dispute, however, the tribunal is concerned primarily with

> the reasonableness of the fee the lawyer actually seeks before the tribunal rather than the reasonableness of earlier fee claims made between the parties. On the extent to which a lawyer's abusive fee-collection methods affects the lawyer's entitlement to a fee, see § 41.

Restatement (Third) of Law Governing Lawyers § 34 cmt. f (2000).

Interestingly, the Restatement explains that lawyers can agree to provide services without charge, and that clients can enforce such agreements.[4]

> **[E 1358]** Although reasonableness is usually assessed as of the time the contract was entered into, later events might be relevant. Some fee contracts make the fee turn on later events. Accordingly, the reasonableness of a fee due under an hourly rate contract, for example, depends on whether the number of hours the lawyer worked was reasonable in light of the matter and client. It is also relevant whether the lawyer provided poor service, such as might make unreasonable a fee that would be appropriate for better services, or services that were better or more successful than normally would have been expected.

Restatement (Third) of Law Governing Lawyers § 34 cmt. c (2000). States take this same approach.

- **[E 1345]** North Carolina LEO 2008-10 (10/24/08) (in a compendium opinion about fees, explain the four existing types of fees paid in advance, and creating a new type of permissible fee to be paid in advance -- called a "minimum fee"; explaining that "[i]t may be difficult to determine whether a legal fee is clearly excessive until the representation is concluded and all of the relevant factors are taken into consideration. At that point, a lawyer may

[4] Restatement (Third) of Law Governing Lawyers § 38 cmt. c (2000) ("Lawyers sometimes represent clients without payment. A lawyer's agreement, explicit or implicit, to render services without charge is as enforceable as any other fee contract. T he lawyer's obligation to seek no compensation can also result from a waiver or estoppel . . . . When a client reasonably believes that no compensation will be expected, the client does not owe the lawyer a fee. Circumstances indicating such a belief include the small quantity of legal services in question, the absence of any history of paid legal services by the lawyer for the client, and the client's evident indigence. . . . On payment for a preliminary consultation not leading to employment, . . . .").

> be required to disgorge some portion of a fee that he or she has already collected to insure that the total fee is not clearly excessive.").

The Restatement recognizes this distinction between fee contracts and regular contracts in the more general context.

> **[Beginning para of this comment, not in E 1357]** In general, clients and lawyers are free to contract for the fee that client is to pay . . . . Many client-lawyer fee arrangements operate entirely without official scrutiny. A client-lawyer fee arrangement will be set aside when its provisions are unreasonable as to the client . . . . **[E 1357]** Court are concerned to protect clients, particularly those who are unsophisticated in matters of lawyers' compensation, when a lawyer has overreached. Information about fees for legal services is often difficult for prospective clients to obtain. Many clients do not bargain effectively because of their need and inexperience. The services required are often unclear beforehand and difficult to monitor as a lawyer provides them. Lawyers usually encourage their clients to trust them. Lawyers, therefore, owe their clients greater duties than are owed under the general law of contracts.
>
> Moreover, the availability of legal services is often essential if people of limited means are to enjoy legal rights. Those seeking to vindicate their rights through the private bar should not be deterred by the risk of unwarranted fee burdens. **[this last para not include in E 1357]**

Restatement (Third) of Law Governing Lawyers § 34 cmt. b (2000).

> Under § 18, a contract between a client and lawyer is to be construed as a reasonable client would have construed it, considering the contract in the circumstances in which it was made . . . .

Restatement (Third) of Law Governing Lawyers § 38 cmt. d (2000).

The Restatement also explains the type of fee that is automatically "unreasonable" because it is illegal.

> A fee that violates a statute or rule regulating the size of fees is impermissible under this Section. General principles governing the enforceability of contracts that violate legal requirements are set forth in Restatement Second, Contracts §§ 178-185. Statutes or rules in some jurisdictions control the percentage of a contingent fee, generally or in particular categories such as worker-compensation claims or medical-malpractice litigation. Other common legislation limits the fees chargeable in proceedings against the government, forbids contingent fees for legislative lobbying, prohibits public defenders or defense counsel paid by the government from accepting payment from their clients, and prohibits lawyers representing wards of the court from accepting payments not approved by the court. A fee for a service a lawyer may not lawfully perform, such as questioning jurors after a trial where that is forbidden . . . , is likewise unlawful regardless of the size of the fee . . . . A lawyer may not require a client to pay a fee larger than that contracted for, unless the client validly agrees to the increase.

Restatement (Third) of Law Governing Lawyers § 34 cmt. g (2000).

> Those factors might be viewed as responding to three questions. First, when the contract was made, did the lawyer afford the client a free and informed choice? Relevant circumstances include whether the client was sophisticated in entering into such arrangements, whether the client was a fiduciary whose beneficiary deserves special protection, whether the client had a reasonable opportunity to seek another lawyer, whether the lawyer adequately explained the probable cost and other implications of the proposed fee contract . . . , whether the client understood the alternatives available from this lawyer and others, and whether the lawyer explained the benefits and drawbacks of

the proposed legal services without misleading intimations. Fees agreed to by clients sophisticated in entering into such arrangements (such as a fee contract made by inside legal counsel in behalf of a corporation) should almost invariably be found reasonable.

Second, does the contract provide for a fee within the range commonly charged by other lawyers in similar representations? To the extent competition for legal services exists among lawyers in the relevant community, a tribunal can assume that the competition has produced an appropriate level of fee charges. A stated hourly rate, for example, should be compared with the hourly rates charged by lawyers of comparable qualifications for comparable services, and the number of hours claimed should be compared with those commonly invested in similar representations. The percentage in a contingent-fee contract should be compared to percentages commonly used in similar representations for similar services (for example, preparing and trying a novel products-liability claim). Whatever the fee basis, it is also relevant whether accepting the case was likely to foreclose other work or to attract it and whether pursuing the matter at the usual fee was reasonable in light of the client's needs and resources. . . .

Third, was there a subsequent change in circumstances that made the fee contract unreasonable? Although reasonableness is usually assessed as of the time the contract was entered into, later events might be relevant. Some fee contracts make the fee turn on later events. Accordingly, the reasonableness of a fee due under an hourly rate contract, for example, depends on whether the number of hours the lawyer worked was reasonable in light of the matter and client. It is also relevant whether the lawyer provided poor service, such as might make unreasonable a fee that would be appropriate for better services, or services that were better or more successful than normally would have been expected . . . . Finally, events not known or contemplated when the contract was made can render the contract unreasonably favorable to the lawyer or, occasionally, to the client. . . . To determine what events client and lawyer contemplated, their contract must be construed in light of its goals and circumstances and in light of the possibilities discussed with the client . . . . A contingent-fee contract, for example, allocates to the lawyer

> the risk that the case will require much time and produce no recovery and to the client the risk that the case will require little time and produce a substantial fee. Events within that range of risks, such as a high recovery, do not make unreasonable a contract that was reasonable when made.

Restatement (Third) of Law Governing Lawyers § 34 cmt. c (2000).

**(a)**

**(b)**

## Best Answer

The best answer to **(a)** is **NO**; the best answer to **(b)** is **MAYBE**.

# Fixed and Alternative Fees

## Hypothetical 4

Like every other managing partner of a law firm, you are encouraging your colleagues to explore alternative fee arrangements that present a "win-win" scenario for you and your clients. One of your more imaginative associates just asked whether it would be permissible for her to enter into certain types of fee arrangements with the firm clients that she works for. Having encouraged such creative thinking, you feel obligated to answer her right away.

**(a)** May you enter into a fee arrangement in which you keep track of billable hours, but decide at the end of the matter whether you will be paid at your hourly rate or at a certain percentage contingency -- whichever is greater?

**MAYBE**

**(b)** May you enter into a fee agreement in which you agree to accept a certain set amount from an insurance company in full payment for handling each matter?

**MAYBE**

## Analysis

State bars take surprisingly varying views about alternative fee arrangements. Some of these positions seem to reflect legitimate debates over ethics, while others appear to involve successful lobbying by one lawyer group or another.

**(a)** One state bar has approved an arrangement like this,[1] but another bar has condemned it.[2]

[1] Michigan LEO RI-6 (5/19/89) ("A fee agreement in which a client agrees to pay a percentage of the net recovery or the lawyer's hourly rate, whichever is greater, is not improper if: 1. Calculations of the fee under both standards result in a reasonable fee; 2. The fee agreement is in writing; 3. The client is kept advised of the calculation under the hourly rate as the matter progresses; 4. The percentage calculation is at a rate lower than the maximum rate allowable if the lawyer had risked no fee; and 5. The hourly rate or flat fee is lower than the normal rate charged by the lawyer for the matter. In a fee agreement which provides for an hourly rate or flat fee and a percentage of the net recovery, the same tests apply; however, in personal injury or wrongful death cases subject to MCR 8.121, where there is in fact a recovery, the total fee under such an agreement may not exceed 33-1/3% of the net recovery").

**(b)** One state bar has approved an arrangement like this,[3] but a court in another state has condemned it.[4]

The North Carolina Bar identified five types of acceptable advance fees -- including a flat fee.

- **[E1349]** North Carolina LEO 2008-10 (10/24/08) (in a compendium opinion about fees, explain the four existing types of fees paid in advance, and creating a new type of permissible fee to be paid in advance -- called a "minimum fee"; identifying five types of fees that can be paid in advance, and providing additional details about all five: advance payment; general retainers, flat fee or prepaid flat fee; hybrid fees and minimum fees; providing additional explanation of a "flat fee or prepaid flat fee," which the bar defines as: fee paid at the beginning of a representation for specified legal services on a discrete legal task or isolated transaction to be completed within a reasonable amount of time; fee pays for all legal services regardless of the amount of time the lawyer expends on the matter; if client consents, treated as earned immediately and paid to the lawyer or deposited in the firm operating account; some or all of the flat fee is subject to refund if clearly excessive under the circumstances as determined upon the termination of the client-lawyer relationship"; explaining that "[a] flat fee may be earned at the beginning of the representation and is payment 'for specified legal services to be completed within a reasonable period of time.' '[T]his type of fee provides economic value to the client and the lawyer alike because it enables the client

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[2] Ohio LEO 95-7 (6/2/95) ("It is improper for an attorney to enter a fee agreement whereby the client agrees to pay an hourly rate until settlement or collection of judgment at which time the attorney chooses between keeping the hourly fee or receiving a total fee equal to one third of the settlement or recovery depending upon whichever results in the larger fee to the attorney").

[3] West Virginia LEO 98-01 (3/26/98) ("In conclusion, an attorney agreeing to accept insurance defense work on a fixed fee basis is, at a minimum, responsible for carefully evaluating the fixed fee offered by the insurance company and ensuring that, in each particular case, the fee is sufficient for the attorney to provide a competent defense consistent with the ethical rules cited above. To the extent that the fixed fee is not sufficient to satisfy these concerns, the arrangement will violate the Rules").

[4] American Ins. Ass'n v. Kentucky Bar Ass'n, 917 S.W.2d 568, 572-73 (1996) ("[A] set fee arrangement enables the insurer to constrain counsel for the insured by, in effect, limiting the defense budget. . . . We agree with Respondent that the pressures exerted by the insurer through the set fee interferes with the exercise of the attorney's independent professional judgment. . . The set fee arrangement also clashes with Rule 1.7(b) in that it creates a situation whereby the attorney has an interest in the outcome of the action which conflicts with the duties owed to the client: quite simply, in easy cases, counsel will take a financial windfall; in difficult cases, counsel will take a financial loss."; The insurance companies argued that the flat fee prohibition was too broad and that counsel should be free to enter into flat fee agreements subject to the continuing responsibility imposed by the rules governing conflict of interest. The court rejected this argument as well, stating: "we do not wear the blinders that [the insurance companies] apparently have in place, for we view the situation surrounding the set fee agreement as ripe with potential conflicts").

to know, in advance, the expense of the representation and it rewards the lawyer for efficiently handling the matter.' A flat fee arrangement is 'customarily identified with isolated transactions such as representations on traffic citations, domestic actions, criminal charges, and commercial transactions.' The flat fee is collected at the beginning of the representation, treated as money to which the lawyer is immediately entitled, and paid to the lawyer or deposited in the lawyer's general operating account."; providing the following as a proposed (but not mandatory) model fee provision dealing with such fees; "As a condition of the employment of Lawyer, client agrees to pay $_____ to Lawyer as a flat fee for the following specified legal work to be performed by Lawyer for Client: [description of legal work]."; Client understands and specifically agrees that: the flat fee is the entire payment for the specified legal work to be performed by Lawyer regardless of the amount of time that it takes Lawyer to perform the legal work; the flat fee will be earned by Lawyer immediately upon payment and will be deposited in Lawyer's business account rather than a client trust account; and when Lawyer's representation ends, Client will not be entitled to a refund of any portion of the flat fee unless (1) the legal work is not completed, in which event a proportionate refund may be owed, or (2) it can be demonstrated that the flat fee is clearly excessive under the circumstances.").

## Best Answer

The best answer to **(a)** is **MAYBE**; the best answer to **(b)** is **MAYBE**.

# Effect of the Lawyer's Termination

## Hypothetical 5

With the recent downturn in both the real estate and transactional practice that your firm primarily handles, your managing partner has asked you to analyze the financial effect of clients' advising your firm to essentially "pull the plug" on various work you were retained to handle. In particular, she wants to know whether your firm will have to refund any money if the client terminates you without cause.

Will your firm have to refund any money to clients terminating your firm without cause in the following scenarios:

**(a)** If the client had paid you a retainer representing an advance payment of fees, but still has part of that retainer in your firm's trust account after the client has paid all of its bills?

**YES**

**(b)** If the client agreed to a fixed fee of $50,000 for the purchase of a cell phone tower site, which the client abandoned after you were about half way through your work on the project?

**YES**

**(c)** If the client paid your firm a "true retainer" in January to make your firm available all year to handle the client's expansion of franchised restaurants in Kentucky, which the client indicated in June it was no longer interested in pursuing?

**YES**

## Analysis

**[MAYBE MOVE SOME OF THE NONREFUNDABLE FEE DISCUSSION HERE]**

The effect of a lawyer's termination on fees depends in part on whether the client terminated the lawyer for cause. Clients are free to terminate lawyers at any time and for any reason, but the effect of termination on fees generally varies depending on the client's justification for firing the lawyer.

The Restatement explains this difference.

> **[E 1382]** Whether the discharge or withdrawal is attributable to the lawyer's misconduct is relevant to whether contractual compensation should be allowed . . . . The claim to contractual compensation of a lawyer discharged without reasonable grounds, or forced to withdraw by a client's misconduct . . . is stronger than that of a lawyer whose acts have provided such grounds, even if not warranting forfeiture of the entire fee . . . , or civil liability . . . . In the context of Subsection (2), misconduct of the lawyer is not limited to conduct that would warrant professional discipline . . . fee forfeiture . . . , or civil liability . . . . It also includes other conduct that would cause a reasonable client to discharge the lawyer, for example, a series of errors that reasonably leads the client to doubt the lawyer's competence, although they cause no damage and do not constitute incompetence subjecting the lawyer to discipline.

Restatement (Third) of Law Governing Lawyers § 40 cmt. c (2000).

Of course, the fee issue also depends at least logistically on whether the client has already paid part of the fee. Courts and bars frequently deal with lawyers who have collected money from a client and do not want to return it. Although conceptually the same issue arises if the lawyer sues the client for some unpaid amount, those situations do not seem to have generated as much case law or ethics opinions.

In any event, the ABA explains the obvious principle that

> a lawyer may require advance payment of a fee, but is obliged to return any unearned portion.

ABA Model Rule 1.5 cmt. [4]; ABA Model Rule 1.16(d).

The Restatement provides a much more detailed explanation of this issue.

> **[E 1377]** If a client-lawyer relationship ends before the lawyer has completed the services due for a matter and the lawyer's fee has not been forfeited under § 37:
>
> (1) a lawyer who has been discharged or withdraws may recover the lesser of the fair value of the lawyer's services as determined under § 39 and the ratable proportion of the compensation provided by any otherwise enforceable contract between lawyer and client for the services performed; except that
>
> (2) the tribunal may allow such a lawyer to recover the ratable proportion of the compensation provided by such a contract if:
>
> > (a) the discharge or withdrawal is not attributable to misconduct of the lawyer;
> >
> > (b) the lawyer has performed severable services: and
> >
> > (c) allowing contractual compensation would not burden the client's choice of counsel or the client's ability to replace counsel.

Restatement (Third) of Law Governing Lawyers § 40 (2000). A comment explains how the reason for the termination might affect the analysis.

> **[E 1382]** Whether the discharge or withdrawal is attributable to the lawyer's misconduct is relevant to whether contractual compensation should be allowed . . . . The claim to contractual compensation of a lawyer discharged without reasonable grounds, or forced to withdraw by a client's misconduct . . . , is stronger than that of a lawyer whose acts have provided such grounds, even if not warranting forfeiture of the entire fee . . . , or civil liability . . . . In the context of Subsection (2), misconduct of the lawyer is not limited to conduct that would warrant professional discipline . . . fee forfeiture . . . , or civil liability . . . . It also includes other conduct that would cause a reasonable client to discharge the lawyer, for example, a series of errors that reasonably leads the client to doubt the lawyer's competence, although they cause no damage and do not constitute incompetence subjecting the lawyer to discipline.

Restatement (Third) of Law Governing Lawyers § 40 cmt. c (2000).

The Restatement also provides an illustration.

> **[E 1379]** Client retained Lawyer to handle Client's divorce. Lawyer requested and Client paid $2,000 in advance, as full payment. After Lawyer had worked eight hours out of the approximately 16 likely to be needed. Client discharged Lawyer in order to hire Client's brother. (a) If the fair value of Lawyer's work is $100 per hour, Lawyer is entitled to $800 for the eight hours actually worked. Lawyer must refund the rest of the $2,000. (b) If the fair value of Lawyer's work is $300 per hour, Lawyer is entitled to that part of the $2,000 applicable to the work performed, that is to $1,000 and not the fair value of $2,400, because $1,000 was the contractual price for the work Lawyer performed, which was approximately half of the work actually contemplated. Lawyer is not entitled to the full $2,000 lump-sum fee because that fee contemplated performance of all work involved in Client's divorce. Accordingly, the $2,000 must be prorated to reflect the extent of Lawyer's actual services.

Restatement (Third) of Law Governing Lawyers § 40 cmt. b, illus. 1 (2000).

In a separate section, the Restatement explains how a termination affects what the Restatement calls an "engagement-retainer fee" (and which other authorities sometimes call a "true" retainer).

> **[E 1376]** A fee payment that does not cover services already rendered and that is not otherwise identified is presumed to be a deposit against future services. The lawyer's fee for those services will be calculated according to any valid fee contract or, if there is none, under the fair-value standard of § 39. If that fee is less than the deposit, the lawyer must refund the surplus . . . . If the fee exceeds the deposit, the client owes the lawyer the difference. The deposit serves as security for the payment of the fee. . . .
>
> A client and lawyer might agree that a payment is an engagement-retainer fee . . . rather than a deposit. Clients who pay a fee without receiving an explanation ordinarily will assume that they are paying for services, not readiness . . . . A client and lawyer might also agree that an advance payment is neither a deposit nor an engagement retainer,

> but a lump-sum fee constituting complete payment for the lawyer's services. Again, the lawyer must adequately explain this to the client. In any event, an engagement-retainer or lump-sum fee must be reasonable . . . . If the lawyer withdraws or is discharged prematurely or for other misconduct, the contractual fee might be subject to reduction . . . .

Restatement (Third) of Law Governing Lawyers § 38 cmt. g (2000). **[MAYBE USE THIS IN AN EARLIER HYPOTHETICAL]**

Not surprisingly, state bars tend to take the same approach -- requiring return of any fees the lawyer has collected from the client but has not yet earned.

- See, e.g., **[E 1138 B 5/10]** North Carolina LEO 2005-13 (1/20/06) (analyzing the following situation: "Partner C, who practiced family law litigation, typically used a fee contract referred to by the firm as a 'minimum fee' contract. The contract provides that the initial fee charged to the clients is the greater of (1) the flat fee established in the contract, or (2) an hourly rate applied to actual time that will be spent in representation of the client. A minimum fee paid by the client was deposited into the firm's general account. The contract, however, did not state that the fee was deemed earned and payable to the attorney upon receipt."; holding that lawyers remaining at the law firm (after Partner C left and took most of his clients with him) are required to refund unused funds to the clients; "In order for a payment made to an attorney to be earned immediately, the attorney must clearly inform the client that it is earned immediately, and the client must agree to this arrangement. See RPC 158. Even with the consent of the client, only true retainers and flat fees are deemed earned by the lawyer immediately and therefore can be deposited into the operating account upon receipt. A minimum fee that will be billed against at the lawyer's hourly rate is client money and belongs in the trust account until earned. See Rule 1.15-2 (b). In the present case, at some point during the representation, Law Firm would calculate the number of hours C spent on the case and determine whether the client owed more money. The fee arrangement was therefore neither a true retainer nor a flat fee. Furthermore, Law Firm's fee contract did not make an allowance for the fee to be deposited into the firm's operating account. Therefore, those portions of the minimum fees that were not earned by C's labor while with Law Firm remain client funds and must be returned to the clients. See Rule 1.16(d). If Law Firm does not return the unearned portions of the funds to C's clients, they will have collected an excessive fee in violation of Rule 1.5(a).").

Case law takes the same basic approach.

- See, e.g., **[E 1042 B 2/10]** In re Mance, 980 A.2d 1196, 1202, 1203, 1204, 1204-05, 1205-06, 1206 (D.C. 2009) (issuing a public censure of a lawyer who deposited part of a client's flat fee in a trust fund, but did not return that amount to the client after the client requested its return; "We hold that when an attorney receives payment of a flat fee at the outset of a representation, the payment is an 'advance[] of unearned fees' and 'shall be treated as property of the client . . . until earned unless the client consents to a different arrangement.' Rule 1.15(d)."; "A flat fee is different from an engagement retainer, which 'is a fee paid, apart from any other compensation, to ensure that a lawyer will be available for the client if required.' RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 34 cmt. e (2000); see In re Sather, 3 P.3d 403, 410 (Colo. 2000) (en banc) ('In contrast to engagement retainers, a client may advance funds -- often referred to as . . . 'flat fees' -- to pay for specific legal services to be performed by the attorney and to cover future costs.') (citations omitted); see D.C. Legal Ethics Op. 264 (February 14, 2006) (an engagement retainer is a nonrefundable payment to assure the availability of the attorney whether services are performed or not). Engagement retainers are earned when received, but it may become necessary to refund even a portion of a retainer if the lawyer withdraws or is discharged prematurely. See RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 38 cmt. g (2000) ('A fee payment that does not cover services already rendered and that is not otherwise identified is presumed to be a deposit against future services.')."; "In sum, a flat fee is an advance of unearned fees because it is money paid up-front for legal services that are yet to be performed."; "Thus, when Mr. Saunders terminated the representation before the first milestone was met (before the client turned himself in to the police), respondent was obligated to return the initial payment -- or the portion that he had not earned -- because a lawyer 'cannot earn a fee for doing nothing.' In re Sather, 3 P.3d at 414 (citing Apland, 577 N.W. 2d at 57 [Iowa Supreme Court Bd. Of Prof'l Ethics & Conduct v. Apland, 577 N.W.2d 50 (Iowa 1998)])."; "A corollary to the rule that a flat fee is an advance of unearned fees, is that the fee must be held as client funds in a client's trust or escrow account until they are earned by the lawyer's performance of legal services."; "Any such agreement, however, is subject to the overarching principle that an attorney's fees must be reasonable, and requires 'return to the client of any unearned portion of advanced legal fees and unincurred costs.' Rule 1.15(d); see Rule 1.16(d). Simply labeling a fee as something other than a flat fee . . . or extreme 'front-loading' of payment milestones in the context of the anticipated length and complexity of the representation will not excuse the lawyer from safekeeping the client's funds until it can reasonably be said that they have been earned in light of the scope of the representation."; "[S]ince we announce for the first time that under Rule 1.15(d) flat fees are an advance of unearned fees that belong to the client until earned by the lawyer (unless other reasonable arrangements have been made), we agree with the recommendation made by both the Board and Bar Counsel that our holding in this case should be prospective

only."; explaining that an informed client might agree to a different arrangement; "Although the default rule is that an attorney must hold flat fees in a client trust or escrow account until earned, we note that an attorney may obtain informed consent from the client to deposit all of the money in the lawyer's operating account or to deposit some of the money in the lawyer's operating account as it is earned, per their agreement.").

- **[E 1350]** North Carolina LEO 2008-10 (10/24/08) (in a compendium opinion about fees, explain the four existing types of fees paid in advance, and creating a new type of permissible fee to be paid in advance -- called a "minimum fee"; identifying five types of fees that can be paid in advance, and providing additional details about all five: advance payment; general retainers, flat fee or prepaid flat fee; hybrid fees and minimum fees; providing additional explanation about a "hybrid fee," which the bar defines as follows: "fee paid at the beginning of a representation that is in part a general retainer or a flat fee and in part an advance payment to secure payment of fees yet to be earned; one portion of the fee is earned immediately and the other remains the client's property on deposit in the trust account; client must consent and agree to the portion that is a flat fee or a general retainer and earned immediately; unearned portion of the advance payment refunded upon termination of the client-lawyer relationship; flat fee/general retainer portion subject to refund if clearly excessive under the circumstances as determined upon the termination of the client-lawyer relationship."; explaining that "[t]he opinion recognizes that a lawyer may charge a client hybrid fees. Such hybrid fees include a payment that is part general retainer or flat fee and part advance to secure the payment of fees yet to be earned. With hybrid fees, one portion of the fee is earned immediately and the other portion remains the client's property and must be deposited in the trust account to be withdrawn as earned. 'There should be a clear agreement between the lawyer and the client as to which portion of the payment is a true general retainer, or a flat fee, and which portion of the payment is an advance. Absent such an agreement, the entire payment must be deposited into the trust account and will be considered client funds until earned.'").

The Restatement also deals with fees that a terminated lawyer may seek.

> If a client-lawyer relationship ends before the lawyer has completed the services due for a matter and the lawyer's fee has not been forfeited under § 37:
>
> (1) a lawyer who has been discharged or withdraws may recover the lesser of the fair value of the lawyer's services as determined under § 39 and the ratable proportion of the compensation provided by any otherwise enforceable contract between lawyer and client for the services performed; except that
>
> (2) the tribunal may allow such a lawyer to recover the ratable proportion of the compensation provided by such a contract if:
>
> (a) the discharge or withdrawal is not attributable to misconduct of the lawyer;
>
> (b) the lawyer has performed severable services; and
>
> (c) allowing contractual compensation would not burden the client's choice of counsel or the client's ability to replace counsel.

Restatement (Third) of Law Governing Lawyers § 40 (2000).

A comment describes this principle in more detail.

> The rule of § 40(1) entitles the discharged lawyer to the lesser of the fair value of the lawyer's services and the contractual fee prorated for the services actually performed. . . . The lawyer receives a fair fee. The client pays only for work already performed and should be able to find new counsel willing not to charge for work already performed. Limiting recovery to the contractual fee, moreover, accepts the parties' own valuation of the worth of the whole representation as a limit on the valuation of part of it. . . . If the contractual fee was an hourly one and the fee is reasonable . . . , the fair value of the lawyer's services is usually the same as the hourly fee for the number of hours worked . . . .

Restatement (Third) of Law Governing Lawyers § 40 cmt. b (2000).

A series of five illustrations provide examples of how this principle works.

1. Client retained Lawyer to handle Client's divorce. Lawyer requested and Client paid $2,000 in advance, as full payment. After Lawyer had worked eight hours out of the approximately 16 likely to be needed, Client discharged Lawyer in order to hire Client's brother. (a) If the fair value of Lawyer's work is $ 100 per hour, Lawyer is entitled to $800 for the eight hours actually worked. Lawyer must refund the rest of the $2,000. (b) If the fair value of Lawyer's work is $300 per hour, Lawyer is entitled to that part of the $2,000 applicable to the work performed, that is to $1,000 and not the fair value of $2,400, because $1,000 was the contractual price for the work Lawyer performed, which was approximately half of the work actually contemplated. Lawyer is not entitled to the full $2,000 lump-sum fee because that fee contemplated performance of all work involved in Client's divorce. Accordingly, the $2,000 must be prorated to reflect the extent of Lawyer's actual services.

2. The same facts as in Illustration 1, except that the $2,000 advance payment is designated in the contract between Client and Lawyer not as full payment for Lawyer's services but as a nonrefundable engagement retainer . . . . If the fair value of Lawyer's work is $100 per hour, Lawyer is entitled to $800 for the eight hours worked. Because Client and Lawyer had agreed to an engagement retainer to ensure that Lawyer would be compensated for costs incurred in reliance on being retained, Lawyer can also recover for the fair value not exceeding $2,000 . . . of expenses or loss of income Lawyer reasonably incurred by accepting the engagement retainer . . . .

3. The same facts as in Illustration 1, except that the $2,000 payment is designated in the fee contract as a nonrefundable engagement-retainer fee . . . , and the contract between Client and Lawyer further provides that Lawyer is to be compensated at Lawyer's typical hourly rate of $100 per hour. If $100 is the fair value of Lawyer's services, Lawyer is entitled to $800 for the eight hours worked. In addition, if $2,000 is a reasonable amount to charge in the circumstances as an engagement retainer (id.), Lawyer is entitled to retain that $2,000.

4. Client retained Lawyer to bring a tort suit for a contingent fee of one-third of any recovery. Client discharged Lawyer after Lawyer had worked 100 hours, because Client found Lawyer's manner overbearing. The

> fair value of Lawyer's time is $100 per hour. Until Client prevails in the suit, Lawyer has no right to a fee, because under the contract no fee was due unless and until Client recovered . . . . If Client recovers $60,000, Lawyer is entitled to $10,000, which is the lesser of the contractual fee ($20,000) and the fair value of Lawyer's services (100 hours at $100 per hour, or $10,000).
>
> 5. Client retained Lawyer to prepare a securities registration statement for a fee of $100 per hour. Because Client preferred to work with another lawyer, Client discharged Lawyer after Lawyer had worked 80 hours but before Lawyer had substantially completed the work. Client owes Lawyer $8,000, unless the tribunal finds that the fair value of Lawyer's services was less than the rate to which Client and Lawyer agreed. Even if the tribunal makes such a finding, to the extent that successor counsel would not have to repeat what the discharged lawyer has already done, the lawyer has completed a severable part of the services and may recover at the contractual rate . . . .

Restatement (Third) of Law Governing Lawyers § 40 cmt. b, illus. 1-5 (2000).

The next Restatement comment addresses the enforceability of the fee agreement in this circumstance.

> Allowing a discharged or withdrawing lawyer to recover compensation under a fee contract with the client is sometimes more appropriate than fee forfeiture or recovery of the lesser of fair value and contractual compensation. The most common situation calling for such treatment is where the client discharges a contingent-fee lawyer without cause just before the contingency occurs, perhaps in order to avoid paying the contractual percentage fee. The reasons for the usual restrictions on contractual recovery then do not apply. . . .
>
> The tribunal therefore may in its discretion allow contractual compensation when circumstances warrant it, as specified in Subsection (2). As is true when a contractual fee is calculated under Subsection (1), the contractual fee is prorated for the services actually performed . . . . For example, if a lawyer who has performed half of the work required on a matter subject to a contingent-fee contract is

> allowed under Subsection (2) to recover a contractual fee, the lawyer should recover half of the contingent fee.
>
> Whether the discharge or withdrawal is attributable to the lawyer's misconduct is relevant to whether contractual compensation should be allowed . . . . The claim to contractual compensation of a lawyer discharged without reasonable grounds, or forced to withdraw by a client's misconduct . . . , is stronger than that of a lawyer whose acts have provided such grounds, even if not warranting forfeiture of the entire fee . . . , or civil liability . . . . In the context of Subsection (2), misconduct of the lawyer is not limited to conduct that would warrant professional discipline . . . , fee forfeiture . . . , or civil liability . . . . It also includes other conduct that would cause a reasonable client to discharge the lawyer, for example, a series of errors that reasonably leads the client to doubt the lawyer's competence although they cause no damage and do not constitute incompetence subjecting the lawyer to discipline.
>
> The lawyer's provision of severable services (Subsection (2)(b)) is also a prerequisite for granting compensation at the contractual rate for those services. When a new lawyer would not have to repeat what has already been done in order to carry on the representation and when it is possible (for example, because the parties agreed to an hourly fee) to determine with reasonable accuracy the portion of the contractual fee allocable to the services performed, there is less occasion than otherwise to apply the rule of Subsection (1). . . .
>
> A third condition stated in Subsection (2)(c) is whether allowing contractual compensation would significantly burden the client's choice of counsel or ability to change counsel, a choice which the rule of Subsection (1) protects. For example, contractual compensation is more appropriate if the lawyer's discharge or withdrawal occurred when the client could find replacement counsel without significant delay or risk.

Restatement (Third) of Law Governing Lawyers § 40 cmt. c (2000).

Another Restatement provision deals with a lawyer's withdrawal for cause.

> A lawyer may properly withdraw on various grounds, for example because the client insists that the lawyer perform

> services in a manner that would violate a lawyer code or refuses to pay the lawyer's proper fees . . . . If the requirements of Subsection (2) are not met and there is no forfeiture, the withdrawing lawyer's compensation is limited to the lesser of the contractual fee for the services performed or the fair value of the lawyer's services. Were that not so, lawyers would be encouraged to withdraw before being discharged in order to avoid the rule of Subsection (1).
>
> When the lawyer withdraws for reasons not attributable to misconduct of the lawyer, the lawyer has performed severable services, and allowing contractual compensation would not significantly burden the client's choice of counsel or ability to replace counsel . . . , the tribunal may in its discretion allow the lawyer to recover at the contractual rate under Subsection (2).

Restatement (Third) of Law Governing Lawyers § 40 cmt. d (2000).

The next Restatement provision deals with a lawyer guilty of some misconduct.

> A lawyer who withdraws in violation of § 32 or commits misconduct before completing services, in some circumstances will forfeit the right to compensation for services already performed or to be performed . . . .
>
> A lawyer who withdraws has the burden of persuading the trier of fact that the withdrawal is not attributable to a clear and serious violation of the lawyer's duty . . . to render loyal and competent service. . . . For example, a lawyer who knowingly or recklessly undertakes to represent a client in a suit against another client of the lawyer's firm without the consent of both clients in violation of § 128(2) is subject to forfeiture of compensation even though the lawyer's withdrawal is compelled under § 32(2)(a). Withdrawal in violation of § 32 can similarly subject the lawyer to forfeiture.
>
> On the other hand, forfeiture is inappropriate when the lawyer's withdrawal or discharge is not attributable to the lawyer's clear and serious violation of duty to the client. For example, the lawyer might have withdrawn or have been discharged because the client insisted that the lawyer violate professional rules. So also, a merger of a corporate client might have created a conflict of interest, requiring the lawyer to withdraw . . . . Similarly, forfeiture is inappropriate where

> termination is compelled by events beyond the lawyer's reasonable control, such as the lawyer's death or illness.

Restatement (Third) of Law Governing Lawyers § 40 cmt. e (2000).

> Dictum in several cases supports using the contractual fee as the measure of quantum meruit recovery when the client discharges the lawyer at the last moment.

Restatement (Third) of Law Governing Lawyers § 40 cmt. c, reporter's note (2000).

> A few jurisdictions hold a lawyer's fee forfeited whenever a client discharges the lawyer 'for cause.'

Restatement (Third) of Law Governing Lawyers § 40 cmt. e, reporter's note (2000).

- **[E 1378]** Restatement (Third) of Law Governing Lawyers § 40 cmt. b (2000) ("A client might discharge a lawyer before substantial completion of the services. The discharge might occur in circumstances not justifying forfeiture of the lawyer's compensation, for example because the client decides unreasonably that the lawyer's approach to the matter is inappropriate. Some older decisions reason that such a lawyer, not having violated the contract, is entitled to receive the contractual fee less the value of any services the lawyer avoided by being discharged. Alternatively, it could be argued that the lawyer should be able to treat the contract as revoked and recover in quantum meruit . . . the fair value of whatever services the lawyer rendered, even if that recovery exceeds the contractual price."; "Those approaches are incorrect except in the circumstances in which contractual recovery is appropriate. . . . The discharged lawyer has not completed the work for which the contractual fee was due. Noncompletion results not from any improper act of the client, but from the client's exercise of the right to discharge counsel. . . . That right should not be encumbered by permitting the lawyer the option of either recovery at the contractual rate or in quantum meruit without appropriate adjustment for work yet to be performed.").

**[APPLIED IN A NONCONTINGENT CASE]**

## Best Answer

The best answer to **(a)** is **YES**; the best answer to **(b)** is **YES**; the best answer to **(c)** is **YES**.

# Liquidated Damages Provision

## Hypothetical 6

Your law firm has been "burned" recently when clients have abandoned various projects after your firm had invested some sunk costs in preparation for long-term representations. You wonder whether you can include a provision in future retainer agreements that would address such a situation.

**(a)** May a retainer agreement contain a "liquidated damages" clause requiring the client to pay a specified amount if it terminates a normal representation without cause?

**NO (PROBABLY)**

**(b)** Can you include a liquidated damage provision requiring the client to pay a specified amount if it terminates (without cause) a representation that had required you to rent office space off site, purchase computers and copy equipment, and licensed very expensive software for which you cannot be reimbursed by the software vendor?

**MAYBE**

## Analysis

Somewhat surprisingly, at least one court has upheld a liquidated damage provision signed by a sophisticated client.

- **[E 424** B 1/09; n 3/09**]** McQueen, Rains & Tresch, LLP v. CITGO Petroleum Corp., 195 P.3d 35 (Okla. 2008) (holding that a sophisticated client like CITGO may agree to a liquidated damages provision in a law firm retainer agreement; explaining that the law firm had agreed to pay fixed-fee four-year contract with CITGO, which included a liquidated damages clause requiring CITGO to pay the firm a certain amount if CITGO terminated the contract; upholding the provision after CITGO terminated the retainer agreement with the law firm).

**[CHECK THIS -- I (Bev) think that part of this should go into the next hypo]**

Most courts and bars probably would not approve such a liquidated damages provision, either because it would amount to an impermissible "nonrefundable" fee, or because the lawyer did not adequately explain the provision to the client.

Not surprisingly, a lawyer guilty of some misconduct might have to disgorge fees.

> **[E 1374]** A lawyer engaging in clear and serious violation of duty of a client may be required to forfeit some or all of the lawyer's compensation for the matter. Considerations relevant to the question or forfeiture include the gravity and timing of the violation, its willfulness, its effect on the value of the lawyer's work for the client, any other threatened or actual harm to the client, and the adequacy of other remedies.

Restatement (Third) of Law Governing Lawyers § 37 (2000).

However, not every ethics violation results either in an obligation to disgorge, or even deprivation of fees. The Restatement explains that lawyers can still recover fees despite some technical violation of the ethics rules.

> **[E 1361]** That a fee contract violates some legal requirement does not necessarily render it unenforceable. The requirement might be one not meant to protect clients or one for which refusal to enforce is an inappropriate sanction. For example, when a lawyer violates a lawyer-code requirement that a fee contract be in writing but the client does not dispute the amount owed under it, that violation along should not make the contract unenforceable. When only certain parts of a contract between client and lawyer contravene the law, moreover, the lawful parts remain enforceable, except where the lawyer should forfeit the whole fee.

Restatement (Third) of Law Governing Lawyers § 34 cmt. g (2000).

Depending on the ethics violation, courts differ on whether lawyers may recover fees despite falling short of their ethics duties.

Some courts explicitly permit lawyers to recover fees despite an ethics violation.

- **[E 1227 B 10/11]** Wagner & Wagner, LLP v. Atkinson, Haskins, Nellis, Brittingham, Gladd & Carwile, P.C., 596 F.3d 84 (2d Cir. 2010) (explaining that a court approving an infant settlement could analyze various law firms' participation, and award a portion of the fee to a law firm despite the law firm's violation of an ethics rule requiring full disclosure of the fee split).

- **[E 1204 B 10/11]** Nabi v. Sells, 892 N.Y.S.2d 41, 43-44, 44 (N.Y. App. Div. 2009) (allowing a lawyer to obtain quantum meruit recovery of fees although the contingency fee retainer agreement did not comply with New York ethics rules; "We need not decide whether any of the alleged defects in the retainer agreement, alone or in combination, bar recovery in contract. Provided that defendant attorneys were not discharged for cause, in which case they would not be entitled to any fee. . . , their recovery would be limited to the fair and reasonable value of their services, computed on the basis of quantum meruit . . . . The rationale for the rule is that, due to the special relationship of the utmost trust and confidence between a client and an attorney, the client has the right to discharge the attorney at any time, for any reason, or for no reason, regardless of any particularized retainer agreement, and the client should not be compelled to pay damages for exercising the absolute right to cancel the contract . . . . Against the client's unqualified right to terminate the attorney-client relationship is balanced the notion that a client should not be unjustly enriched at the attorney's expense to take undue advantage of the attorney, and therefore the attorney is entitled to recover the reasonable value of services rendered . . . . After the termination of the relationship, the client and attorney of course remain free to reach a new agreement that, in lieu of a fixed dollar amount for the quantum meruit value of services rendered, the discharged attorney shall receive as compensation a contingent percentage of the recovery, determined either at the time of substitution or the conclusion of the case . . . . However, such an arrangement of payment cannot be compelled by the attorney; it can only be reached with the consent of the client."; explaining that different rules applied when lawyers were fighting over fees; "By contrast, where the dispute is between successive lawyers, rather than between the client and the attorney, a different set of rules applies . . . . In that situation, the outgoing attorney may elect, even over the objections of the incoming attorney, either quantum meruit compensation in a fixed dollar amount at the time of discharge, or a contingent percentage fee, determined either at the time of substitution or the conclusion of the case . . . . Even then, however, in the absence of an agreement between the outgoing and incoming attorneys, the contingent percentage fee is measured by quantum meruit, based on the discharged attorney's proportionate share of the work performed on the whole case, in addition to the amount of recovery . . . . Indeed, the additional option of contingent percentage compensation that a discharged attorney has against incoming attorneys, not available as against the former client, sounds in quantum meruit: the incoming attorneys should not unjustly enriched at the expense of the outgoing attorney."; ultimately concluding that the dispute before the court was "between only the client and the discharged

attorney," so that the "if it is established that defendants were discharged without cause, their recovery is limited to quantum meruit in a fixed dollar amount, which may be more or less than that provided in the rescinded contract that had existed between them and plaintiff, and which may be presently payable or secured by lien.").

- **[E 441 B 2/09]** Bertelsen v. Harris, 537 F.3d 1047 (9th Cir. 2008) (holding that a lawyer who had violated fiduciary duties should not automatically be ordered to disgorge fees; upholding the lower court's decision not to order disgorgement despite a possible breach of fiduciary duty).

- **[E 371 B 1/09]** Roatenberry v. Ford Motor Co., 74 Va. Cir. 509 (Va. Cir. Ct. 2008) (in a lemon law case, holding that a lawyer may recover contingent fee although there was no written contingent-fee arrangement, as required by the ethics rules).

- **[E 179 N 1/08]** Seth Rubenstein, P.C. v. Ganea, 833 N.Y.S.2d 566, 573 (N.Y. App. Div. 2007) (holding that a lawyer's failure to comply with the New York ethics rules' requirement of a written retainer agreement did not preclude the law firm's quantum meruit fee for "the fair and reasonable value of the services rendered on behalf of [the client] prior to his discharge as counsel"; "Attorneys continue to have every incentive to comply with 22 NYCRR 1215.1, as compliance establishes in documentary form the fee arrangements to which clients become bound, and which can be enforced through Part 137 arbitration or through court proceedings. Attorneys who fail to heed Rule 1215.1 place themselves at a marked disadvantage, as the recovery of fees becomes dependent upon factors that attorneys do not necessarily control, such as meeting the burden of proving the terms of the retainer and establishing that the terms were fair, understood, and agreed upon. There is never any guarantee that an arbitrator or court will find this burden met or that the fact-finder will determine the reasonable value of services under quantum meruit to be equal to the compensation that would have been earned under a clearly written retainer agreement or letter of engagement.").

In contrast, some courts have found lawyers violating an ethics rule have essentially forfeited their right to obtain fees.

- **[E 1649 B 4/11]** Eng v. Cummings, McClorey, Davis & Acho, PLC, 611 F.3d 428, 433 & n.8, 434, 435 & n.11 (8th Cir. 2010) (analyzing a fee-sharing situation, in which the Missouri law firm of Eng & Woods successfully sought a declaratory judgment holding that it did not owe a portion of its fees to the other law firm which referred a personal injury client to Eng & Woods, but did not comply with Missouri's fee-sharing rules; explaining that the plaintiff law firm only provided the referring law firm ten percent of its ultimate attorneys' fees recovered in the case, not the one-third that the defendant law firm

claims it was owed; "We agree with the district court that, assuming there was a fee-splitting agreement between Acho [referring lawyer] and Eng [plaintiff lawyer, which handled the case], this agreement did not comply with Rule 4-1.5(e). First, there is no written agreement between CMDA [referring law firm which sought additional fees from the plaintiff law firm] and either Richina or MitRahina [clients]. CMDA has produced no representation agreement with Richina or MitRahina, and Acho is 'not certain if [Richina] returned a signed employment agreement or not.'. . . Moreover, it appears that CMDA had no direct contact with MitRahina whatsoever, thus any argument that CMDA is entitled to a share of the attorney's fees from her recovery finds no support in Rule 4-1.5(e)."; "Due to this lack of communication with MitRahina, it appears that any alleged agreement to share the fee from her recovery also runs afoul of Rule 4-1.5(e)(2), which requires that 'the client is advised of and does not object to the participation of all the lawyers involved.'"; "To be sure, the evidence demonstrates that Richina was aware of the fee-splitting arrangement, and while we might agree with CMDA that the underlying purpose of Rule 4-1.5(e) -- to advise the client that each lawyer will assume joint responsibility for the case and ensure the client does not object -- was satisfied here, the letter of the Rule was not."; explaining that the referring law firm had not complied with Missouri's fee-sharing rules; "[T]he record clearly shows the lack of any signed agreement between CMDA and Richina or MitRahina."; "[E]ven if the December 1 letter qualifies as a written agreement, it does not meet Rule 4-1.5(e)(1)'s joint responsibility requirement. By its terms, Rule 4-1.5(e)(1) requires that the written agreement itself inform the client that each lawyer will assume joint responsibility for the case, not just that the lawyers will split the fee between them. . . . Rule 4-1.5(e) requires that the written agreement itself state that each lawyer is jointly responsible. . . . The fact that CMDA was in touch with one of the clients or could have been liable for malpractice if Richina or MitRahina were unhappy with their representation is not enough to show joint representation."; "[E]ven if CMDA's actions show the exercise of some level of professional responsibility, they do not amount to 'joint responsibility' as that term is used in Rule 4-1.5(e)(1)."; "Nothing that Acho did rises to this level. He did not file an appearance in the wrongful death action; he did not pay any portion of the court fees; he did not take depositions (although it appears at one point he offered to); and he did not assist Eng & Woods in formulating a trial strategy. Indeed, he appears to never have actually met Richina, MitRahina, or Eng. Acho's role appears to have been limited to occasional telephone conversations with one of the clients and with that client's uncle. . . . While Acho's actions might amount to more than a mere referral, it is little more. Thus, we hold that any fee-splitting agreement between Acho and Eng did not comply with Rule 4-1.5(e). As such, the agreement is unenforceable as a matter of law."; noting that other authorities disagree with this position; "Although we are bound to apply settled Missouri law on this point, we note that other federal courts have come to different conclusions when interpreting rules similar to Rule 4-1.5(e). See Freeman v. Mayer, 95 F.3d 569, 574-75

(7th Cir. 1996) (holding that a technical violation of the written-agreement requirement of Indiana Rule of Professional Conduct 1.5(e) did not operate to invalidate a fee-splitting agreement that was otherwise valid); Sanders v. Mueller, 133 F. App'x 37, 43 (4th Cir. 2005) (unpublished) ('A court must not declare invalid a fee-sharing agreement for violations [of the Maryland Rules of Professional Conduct] that are merely technical, incidental, or insubstantial or when it would be manifestly unfair and inequitable not to enforce the agreement.' (quotation omitted)). As in Freeman and Sanders, it appears that, if a fee-splitting agreement existed between Acho and Eng, Acho's violations of Rule 4-1.5(e) were merely technical, at least as to Richina. However, the fact remains that the agreement runs afoul of Rule 4-1.5(e) and is, therefore, unenforceable under Missouri law."; affirming judgment for the plaintiff law firm, and denying the referring law firm's claim for more fees).

- **[E 481 B 2/09]** Strong v. Beydoun, 83 Cal. Rptr. 3d 632 (Cal. Ct. App. 2008) (holding that a lawyer could not recover under the quantum meruit doctrine for work performed under an improper fee-split arrangement that the client had not approved).

- **[E 661 B 3/09]** McTyeire v. Hunt (In re McTyeire), 357 B.R. 898, 901 (Bankr. M.D. Ga. 2006) (ordering a debtor's lawyer to disgorge fees, as well as ordering the lawyer to pay actual damages to his former clients and reprimanding the lawyer for improper behavior; "When the McTyeires [debtors represented by the lawyer] began contemplating bankruptcy, they consulted Mr. Hunt [lawyer]. Before they hired him, they watched a video that he shows to prospective clients. The video states several consequences for failing to pay Mr. Hunt's attorney fees, including suing the clients, hunting them down and selling their children into slavery, and dismissing their bankruptcy case.").

## Best Answer

The best answer to **(a)** is **PROBABLY NO**; the best answer to **(b)** is **MAYBE**.

# Effect of an Ethics Violation

## Hypothetical 7

As the assistant general counsel of a large public company, you oversee your client's relationship with its outside counsel network. You recently confronted two issues requiring your attention.

**(a)** Can you recover all of the hourly fees you paid an outside law firm which handled a matter for your client while simultaneously representing another company in a lawsuit against you -- because the lawyer representing the other company had not properly entered that matter in the law firm's conflicts database?

**MAYBE**

**(b)** Can you recover all of the hourly fees you paid an outside law firm which knowingly represented you in a corporate transaction while simultaneously representing another company in a lawsuit against you in south Texas?

**NO (PROBABLY)**

## Analysis

- **[E 1361]** Restatement (Third) of Law Governing Lawyers § 34 cmt. g (2000) ("That a fee contract violates some legal requirement does not necessarily render it unenforceable. The requirement might be one not meant to protect clients or one for which refusal to enforce is an inappropriate sanction. For example, when a lawyer violates a lawyer-code requirement that a fee contract be in writing but the client does not dispute the amount owed under it, that violation along should not make the contract unenforceable. When only certain parts of a contract between client and lawyer contravene the law, moreover, the lawful parts remain enforceable, except where the lawyer should forfeit the whole fee.").

- **[E 1375]** Restatement (Third) of Law Governing Lawyers § 38(1) (2000) ("Before or within a reasonable time after beginning to represent a client in a

> matter, a lawyer must communicate to the client, in writing when applicable rules so provide, the basis or rate of the fee, unless the communication is unnecessary for the client because the lawyer has previously represented that client on the same basis or at the same rate.").

The Restatement generally indicates that a lawyer's ethics violation (or other wrongful conduct) affects that lawyer's entitlement to fees.

> A lawyer's improper conduct can reduce or eliminate the fee that the lawyer may reasonably charge under § 34. . . . A lawyer is not entitled to be paid for services rendered in violation of the lawyer's duty to a client or for services needed to alleviate the consequences of the lawyer's misconduct. . . . (agent entitled to no compensation for conduct which is disobedient or breach of duty of loyalty to principal). A tribunal will also consider misconduct more broadly, as evidence of the lawyer's lack of competence and loyalty, and hence of the value of the lawyer's services.

Restatement (Third) of Law Governing Lawyers § 37 cmt. a (2000). An illustration provides some additional insight.

> Lawyer has been retained at an hourly rate to negotiate a contract for Client. Lawyer assures the other parties that Client has consented to a given term, knowing this to be incorrect. Lawyer devotes five hours to working out the details of the term. When Client insists that the term be stricken . . . , Lawyer devotes four more hours to explaining to the other parties that Lawyer's lack of authority and Client's rejection of the term requires further negotiations. Lawyer is not entitled to compensation for any of those nine hours of time under either § 34 or § 39. The tribunal, moreover, may properly consider the incident if it bears on the value of such of Lawyer's other time as is otherwise reasonably compensable.

Restatement (Third) of Law Governing Lawyers § 37 cmt. a, illus. 1 (2000).

The Restatement explains the basis for this harsh rule.

> The remedy of fee forfeiture presupposes that a lawyer's clear and serious violation of a duty to a client destroys or severely impairs the client-lawyer relationship and thereby the justification of the lawyer's claim to compensation. . . . Forfeiture is also a deterrent. The damage that misconduct causes is often difficult to assess. In addition, a tribunal often can determine a forfeiture sanction more easily than a right to compensating damages.
>
> Forfeiture of fees, however, is not justified in each instance in which a lawyer violates a legal duty, nor is total forfeiture always appropriate. Some violations are inadvertent or do not significantly harm the client. Some can be adequately dealt with by the remedies described in Comment a or by a partial forfeiture . . . . Denying the lawyer all compensation would sometimes be an excessive sanction, giving a windfall to a client. The remedy of this Section should hence be applied with discretion.

Restatement (Third) of Law Governing Lawyers § 37 cmt. b (2000). The Restatement explains that this rule only applies to a lawyer's breach of duty to a client, and not to others.

> This Section provides for forfeiture when a lawyer engages in a clear and serious violation . . . of a duty to the client. The source of the duty can be civil or criminal law, including, for example, the requirements of an applicable lawyer code or the law of malpractice. The misconduct might have occurred when the lawyer was retained, during the representation, or during attempts to collect a fee. . . On improper withdrawal as a ground for forfeiture. . . .
>
> The Section refers only to duties that a lawyer owes to a client, not to those owed to other persons. That a lawyer, for example, harassed an opponent in litigation without harming the client does not warrant relieving the client of any duty to pay the lawyer. . . . But sometimes harassing a nonclient will also violate the lawyer's duty to the client, perhaps exposing the client to demands for sanctions or making the client's cause less likely to prevail. Forfeiture

> will then be appropriate unless the client is primarily responsible for the breach of duty to a nonclient.

Restatement (Third) of Law Governing Lawyers § 37 cmt. c (2000).

The Restatement provides a further explanation of the factors to consider.

> A lawyer's violation of duty to a client warrants fee forfeiture only if the lawyer's violation was clear. A violation is clear if a reasonable lawyer, knowing the relevant facts and law reasonably accessible to the lawyer, would have known that the conduct was wrongful. The sanction of fee forfeiture should not be applied to a lawyer who could not have been expected to know that conduct was forbidden, for example when the lawyer followed one reasonable interpretation of a client-lawyer contract and another interpretation was later held correct.
>
> To warrant fee forfeiture a lawyer's violation must also be serious. Minor violations do not justify leaving the lawyer entirely unpaid for valuable services rendered to a client, although some such violations will reduce the size of the fee or render the lawyer liable to the client for any harm caused . . . .
>
> In approaching the ultimate issue of whether violation of duty warrants fee forfeiture, several factors are relevant. The extent of the misconduct is one factor. Normally, forfeiture is more appropriate for repeated or continuing violations than for a single incident. Whether the breach involved knowing violation or conscious disloyalty to a client is also relevant. . . . Forfeiture is generally inappropriate when the lawyer has not done anything willfully blameworthy, for example, when a conflict of interest arises during a representation because of the unexpected act of a client or third person.
>
> Forfeiture should be proportionate to the seriousness of the offense. For example, a lawyer's failure to keep a client's funds segregated in a separate account . . . should not result in forfeiture if the funds are preserved undiminished for the client. But forfeiture is justified for a flagrant violation even though no harm can be proved.
>
> The adequacy of other remedies is also relevant. If, for example, a lawyer improperly withdraws from a

> representation and is consequently limited to a quantum meruit recovery significantly smaller than the fee contract provided . . . , it might be unnecessary to forfeit the quantum meruit recovery as well.

Restatement (Third) of Law Governing Lawyers § 37 cmt. d (2000). The Restatement also explains how a court or bar should determine the degree of fee forfeiture based on the lawyer's misconduct.

> Ordinarily, forfeiture extends to all fees for the matter for which the lawyer was retained, such as defending a criminal prosecution or incorporating a corporation. (For a possibly more limited loss of fees under other rules, see Comment a hereto.) . . . . Forfeiture does not extend to a disbursement made by the lawyer to the extent it has conferred a benefit on the client . . . .
>
> Sometimes forfeiture for the entire matter is inappropriate, for example when a lawyer performed valuable services before the misconduct began, and the misconduct was not so grave as to require forfeiture of the fee for all services. Ultimately the question is one of fairness in view of the seriousness of the lawyer's violation and considering the special duties imposed on lawyers, the gravity, timing, and likely consequences to the client of the lawyer's misbehavior, and the connection between the various services performed by the lawyer.
>
> When a lawyer-employee of a client is discharged for misconduct, except in an extreme instance this Section does not warrant forfeiture of all earned salary and pension entitlements otherwise due. The lawyer's loss of employment will itself often be a penalty graver than would be the loss of a fee for a single matter for a nonemployee lawyer. Employers, moreover, are often in a better position to protect themselves against misconduct of their lawyer-employees through supervision and other means. . . .

Restatement (Third) of Law Governing Lawyers § 37 cmt. d (2000).[1]

[1] A later provision indicates that lawyers seeking fees in this context will be treated as if there had been no fee contract. Restatement (Third) of Law Governing Lawyers § 39 cmt. e (2000) ("A lawyer typically seeks recovery as provided under this Section when there is no applicable client-lawyer fee contract . . . or the parties have agreed to abrogate such a contract. In addition, should a fee contract be unenforceable a lawyer

> Second, under contract law a lawyer's conduct can render unenforceable the lawyer's fee contract with a client. Thus under contract law the misconduct could constitute a material breach of contract . . . or vitiate the formation of the contract (as in the case of misrepresentations concerning the lawyer's credentials). Alternatively, the contract can be unenforceable because it contains an unlawful provision . . . . In some cases, although the contract is unenforceable on its own terms, the lawyer will still be able to recover the fair value of services rendered . . . .
>
> Third, a lawyer's misconduct can constitute malpractice rendering the lawyer liable for any resulting damage to the client under the common law or, in some jurisdictions, a consumer-protection statute . . . . Malpractice damages can be greater or smaller than the forfeited fees. Conduct constituting malpractice is not always the same as conduct warranting fee forfeiture. A lawyer's negligent legal research, for example, might constitute malpractice, but will not necessarily lead to fee forfeiture. . . .

Restatement (Third) of Law Governing Lawyers § 37 cmt. a (2000).

**[MAYBE MOVE TO TERMINATION OF LAWYER DISCUSSION]**

Of course, one possible ethics violation of which a lawyer might be guilty is the absence of a valid fee arrangements (such as the absence of a written fee arrangement

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can obtain quantum meruit recovery under this Section, unless the lawyer's conduct warrants fee forfeiture under § 37. See also § 40, stating the effects of a lawyer's withdrawal or discharge on a fee contract. On the liability of an incompetent client for services constituting "necessaries.").

in a state requiring fee arrangements to be in writing). The Restatement provides some guidance to lawyers in this setting.

> If a client and lawyer have not made a valid contract providing for another measure of compensation, a client owes a lawyer who has performed legal services for the client the fair value of the lawyer's services.

Restatement (Third) of Law Governing Lawyers § 39 (2000). An comment provides some explanation.

> The "fair value" fee recoverable under this Section is not measured by the standards applied when a party recovers a reasonable attorney fee from an opposing party under a fee-award statute or doctrine. The latter kind of fee often implicates factors -- such as a legislative intent to encourage such suits or to limit fee awards to less than full compensation (for example, when the main purpose of the fee award is to deter misconduct by the fee-paying party) -- not present in quantum meruit recovery under this Section.

Restatement (Third) of Law Governing Lawyers § 39 cmt. a (2000).

Another comment explains the lawyer's general right to be paid for the lawyer's services.

> The law permits a lawyer who has not agreed on a fee to recover one. Although both lawyers and clients might be reluctant to discuss fees in advance, both usually expect that some payment will be due. Denying compensation would be unfair to the lawyer and a windfall to the client. Moreover, the parties might have agreed on a measure of compensation, but in a contract unenforceable because it does not meet an applicable legal standard . . . -- for example, because it is a contingent-fee contract but is not in writing as a court rule requires. Quantum meruit recovery then provides compensation in circumstances in which it would be contrary to the parties' expectation to deprive the lawyer of all compensation.

Restatement (Third) of Law Governing Lawyers § 39 cmt. b(i) (2000). The next comment discusses how to determine the appropriate compensation.

> The market value of a lawyer's services is relevant in determining fair value but is not as such the measure of restitutionary recovery. Market value is the basis on which quantum meruit recoveries for other services or goods are often computed . . . . When applicable, it assists the tribunal's inquiry, because those active in the market will know the going price and can give evidence about it.
>
> However, some measures of price from a competitive market might be inappropriate. For example, the market price of services for the vigorous litigation of a claim for specific performance of a land-purchase contract might be disproportionate to the value of a particular claim. For some clients, particularly those of small means, paying that price might be a foolish investment. Moreover, a strictly economic calculation of market value presupposes an informed client. But market prices might reflect client ignorance rather than fair bargaining. Where there has been no prior contract as to fee, the lawyer presumably did not adequately explain the cost of pursuing the claim and is thus the proper party to bear the risk of indeterminacy. Hence, the fair-value standard assesses additional considerations and starts with an assumption that the lawyer is entitled to recovery only at the lower range of what otherwise would be a reasonable negotiated fee.

Restatement (Third) of Law Governing Lawyers § 39 cmt. b(ii) (2000). A very lengthy comment provides some guidance to those trying to apply such a "fair value" standard.

> Assessing the fair value of a lawyer's services might require answers to three questions. What fees are customarily charged by comparable lawyers in the community for similar legal services? What would a fully informed and properly advised client in the client's situation agree to pay for such services? In light of those and other relevant circumstances, what is a fair fee . . . ?
>
> In some cases, a standard market rate for a legal service might in fact exist. A lawyer who proves that a standard fee exists in the area should ordinarily be entitled to receive it, unless the client shows that a sophisticated, informed, and properly advised client in the client's situation would have refused to pay the standard fee -- for example, because such a client would have decided not to proceed . . . . Similarly, a client should not be required to

> pay more than the standard fee unless the lawyer shows that, because of the circumstances of the case, a sophisticated, informed, and properly advised client would have agreed to pay a higher fee.
>
> Calculation of an hourly fee might provide guidance. Except in certain areas such as criminal-defense or tort-plaintiff representation, hourly fees are a common contractual basis of payment for legal services. The hourly fee would be that charged by lawyers of similar experience and other credentials in comparable cases, but not more than the standard rate of the lawyer in question for that type of work. The lawyer must show, by records or otherwise, the hours actually and reasonably devoted to the case in view of the importance of the case to the client, the client's financial situation and instructions, and the time that a comparable lawyer would have needed.
>
> The standard rate or hourly fee might be modified by other factors bearing on fairness, including success in the representation and whether the lawyer assumed part of the risk of the client's loss, as in a contingent-fee contract . . . . Reference can be made to the factors in § 34, Comment c. Concerning expenses and disbursements paid by the lawyer and attorney-fee awards and sanctions collected from an opposing party, the principles of § 38(3)(a) and (b) apply.
>
> A conservative evaluation is usually appropriate in assessing fees under this Section. When a lawyer fails to agree with the client in advance on the fee to be charged, the client should not have to pay as much as some clients might have agreed to pay. A fair-value fee under this Section is thus less than the highest contractual fee that would be upheld as reasonable under § 34.

Restatement (Third) of Law Governing Lawyers § 39 cmt. c (2000).

The Restatement indicates that the same standards apply if the lawyer and client agree to abandon the contract, or the lawyer seeks recover on the quantum meruit theory.

> A lawyer typically seeks recovery as provided under this Section when there is no applicable client-lawyer fee contract . . . or the parties have agreed to abrogate such a contract. In addition, should a fee contract be unenforceable a lawyer can obtain quantum meruit recovery under this Section, unless the lawyer's conduct warrants fee forfeiture under § 37. See also § 40, stating the effects of a lawyer's withdrawal or discharge on a fee contract. On the liability of an incompetent client for services constituting "necessaries," . . . .

Restatement (Third) of Law Governing Lawyers § 39 cmt. e (2000).

If a lawyer seeks payment for services other than legal services, the Restatement's standards apply only to the legal services.

> This Section presupposes that the client has retained the lawyer to perform legal services. If the client retained the lawyer to perform other kinds of services, general principles of quantum meruit apply. When a lawyer has properly performed both legal and other services, the lawyer may recover for both kinds of services if that is just considering all the circumstances. It is relevant to consider the prior dealings between client and lawyer and the interconnection of the legal and other services in question.

Restatement (Third) of Law Governing Lawyers § 39 cmt. d (2000).

## Best Answer

The best answer to **(a)** is **MAYBE**; the best answer to **(b)** is **PROBABLY NO**.

# Permissibility of Contingent Fees in Certain Cases

## Hypothetical 8

You are the managing partner of a relatively small firm which has found itself hurt by the decline in hourly rates paid by insurance companies for defending their insureds. You are now looking at increasing the amount of work you handle under contingent-fee arrangements. Before spending too much time on this project, you want to make sure that you understand the ground rules.

**(a)** May you ever charge a contingent fee in a criminal case?

**NO**

**(b)** May you ever charge a contingent fee in a family law case?

**YES**

## Analysis

Contingent fees stand as an exception to the traditional rule (ABA Model Rule 1.8(j)(2)) that prohibits lawyers from acquiring an interest in litigation. Both the ethics rules and bar "common law" ethics rulings have defined the acceptable form of contingent fees which serve a societal purpose.

The Restatement explains the societal purpose that contingent fees serve.

> Contingent-fee arrangements perform three valuable functions. First, they enable persons who could not otherwise afford counsel to assert their rights, paying their lawyers only if the assertion succeeds. Second, contingent fees give lawyers an additional incentive to seek their clients' success and to encourage only those clients with claims having a substantial likelihood of succeeding. Third, such fees enable a client to share the risk of losing with a lawyer,

> who is usually better able to assess the risk and to bear it by undertaking similar arrangements in other cases . . . .

Restatement (Third) of Law Governing Lawyers § 35 cmt. b (2000).

**(a)** The ABA Model Rules flatly prohibit contingent fees in criminal cases. ABA Model Rule 1.5(d)(2).[1]

The Restatement explains the continuing debate about the permissibility of contingent fees in criminal cases.

> **[E 1368]** The prohibition of contingent fees for defending criminal cases has been criticized. . . . A fee arrangement giving lawyers a direct financial incentive to seek their clients' acquittal or favorable plea would increase client choice and promote effective assistance of counsel and might be no more likely to induce misconduct due to overzealousness than a contingent fee in civil cases. Presumably many such contracts, if permissible, would link the size of the fee to the length of the client's sentence, if any, so that lawyers would be encouraged to plea bargain or go to trial, whichever would lead to the most favorable outcome. In any event, the prohibition of criminal contingent fees remains in effect. No authority supports extending the contingent fee to criminal-defense representations.

Restatement (Third) of Law Governing Lawyers § 35 cmt. f(i), reporter's note (2000). A 2010 New Jersey legal ethics opinion also noted the debate -- in the context of what the New Jersey Bar called a "quasi-criminal" matter.

- **[E 1293 B 8/11]** New Jersey LEO 717 (3/3/10) (finding that New Jersey's ethics rule governing contingent fees prevented the use of such fees in "quasi-criminal" matters; quoting a 1993 law review article in explaining why the ethics rules prohibit contingent fees in criminal cases: Pamela S. Karlan, Contingent Fees and Criminal Cases, 93 Colum. L. Rev. 595, 611 (April 1993); "If an attorney gets paid only if she obtains an outright acquittal or dismissal of all charges, she may experience a conflict of interest when faced

[1] **[E 1306]** ABA Model Rule 1.5(d) ("A lawyer shall not enter into an arrangement for, charge, or collect: (1) any fee in a domestic relations matter, the payment or amount of which is contingent upon the securing of a divorce or upon the amount of alimony or support, or property settlement in lieu thereof; or (2) a contingent fee for representing a defendant in a criminal case.").

with a plea bargain: her client might be better off pleading guilty to reduced charges, but the lawyer will lose her fee if he does. Similarly, at trial, if the attorney asks for instructions on lesser-included offenses, her client may avoid conviction on the top count, but again she will lose her fee."; ultimately concluding that "the contingency fee prohibition in RPC 1.5(d)(2) applies to cases in municipal court. There is no principled reason to differentiate 'criminal' matters from 'quasi-criminal' matters when considering the potential conflict that may arise when an attorney charges a contingency fee. The primary difference between the two types of matters is the forum in which they are heard and the severity of the penalty. The potential conflict that is the subject of RPC 1.5(d)(2) may arise in either criminal matters or quasi-criminal matters."; acknowledging that in many quasi-criminal matters (such as motor vehicle cases), the purpose of the prohibition on contingent fees does not apply, because "the interest of the attorney and the client usually are aligned"; nevertheless finding that the New Jersey rule prohibited contingent fees in such situations; "RPC 1.5(d)(2) as currently written, however, is a bright line, prophylactic rule, flatly prohibiting an attorney from offering or collecting a contingent fee in a criminal (or quasi-criminal) matter. The benefit of a bright line rule is its clarity and ease of administration."; "Accordingly, the Committee finds that RPC 1.5(d)(2) prohibits contingent fees is quasi-criminal matters in municipal court, including motor vehicle cases, driving while intoxicated cases, ordinance violations, petty disorderly persons offenses, and disorderly persons offenses. Attorneys may not offer a contingency fee in such cases. More specifically, attorneys may not offer to refund legal fees if, for example, a motor vehicle charge is not reduced to a lesser-point or no-point offense."; ultimately inviting the New Jersey Supreme Court to evaluate the New Jersey contingent fee rule and considering "whether a revision would be appropriate").

**(b)** The ABA Model Rules follow the traditional approach, which generally prohibits contingent fees in family law matters. ABA Model Rule 1.5(d)(1).[2]

The Restatement explains this issue in more detail in the ABA Model Rules.

> **[E 1365]** Most jurisdictions continue to prohibit fees contingent on securing divorce or child custody. The traditional grounds of the prohibition in divorce cases are that such a fee creates incentives inducing lawyers to discourage reconciliation and encourage bitter and wounding court battles . . . . Since the passage of no-fault divorce

[2] **[E 1306]** ABA Model Rule 1.5(d) ("A lawyer shall not enter into an arrangement for, charge, or collect: (1) any fee in a domestic relations matter, the payment or amount of which is contingent upon the securing of a divorce or upon the amount of alimony or support, or property settlement in lieu thereof; or (2) a contingent fee for representing a defendant in a criminal case.").

> legislation, however, public policy does not clearly favor the continuation of a marriage that one spouse wishes to end. Furthermore, in practice, once one spouse retains a lawyer to seek a divorce, a divorce will follow in most cases regardless of the basis of the fee. The principal dispute is likely to be a financial one. The prohibition might hence make it more difficult for the poorer spouse to secure vigorous representation, at least in the relatively rare instances in which law does not provide fee-shifting for the benefit of that client.

Restatement (Third) of Law Governing Lawyers § 35 cmt. g (2000) (citation omitted). A Restatement comment explains situations where a lawyer may properly charge a contingent fee in a domestic relations matter.

> **[E 1366]** If, for example, a divorce or custody order has already been finally approved when the fee contract is entered into, there can be little concern that a contingent fee based on the size of the property settlement or child-support payments will discourage reconciliation or custody compromises. . . . In such a situation, the fee is not contingent upon the securing of a divorce or custody order, and this Section does not apply, just as it does not apply to contingent fee in a property dispute between nondivorcing or already divorced spouses.

Restatement (Third) of Law Governing Lawyers § 35 cmt. g (2000).

Not surprisingly, courts and bars analyze domestic relations matters in deciding the permissibility of a contingent fee. Some courts take the traditional approach.

- See, e.g., **[E 438 B 2/09]** Maxwell Schuman & Co. v. Edwards, 663 S.E.2d 329 (N.C. Ct. App. 2008) (invalidating a contingent-fee arrangement in a child custody case).

Other bars and courts analyzing different situations have permitted the use of contingent fees.

- **[E 1260 B 10/11]** Massachusetts LEO 09-02 (1/15/09) ("A lawyer may enter a contingent fee agreement to collect past due child support following entry of a divorce judgment. The lawyer should disclose to her client the availability of free collection services from the Child Support Enforcement Division of the

Massachusetts Department of Revenue and may not base any of her fee on any amounts collected through the use of the Department's services.").

- **[E 503 B 2/09]** Gil v. Gil, 956 A.2d 593 (Conn. App. Ct. 2008) (holding that a lawyer could charge a contingent fee in a post-judgment divorce hearing; explaining that the divorce had already been granted and the couple's property divided, so that there was no worry that a lawyer's contingent-fee arrangement would prolong the divorce proceeding).

The Restatement adopts essentially the same principle.

> (1) A lawyer may contract with a client for a fee the size or payment of which is contingent on the outcome of a matter, unless the contract violates § 34 or another provision of this Restatement or the size or payment of the fee is:
>
> > (a) contingent on success in prosecuting or defending a criminal proceeding; or
> >
> > (b) contingent on a specified result in a divorce proceeding or a proceeding concerning custody of a child.

Restatement (Third) of Law Governing Lawyers § 35(1) (2000). A Restatement comment generally explains the bases for these exceptions.

> Contingent-fee arrangements perform three valuable functions. First, they enable persons who could not otherwise afford counsel to assert their rights, paying their lawyers only if the assertion succeeds. Second, contingent fees give lawyers an additional incentive to seek their clients' success and to encourage only those clients with claims having a substantial likelihood of succeeding. Third, such fees enable a client to share the risk of losing with a lawyer, who is usually better able to assess the risk and to bear it by undertaking similar arrangements in other cases. . . .
>
> Although contingent fees were formerly prohibited in the United States and are still prohibited in many other nations, the prohibition reflects circumstances not present in the contemporary United States. Many other nations routinely award attorney fees to the winning party and often

> have relatively low, standardized and regulated attorney fees, thus providing an alternative means of access to the legal system, which is not generally available here. Those nations might also regard civil litigation as more of an evil and less of an opportunity for the protection of rights than do lawmakers here. Contingent fees are thus criticized there as stirring up litigation and fostering overzealous advocacy.
>
> While many of those criticisms of contingent fees are inapposite in the United States, it remains true that contingent-fee clients are often unsophisticated and inexperienced users of legal services, and their financial position might leave them little choice but to accept whatever contingent-fee arrangements prevail in the locality. It is often difficult even for a careful client or lawyer to estimate in advance how likely it is that a claim will prevail, what the recovery will be, and how much lawyer time will be needed. Finally, standardized contingent-fee arrangements might not take proper account of cases with low risks or high recoveries. Accordingly, courts scrutinize contingent fees with care in determining whether they are reasonable.

Restatement (Third) of Law Governing Lawyers § 35 cmt. b (2000).

A later Restatement comment explains provisions for generally prohibiting contingent fees in criminal cases. The Restatement first explains how the general rule applies to defense counsel.

> Contingent fees for defending criminal cases have traditionally been prohibited. The prohibition applies only to representations in a criminal proceeding. It does not forbid a contingent fee for legal work that forestalls a criminal proceeding or work that partly relates to a criminal matter and partly to a noncriminal matter. A lawyer may thus contract for a contingent fee to persuade an administrative agency to terminate an investigation that might have led to civil as well as criminal proceedings or to bring a police-brutality damages suit in which the settlement includes dismissal of criminal charges against the plaintiff.

Restatement (Third) of Law Governing Lawyers § 35 cmt. f(i) (2000). The next section deals with prosecutors.

> Fees contingent on success in prosecuting a criminal case violate public policy. Thus, for example, a lawyer in private practice retained to prosecute a criminal contempt should not be compensated contingent on success in the prosecution. A prosecutor whose pay depends on securing a conviction might be tempted to seek convictions more than justice . . . . The government does not generally need contingent fees to afford counsel or to transfer to counsel the risk of loss.

Restatement (Third) of Law Governing Lawyers § 35 cmt. f(ii) (2000).

The Restatement also explains the more subtle approach in the family law context.

> Most jurisdictions continue to prohibit fees contingent on securing divorce or child custody. The traditional grounds of the prohibition in divorce cases are that such a fee creates incentives inducing lawyers to discourage reconciliation and encourages bitter and wounding court battles . . . . Since the passage of no-fault divorce legislation, however, public policy does not clearly favor the continuation of a marriage that one spouse wishes to end. Furthermore, in practice, once one spouse retains a lawyer to seek a divorce, a divorce will follow in most cases regardless of the basis of the fee. The principal dispute is likely to be a financial one. The prohibition might hence make it more difficult for the poorer spouse to secure vigorous representation, at least in the relatively rare instances in which law does not provide fee-shifting for the benefit of that client.
>
> The other argument for the prohibition in divorce cases, and the ground for prohibition in custody cases, is that such a fee arrangement is usually unnecessary in order to secure an attorney in a divorce proceeding or custody dispute. The issue usually arises when one or the other spouse has assets, because otherwise there would be no

> means of paying a contingent fee. If the spouse retaining counsel has assets, no contingent fee is necessary. If it is the other spouse that has assets, the courts will usually require that spouse to pay the first spouse reasonable attorney fees. Again, no contingent fee is necessary.
>
> When either of the two policies supporting the prohibition is inapplicable, the Section should not apply. If, for example, a divorce or custody order has already been finally approved when the fee contract is entered into, there can be little concern that a contingent fee based on the size of the property settlement or child-support payments will discourage reconciliation or custody compromises. (On limitations on post-inception fee contracts, see § 18(1)(a).) In such a situation, the fee is not contingent upon the securing of a divorce or custody order, and this Section does not apply, just as it does not apply to a contingent fee in a property dispute between nondivorcing or already divorced spouses. The prohibition would, however, apply to a contract with a client who is then married that provides for a fee contingent on the amount of the alimony, property disposition, or child-support award but that does not explicitly condition the fee on the grant of a divorce.

Restatement (Third) of Law Governing Lawyers § 35 cmt. g (2000).

## Best Answer

The best answer to **(a)** is **NO**; the best answer to **(b)** is **YES**.

# Contingent Fees: Logistics and Alternative Fees

## Hypothetical 9

You are trying to move away from a billable hour format, and you are exploring the increasing use of alternative contingent-fee arrangements. However, you are not familiar with the logistics of those fees, or whether they are permissible in certain circumstances.

**(a)** Must contingent-fee agreements be in writing?

**YES**

**(b)** May you ever charge a "reverse" contingent fee (in which the client pays a percentage of money that you save the client through successful advocacy)?

**YES**

**(c)** Can you charge a contingent fee calculated as a certain percentage of a settlement or judgment, along with a reduced hourly rate for the time that your lawyers spend on the matter?

**YES**

**(d)** Can you charge a client a contingent fee calculated as a percentage of money that it will save if you successfully represent it in terminating a government contract?

**YES**

**(e)** Can you charge a client a contingent fee based on a percentage of the other side's highest offer to settle a matter, even if your client rejects the settlement?

**??**

## Analysis

**(a)** Unlike other fee arrangements, contingent-fee agreements must be in writing, and must contain specified information.

> A fee may be contingent on the outcome of the matter for which the service is rendered, except in a matter in which a contingent fee is prohibited by paragraph (d) or other law. A contingent fee agreement shall be in a writing signed by the client and shall state the method by which the fee is to be determined, including the percentage or percentages that shall accrue to the lawyer in the event of settlement, trial or appeal; litigation and other expenses to be deducted from the recovery; and whether such expenses are to be deducted before or after the contingent fee is calculated. The agreement must clearly notify the client of any expenses for which the client will be liable whether or not the client is the prevailing party.

ABA Model Rule 1.5(c).

In addition to this requirement that the initial fee agreement be in writing, the Rules also require that a lawyer who has represented a client under a contingent-fee arrangement send another writing when the representation ends, explaining how the contingent fee has been calculated.

> Upon conclusion of a contingent fee matter, the lawyer shall provide the client with a written statement stating the outcome of the matter and, it there is a recovery, showing the remittance to the client and the method of its determination.

ABA Model Rule 1.5(c).

- **[E 366 B 1/09]** Stroud v. Tunzi, 72 Cal. Rptr. 3d 756 (Cal. Ct. App. 2008) (agreements to modify a contingent-fee arrangement must meet all of the statutory standards of the original retainer agreement; noting that among other things California requires that contingent-fee arrangements be signed by the lawyer and the client).

Not surprising, courts and bar require lawyers to explain exactly how any contingent fee is calculated.

- **[E 1681]** Alioto v. Hoiles, 2010 U.S. Dist. LEXIS 98967 (D. Colo. Sept. 21, 2010) (analyzing a contingent-fee agreement; ultimately concluding that the contingent-fee agreement was voidable because it failed to explain how their lawyer would charge for additional work described in the agreement; "Regardless of whether the Contingent Fee Agreement encompassed the shares of Hoiles' ex-wife and two adult daughters, Alioto's attempt to recover additional compensation, combined with Alioto's testimony as to his justification for seeking such additional compensation, provides conclusive evidence that at least one related matter existed, i.e., receiving a fair share price for shareholders other than Hoiles. Alioto is attempting to collect fees for at least one related matter and because the Contingency Fee Agreement does not include a related matter statement, the Contingency Fee Agreement is voidable at Hoiles' option."; "This Court concludes that the January 21, 2004 letter from Hoiles to Alioto, which included an instruction to engage in no further legal services on Hoiles' behalf and which also included a statement regarding payment at an hourly rate, was sufficient to void the Contingency Fee Agreement."; ultimately finding that the lawyer was entitled to a quantum meruit award; "[T]he Court rejects Alioto's argument that a jury should be allowed to consider the Contingent Fee Agreement in deciding upon a reasonable fee for Alioto on his quantum meruit claim.").

- **[E 728 B 2/10]** Los Angeles LEO 523 (6/15/09) ("This Opinion addresses whether it is permissible, in a contingency representation, for the attorney and client to include within the gross recovery the statutory award of attorney's fees which, absent an agreement to the contrary, would otherwise belong to the attorney. This issue is whether such an agreement that allocates the gross recovery between the attorney and the client constitutes 'fee splitting' with a non-lawyer. The Committee believes that it does not.").

- **[E 69 N 12/06]** In re Van Sickle, No. 99-O-12923, 2006 WL 2465633 (Cal. State Bar Ct. Review Dep't Aug. 24, 2006) (suspending for one year a lawyer who arranged for a 35% contingent fee without accounting for fees that the client owed his previous lawyer; noting that the lawyer claimed he had advised the client that the client would have to pay the former lawyer out of the recovery; finding that the lawyer charged an inappropriately high fee).

**(b)** The ABA has held that "reverse" contingent fees can pass ethical muster. ABA LEO 373 (4/16/93) (permitting a "reverse" contingent fee based on the amount of money a client saves through a lawyer's efforts).

As long as it passes muster under the "reasonableness" standard, such hybrid fees normally pass muster.

State bars generally are open to imaginative contingent fees.

- **[E 1478]** Texas LEO 596 (4/10) ("Under the Texas Disciplinary Rule of Professional Conduct, a lawyer may receive an assignment of insurance proceeds as compensation for legal services already completed at the time of the assignment, subject only to the generally applicable requirements concerning legal fees as set forth in Rule 1.04. If a proposed assignment of insurance proceeds to a lawyer is compensation for legal services that have not been completed at the time of the assignment, the lawyer may receive such assignment provided the insurance recovery is not the subject of the legal services and provided the assignment and any payment relating thereto are held and accounted for in compliance with Rule 1.14 until the completion of the services. A lawyer may not receive an assignment of proceeds of an insurance policy if the assignment is compensation for legal services in litigation that has not been completed with respect to a claim on the insurance policy and the assignment to the lawyer is not a permissible contingent fee for the representation.").

- **[E 1354]** Illinois LEO 91-13 (11/22/91) (analyzing the following effect pattern: "An attorney practicing in the corporate and securities fields has been asked by a corporate client to prepare and undertake all necessary steps to properly and successfully register client's securities offering. Client proposes to pay attorney a specific percentage of such securities, 'contingent' upon the successful registration of same."; concluding that "[i]t is not professionally improper for attorney to represent corporate client under stated 'contingent' fee arrangement, provided said arrangement violates no other laws; advertising such 'contingent' fee arrangements, within limits imposed by Rules, is also not professionally improper.").

**[MOVE THIS??]**

In some situations, courts have even had difficulty determining if a fee should be properly considered contingent.

> **[E 1336]** Brickell Place Condo Ass'n v. Joseph H. Ganguzza & Assocs., P.A., 2010 Fla. App. LEXIS 4201 (Fla. Ct. App. March 31, 2010) (holding that a lawyer who had arranged to

> charge an condominium association a flat fee for collection and foreclosure matters was bound by the ethics rules governing contingent fees, because the law firm was not paid until collection; ultimately holding that the law firm could not refuse to turn over its files until the contingency had occurred; "As we find that the fee arrangement for collection and foreclosure matters was, in reality, a contingent fee arrangement and a law firm may not assert a retaining lien for fees owed in a contingency fee case until the contingency has occurred, we find that the retaining lien was unlawful."; "Because the evidence reveals that the law firm was paid a flat fee for its services on collection matters if and when its collection efforts were successful, its fees were contingent on the outcome of the matter and the arrangement between the parties reflects that it was a contingency fee arrangement.").

**(c)** The Restatement explicitly explains that reverse contingent fees are not per se prohibited.

> **[E 1367]** Contingent-fee contracts are most commonly used when representing claimants. If reasonable and entered into by a fully informed client, such a contract may also be appropriate when defending a client against a civil claim.

Restatement (Third) of Law Governing Lawyers § 35 cmt. c, reporter's note (2000).

State bars generally take the same approach

- See, e.g., combine **[E 581 N 6/09] and [E 1450 not checked]** District of Columbia LEO 347 (3/2009) ("A reverse contingent fee is a fee that is based upon the difference between the amount a third party demands from a lawyer's client, and the amount ultimately obtained from the client, whether by settlement or judgment. The Rules of Professional Conduct ('Rules') do not prohibit reverse contingent fees, and a fee arrangement of this nature may align the lawyer's and client's interest more closely than hourly or fixed fee arrangements. Like all fees, reverse contingent fees must be reasonable. Beyond the requirement of reasonableness, entering into a reverse contingent fee arrangement places increased burdens of disclosure on the lawyer in order to obtain informed consent to such a fee arrangement. The lawyer is in a better position to assess the likely outcome of a dispute than a

client is, and the lawyer must fully and fairly communicate that assessment to the client in any discussion concerning a reverse contingent fee. In addition, a lawyer should take particular care in setting the percentage of the reverse contingent fee, because unlike contingent fees based upon a client's recovery, there is little established practice upon which a client and lawyer can rely. Finally, as with other Rule provisions, the degree and nature of the disclosure required of the lawyer and the ensuing scrutiny of the fee arrangement may vary based upon the experience and sophistication of the client.") **AND** District of Columbia LEO 347 (3/09) ("Consistent with ABA Formal Opinion 93-373 and other authorities discussed above, we conclude that reverse contingency fee agreements are not unethical. Indeed, in the appropriate instance, such arrangements 'may be in the best interests of the clients.' ABA Formal Opinion 93-373 (1993). Unlike a typical fixed fee or hourly arrangement, under a reverse contingency arrangement, the lawyer could 'receive no fee if not successful in saving the client money.' Id. Like any other fee, a reverse contingent fee must be reasonable, as judged both at the outset and the conclusion of the representation. A reverse contingent arrangement must also be reflected in a written fee agreement under Rule 1.5(c) and such fee agreement must state the 'method by which the fee is to be determined.'"; "The percentage to be applied to the savings obtained by the lawyer must similarly be the product of full disclosure by the lawyer and informed consent by the client. Unlike the typical contingent fee arrangements, there are no established norms concerning the appropriate percentages for a lawyer to use. It is beyond the expertise of this Committee to opine about the percentages or range of percentages that might be appropriate. To support the reasonableness of a particular percentage, the lawyer should consider discussing with the client the likely range of fees under hourly or fixed fee arrangements as compared to the range of fees that might result from a reverse contingent fee arrangement."; "To the extent that a reverse contingent fee arrangement is with a sophisticated client, who has the benefit of independent legal advice and who provides the lawyer with suggested figures and percentages to base the fee arrangement upon, many of the above disclosures and discussions may not be necessary. On the other hand with respect to an unsophisticated client, the lawyer should be assured before proceeding with the representation that the client has a full understanding of the amount from which the client's savings would be computed and the percentage to be applied to that amount to produce the lawyer's fee.").

**(d)** At least one court has prohibited lawyers from earning a contingent fee as based on the value of an offer that the client has rejected.

- **[E 133 N 2/07]** Hoover Slovacek LLP v. Walton, 206 S.W.3d 557 (Tex. 2006) (a lawyer's contingent-fee arrangement may not allow a terminated lawyer to

> collect the present value of a 30 percent contingent fee based on the settlement offer, when the fee exceeded the client's actual recovery).

On the other hand, an earlier California decision at least implied that such an arrangement would not be automatically impermissible.

- **[E 249]** Mardirossian & Assocs., Inc. v. Ersoff, 62 Cal. Rptr. 3d 665, 669 & 671 (Cal. Ct. App. 2007) (certified for partial publication pursuant to Cal. R. Ct. 8.100 and 8.1110) (allowing a lawyer retained under a contingent-fee agreement to seek quantum meruit damages; noting that the retainer agreement included a lawyer's lien, which was based on a specified hourly rate, which the client agreed to pay if the client discharged the lawyer or terminated the claim; explaining that the client settled the case on the same day that the client terminated the lawyer; also acknowledging that the retainer agreement allowed the lawyer to "elect compensation based upon the agreed contingency for any offer to Client to settle the matter prior to the Attorney's discharge," but noting that "there had been no settlement offer prior to its discharge"; not dealing with the enforceability of such a clause; upholding the jury's damage award in the lawyer's favor of approximately $650,000; noting that the jury could rely on the lawyers' own testimony about the time they spend and expert testimony, even though the lawyer had not maintained careful time records), review denied, No. S155663, 2007 Cal. LEXIS 11053 (Cal. Oct. 10, 2007). **Tom -- How do you want to show this ?** **NOTICE:** CERTIFIED FOR PARTIAL PUBLICATION** Pursuant to California Rules of Court, rules 8.1100 and 8.1110, this opinion is certified for publication with the exception of parts 4 and 6 of the Discussion.

**(e)**

The Restatement explains the essence of a contingent-fee arrangement.

> A contingent-fee contract is one providing for a fee the size or payment of which is conditioned on some measure of the client's success. Examples include a contract that a lawyer will receive one-third of a client's recovery and a contract that the lawyer will be paid by the hour but receive a bonus should a stated favorable result occur . . . .

Restatement (Third) of Law Governing Lawyers § 35 cmt. a (2000).

## Best Answer

The best answer to **(a)** is **YES**; the best answer to **(b)** is **YES**; the best answer to **(c)** is **YES**; the best answer to **(d)** is **YES**; the best answer to **(e)** is **[??]**.

# Calculating Contingent Fees

## Hypothetical 10

You recently moved from a law firm that primarily charges by the hour, and now practice at a firm that usually handles matters on a contingent fee basis. Not surprisingly, you have some questions about how contingent-fee arrangements work.

**(a)** How do you calculate a contingent fee if the client receives nonmonetary relief such as an injunction or ownership of intellectual property?

**(INSERT NARRATIVE ANSWER)**

**(b)** How do you calculate a contingent fee if your client enters into a settlement with the other in which your client receives the settlement amount over a ten-year period?

**(INSERT NARRATIVE ANSWER)**

**(c)** How do you calculate a contingent fee if your client is also entitled to receive a payment of attorney's fees from the other side, under either a statutory or contractual fee-shifting provision?

**(INSERT NARRATIVE ANSWER)**

**(d)** How do you calculate a contingent fee if the client wins $200,000 on her claim, but the defendant wins $100,000 on the defendant's counterclaim?

**[??]**

## Analysis

**[MAYBE MOVE WRITING REQUIREMENT HERE]**

Courts sometimes address the effect on contingent fees of clients obtaining in-kind benefits.

- **[E 1403]** Wolk v. Flight Options, Inc., 2005 U.S. Dist. LEXIS 19891 (E.D. Penn. Sept. 13, 2005) ("Federal courts applying Pennsylvania law have held that a client must recover a settlement or prevail in a lawsuit during the contingency representation in order for the attorney to receive his contingency

fee and not be limited to quantum meruit claim."; noting that the lawyer had not pursued a quantum meruit claim, but could do so in the future; denying summary judgment on the issue of the contingent agreement's meaning, because of a factual dispute; "The issue is essentially whether the acceptance of in-kind services or credit by Flight Options constitutes money under the terms of the contingency fee agreement. Here, a genuine issue of material fact exists as to the interpretation of the agreement. Viewed in the light most favorable to Plaintiff, the fee agreement can be read to provide for one-third the sum of the value of the settlement. Therefore, Defendant's motion for summary judgment must be denied. Since we cannot enter summary judgment at this time, this court will await the evidence produced at the trial stage.").

In 2010, the Seventh Circuit dealt with a lawyer's claim for a percentage of an amount that the lawyer argued he confirmed as belonging to the client.

- **[E 1648 B 4/11]** In re Solis, 610 F.3d 969, 970, 972, 974 (7th Cir. 2010) (analyzing a situation in which a debtor's lawyer sought to recover contingent fees on an amount of money that the debtor had already recovered, but which the lawyer claims to have confirmed was the debtor's; providing the background; "The legal profession has not treated debtor Luis Solis well. The secretary of an attorney who settled Solis' workers' compensation claim stole nearly half of the amount he was owed. Then a second attorney whom Solis had hired to recover the rest of the stolen settlement -- appellant Joseph O'Callaghan -- asserted an attorney fee claim for a percentage of the entire amount of the settlement, including the portion that Solis had already been paid before he hired that second attorney. The legal issue in this appeal is whether the second attorney 'recovered' money for his client when he established the client's entitlement to the sum of money already in the client's possession. Appellant O'Callaghan insists that the answer is yes. We disagree. Under the terms of the contingent fee agreement in this case, O'Callaghan is entitled to a percentage of only the money he actually recovered from other parties, not a percentage of the money Solis had received earlier."; explaining that "Solis retained a second attorney, appellant O'Callaghan, to recover the rest of the settlement that was owed to him. O'Callaghan took the case on a contingent fee basis. Under the written contingent fee agreement, O'Callaghan would receive 40 percent of 'any gross amount recovered in the event of suit being filed.' 'Gross amount' was defined as 'the total amount of money received on [the] case before deduction of any expenses.'"; explaining what the term "recovered" means in the contingent fee arrangement: "Read in context -- as part of a contingent fee

agreement -- the term 'recovered' most naturally encompasses situations in which the client actually receives cash or property from some other parties as a result of the attorney's efforts. That the Illinois court read contingent fee agreements strictly in favor of the client support this interpretation. This contingent fee agreement cannot fairly be read as an agreement by Solis to pay O'Callaghan 40 percent of the $ 62,410 that Solis had already received. Nor can it fairly be read as a promise to pay O'Callaghan 40 percent of that sum for securing Solis' title to the money or for defending him against any claims for that money. The agreement makes no mention of any such claims having been asserted against Solis at the time he and O'Callaghan entered the agreement."; ultimately holding that "[t]he problem here is that O'Callaghan did not actually recover that money for Solis, as required by the fee agreement. Rather, as the bankruptcy court observed, O'Callaghan at best clarified Solis' title to that money through a binding legal judgment.").

Because it is so much easier to deal with the allocation of fees when a settlement involves a dollar payment, not many courts or bars have dealt with analyzing any fees (including contingent fees) when settlement involves other forms of possible benefit to the client.

However, several bars and courts have expressed an openness to analyze contingent fees in these unusual situations.

- **[E 1711]** Cotchett, Pitre & McCarthy v. Universal Paragon Corporation, 2010 Cal. App. LEXIS 1520 (Cal. Ct. App. Aug. 31, 2010) (upholding a contingent-fee agreement that was carefully negotiated between a corporate client and a law firm -- even though the arrangement called for the lawyer to a percentage of real property, and therefore allowed the lawyer to collect more money than the client gained in the settlement; "The settlement of this case may involve or a related entity acquiring real property from one or more Defendants. In such an event, the amount of the contingency fee payable to [CP&M] would be difficult to value. If such a settlement occurs, [UPC] has specifically requested that [CP&M] be paid a percentage of [an] amount equal to the greater of the fair market value (based on its highest and best use) of [UPC]'s real property as determined by a registered MAI appraiser in the litigation (The 'Fair Market Value of the Property'), or the total damages suffered by [UPC] (e.g. remediation costs, insurance, demolition and diminution in value). Therefore, in the event that settlement of the case includes a provision

whereby [UPC] or any of its related entities acquires real property from one or more Defendants, the fees payable to [CP&M] shall include two parts: (a) [UPC] shall pay [CP&M] a contingency sum equal to sixteen percent (16%) of the greater of (i) the Fair Market Value of the Property, or (ii) the Total Damages as contained in [UPC]'s most recent damages assessment made for settlement purposes; and (b) In addition to the contingency set forth in subparagraph 3(a), above, [UPC] agrees to pay attorneys fees under the May 2005 Hourly Agreement; however, the hourly rates shall be reduced to $200 for partners and $100 for associates. Should there be a recovery pursuant to this paragraph 3, [UPC] shall be credited above for one-half of the attorneys fees paid, if any. Said sums are due at the time the settlement agreement is executed. An example of the foregoing is attached to this Agreement.'"; "UPC argues that a contingency fee based on a damages assessment rather than the actual amount of recovery is unconscionable because it creates a conflict of interest between the attorney and the client. We are not persuaded.' '[A]lmost any fee arrangement between attorney and client may give rise to a 'conflict.' An attorney who received a flat fee in advance would have a 'conflicting interest' to dispose of the case as quickly as possible, to the client's disadvantage; and an attorney employed at a daily or hourly rate would have a 'conflicting interest' to drag the case on beyond the point of maximum benefit to the client. The contingent fee contract so common in civil litigation creates a 'conflict' when either the attorney or the client needs a quick settlement while the other's interest would be better served by pressing on in the hope of a greater recovery. The variants of this kind of 'conflict' are infinite. Fortunately most attorneys serve their clients honorably despite the opportunity to profit by neglecting or betraying the client's interest.' (People v. Doolin (2009) 45 Cal. 4th 390, 416 [87 Cal. Rptr. 3d 209, 198 P.3d 11].).").

- **[E 1478]** Texas LEO 596 (4/10) ("Under the Texas Disciplinary Rule of Professional Conduct, a lawyer may receive an assignment of insurance proceeds as compensation for legal services already completed at the time of the assignment, subject only to the generally applicable requirements concerning legal fees as set forth in Rule 1.04. If a proposed assignment of insurance proceeds to a lawyer is compensation for legal services that have not been completed at the time of the assignment, the lawyer may receive such assignment provided the insurance recovery is not the subject of the legal services and provided the assignment and any payment relating thereto are held and accounted for in compliance with Rule 1.14 until the completion of the services. A lawyer may not receive an assignment of proceeds of an insurance policy if the assignment is compensation for legal services in litigation that has not been completed with respect to a claim on the insurance policy and the assignment to the lawyer is not a permissible contingent fee for the representation.").

- **[E 178 N 1/08]** Schrader Byrd & Companion, P.L.L.C. v. Marks, 648 S.E.2d 8 (W. Va. 2007) (upholding a contingent-fee arrangement that included royalty payments that the client would receive in the future).

**(d)** The Restatement explains that

> In addition to unreasonableness due to lack of risk, a contingent fee can also be unreasonable because either the percentage rate is excessive or the base against which the percentage is applied is excessive or otherwise unreasonable. If different from the customary base -- the plaintiff's recovery -- a contingent base will be unreasonable if it is an inappropriate measure of the lawyer's work and risk and the benefit the client derived from the lawyer's services. Contingent-fee contracts typically contemplate that the client, if successful, will receive a lump-sum award, a stated percentage of which will constitute the lawyer's fees. A client entering a contingent-fee contract reasonably expects that the lawyer will be paid only if and to the extent that the client recovers. For example, when a judgment for the client is entered but not collected, no fee is due unless the contract so provides.
>
> The rule stated in Subsection (2) also requires that, unless the contract indicates otherwise, a contingent-fee lawyer is to receive the specified share of the client's actual-damages recovery. For that purpose, recovery includes damages, restitution, back pay, similar equitable payments, and amounts received in settlement. Unless the contract with the client indicates otherwise, the lawyer is not entitled to the specified percentage of items such as costs and attorney fees that are not usually considered damages. In the absence of prior agreement to the contrary, the amount of the client's recovery is computed net of any offset, such as a recovery by an opposing party on a counterclaim.

Restatement (Third) of Law Governing Lawyers § 35 cmt. d (2000).

Case law takes the same approach.

- **[E 1292 B 8/11]** Camden Nat'l Bank v. S.S. Navigation Co., 991 A.2d 800, 803-04, 804 (Me. 2010) (analyzing a lawyer's contingent-fee arrangement

> with a client involved in several matters, one of which involved a set off based on a counterclaim; "Unless the contingent fee agreement provides otherwise, an attorney 'is entitled to receive the specified fee only when and to the extent the client receives payment.' Restatement (Third) of The Law Governing Lawyers § 35(2) (2000); see also M. Bar R. 8(e)(4) (2008) (abrogated 2009). 'In the absence of [a] prior agreement to the contrary, the amount of the client's recovery of [the] computed net of any offset, such as a recovery by an opposing party on a counterclaim.' Restatement (Third) of The Law Governing Lawyers § 35 cmt. d; see also Levine v. Bayne, Snell & Krause, Ltd., 40 S.W. 3d 92, 94-96 (Tex. 2001) (applying Restatement (Third) of The Law Governing Lawyers § 35 cmt. d); Underwood v. Rich, 48 Ga. App. 550, 173 S.E. 224, 226-27 (Ga. Ct. App. 1934) (finding that basis for calculating attorney's contingent fee was client's net recovery after any set offs); Wooldridge v. Bradbury, 185 Ky. 587, 215 S.W. 406, 407-08 (Ky. 1919) (same); Maiullo v. Genematas, 16 Mich. App. 231, 167 N.W. 2d 849, 850-51 (Mich. Ct. App. 1969) (same); Kramer v. Fallert, 628 S.W.2d 671, 674 (Mo. Ct. App. 1981) (same); William J. Murphy, Attorney At Law, P.C. v. State, 157 A.D.2d 155, 557 N.Y.S.2d 555, 556 (App. Div. 1990) (same)." (footnote omitted); "According to the 2004 Agreement, Lilley may only base its contingent fee on the total amount that was recovered, actually collected, and received in trust. Nothing in the 2004 Agreement overcomes the presumption that an attorney's contingent fee is based on the amount received for the client after any set offs.").

The Restatement provides an illustration of how lawyers and clients should calculate contingent fees.

> Client agrees to pay Lawyer "35 percent of the recovery" in a suit. The court awards Client $20,000 in damages, $500 in costs for disbursements, and $1,000 in attorney fees because of the defendant's discovery abuses. Lawyer is entitled to receive a contingent fee of $7,000 (35% of $20,000), but not 35 percent of the costs' payments. If Lawyer advanced the $ 500 costs in question, Client must reimburse Lawyer unless their contract validly provides to the contrary . . . . Whether Lawyer is entitled to recover a portion of the $1,000 attorney-fee award requires both interpretation of the fee contract and consideration of the nature of the fee-shifting award . . . .

Restatement (Third) of Law Governing Lawyers § 35 cmt. d, illus. 2 (2000).

> Same facts as in Illustration 2, except that Lawyer has also expended $1,500 in disbursements not recoverable from the opposing party as costs but recoverable from Client . . . . Unless their contract construed in its circumstances provides otherwise, Lawyer is entitled to reimbursement of the $1,500 out of the $20,000 award and to a contingent fee of $6,475, that is, 35 percent of $18,500, the balance of the award.

Restatement (Third) of Law Governing Lawyers § 35 cmt. d, illus. 3 (2000).

Another illustration explains the calculation in a different context.

> Lawyer brings a personal-injury suit for Client against Defendant under a fee contract stating that, if the suit is settled before trial, Lawyer is to receive a fee equaling "thirty percent of the recovery." Client and Defendant enter a structured settlement under which Defendant is to pay Client $100,000 at once and to buy an annuity (which will in fact cost Defendant $200,000) entitling Client to monthly payments of $1,500 until Client dies. In the absence of a contrary agreement, lawyer is entitled to receive $30,000 when the $100,000 payment is made and $450 (30% of $1,500) if and when each $1,500 payment is made.

Restatement (Third) of Law Governing Lawyers § 35 cmt. d, illus. 4 (2000).

A later Restatement provision provides an additional rule.

> As a corollary of the rule that a lawyer is not entitled to a contingent fee unless the client actually receives a favorable disposition of a matter, a lawyer is not entitled to additional fees for efforts in collecting a judgment, in the absence of a specific agreement to that effect.

Restatement (Third) of Law Governing Lawyers § 35 cmt. c, reporter's note (2000).

> Under "structured settlements" and some legislation, a claimant will receive regular payments over the claimant's lifetime or some other period rather than receiving a lump sum. If so, under the rule of this Section the lawyer is entitled to receive the stated share of each such payment if and when it is made to the client or (when so provided) for the client's benefit, unless the client-lawyer contract provides otherwise. When a contingent-fee contract provides that the fee is to be paid at once if there is a structured settlement and provides no other method of calculation, the fee should be calculated only on the present value of the settlement.

Restatement (Third) of Law Governing Lawyers § 35 cmt. e (2000).

## Best Answer

The best answer to **(a)** is **??**; the best answer to **(b)** is **??**; the best answer to **(c)** is **??**; the best answer to **(d)** is **??**.

# Effect of Client Control Over Settlements

## Hypothetical 11

You were excited to arrange for a contingent fee in a commercial litigation case that you and your partner conservatively estimate as involving more than $3 million. After eighteen months of extensive discovery, it looks as if the case might settle for even more than that -- as much as $4 million. You are confident that the amount of work that you spent on the case so far would justify your contingent fee. However, the client just called you to say that his doctor just advised him that he suffers from terminal brain cancer -- and will live for only another few months. The client tells you that he does not want to spend his few remaining months involved in litigation, and intends to settle the case for $1 million, which was the last offer that the defendants made. In addition to the emotional impact of this news, you also think about the financial impact on you and your law firm.

May the client settle a case for what everyone would agree is too low a figure, thereby depriving you a larger contingent fee?

**YES**

Every state's ethics rules give clients sole power to settle cases.

**[CITE ABA MODEL RULE, USE DISCUSSION FROM CLAIMS AND SETTLEMENT PROGRAM]**

Therefore, it would seem that you have nothing to say about the client's decision here.

## Best Answer

The best answer to this hypothetical is **YES**.

# Judging the Reasonableness of a Contingent Fee

## Hypothetical 12

Last month a bank hired you to pursue a charter airline in a significant controversy over airplane leases. The amount at issue exceeded $10 million. The dispute had been brewing for some time (with the bank represented by its inside lawyers), and the bank asked you to prepare and file a lawsuit to bring matters to a head. You negotiated a contingent-fee agreement with the bank entitling you to five percent of the amount of any settlement arranged before a trial and ten percent of any amount recovered in a trial.

You read in this morning's paper that a federal agency just began investigating possible criminal violations by the charter airline. When you arrived at your office, you had a message on your voicemail from a lawyer representing the charter airline. She offers to resolve the case by paying the full $10 million in dispute. Your client is ecstatic with the news, but wants to make sure that you will not insist on being paid the $500,000 specified in the retainer agreement.

May you insist on receiving the $500,000 contingent fee?

## NO (PROBABLY)

## Analysis

Determining the reasonableness of a contingent fee can be extremely difficult -- because such fees generally involve a macro judgment while the issue arises only in a micro context.

Contingent-fee lawyers generally do not make money on every case. Just like realtors who justify their percentage recovery by pointing to all of the work they do for sales transactions that do not close, contingent-fee lawyers generally justify their standard contingent-fee arrangements by noting (correctly in nearly every case) that they frequently lose cases and therefore recover nothing. This macro look justifies a high contingent-fee percentage -- usually one third or even 40 percent.

However, the fight between a client and a lawyer only involves that client's contingent-fee arrangement. Without looking at all of the other cases a contingent-fee lawyer handles (and sometimes loses), it might seem unfair for a client to pay a hefty percentage of a recovery to the contingent-fee lawyer.

Despite the difficulty of analyzing the reasonableness of a contingent fee, courts must occasionally do so.

All courts and bars agree that every fee must be reasonable.

> **[E 1310]** Contingent fees, like any other fees, are subject to the reasonableness standard of paragraph (a) of this Rule. In determining whether a particular contingent fee is reasonable, or whether it is reasonable to charge any form of contingent fee, a lawyer must consider the factors that relevant under the circumstances. Applicable law may impose limitations on contingent fees, such as a ceiling on the percentage allowable, or may require a lawyer to offer clients an alternative basis for the fee. Applicable law also may apply to situations other than a contingent fee, for example, government regulations regarding fees in certain tax matters.

ABA Model Rules 1.5 cmt. [3]. A 1994 legal ethics opinion provided some additional analysis.

> Given the foregoing, the Committee concludes that as a general proposition contingent fees are appropriate and ethical in situations where liability is certain and some recovery is likely. That having been said, there may nonetheless be special situations in which a contingent fee may not be appropriate. For example, if in a particular instance a lawyer was reasonably confident that as soon as the case was filed the defendant would offer an amount that the client would accept, it might be that the only appropriate fee would be one based on the lawyer's time spent on the case since, from the information known to the lawyer, there was little risk of non-recovery and the lawyer's efforts would have brought little value to the client's recovery. And even if, in such circumstances, after a full discussion, it were agreed between lawyer and client that a contingent fee was

> appropriate, the fee arrangement should recognize the likelihood of an early favorable result by providing for a significantly smaller percentage recovery if the anticipated offer is received and accepted than if the case must go forward through discovery, trial and appeal.

ABA LEO 389 (12/5/94) (footnote omitted). The Restatement takes the same basic approach.

> **[E 1363]** A contingent fee may permissibly be greater than what an hourly fee lawyer of similar qualifications would receive for the same representation. A contingent-fee lawyer bears the risk of receiving no pay if the client loses and is entitled to compensation for bearing that risk. Nor is a contingent fee necessarily unreasonable because the lawyer devoted relative little time to a representation, for the customary terms of such arrangements commit the lawyer to provide necessary effort without extra pay if a relatively large expenditure of the lawyer's time were entailed. However, large fees unearned by either effort of a significant period of risk are unreasonable . . . .

Restatement (Third) of Law Governing Lawyers § 35 cmt. c (2000).

> A contingent fee may permissibly be greater than what an hourly fee lawyer of similar qualifications would receive for the same representation. A contingent-fee lawyer bears the risk of receiving no pay if the client loses and is entitled to compensation for bearing that risk. Nor is a contingent fee necessarily unreasonable because the lawyer devoted relatively little time to a representation, for the customary terms of such arrangements commit the lawyer to provide necessary effort without extra pay if a relatively large expenditure of the lawyer's time were entailed. However, large fees unearned by either effort or a significant period of risk are unreasonable . . . .
>
> A tribunal will find a contingent fee unreasonable due to a defect in the calculation of risk in two kinds of cases in particular: those in which there was a high likelihood of substantial recovery by trial or settlement, so that the lawyer bore little risk of nonpayment; and those in which the client's recovery was likely to be so large that the lawyer's fee would clearly exceed the sum appropriate to pay for services performed and risks assumed. A lawyer's failure to disclose

> to the client the general likelihood of recovery, the approximate probable size of any recovery, or the availability of alternative fee systems can also bear upon whether the fee is reasonable.

Restatement (Third) of Law Governing Lawyers § 35 cmt. c (2000). An illustration provides an example of an impermissible contingent fee.

> **[E 1364]** Client seeks Lawyer's help in collecting life-insurance benefits under a $15,000 policy on Client's spouse and agrees to pay a one-third contingent fee. There is no reasonable ground to contest that the benefits are due, the claim has not been contested by the insurer, and when Lawyer presents it the insurer pays without dispute. The $5,000 fee provided by the client-lawyer contract is not reasonable.

Restatement (Third) of Law Governing Lawyers § 35 cmt. c, illus. 1 (2000)

Every court and bar acknowledges that contingent fees must be judged both at the time the lawyer and the client agree to them, and the time that the lawyer would like to enforce them.

- Restatement (Third) of Law Governing Lawyers § 34 cmt. c (2000) ("Although reasonableness is usually assessed as of the time the contract was entered into, later events might be relevant.").
- Virginia LEO 1667 (7/8/96) (a fee's reasonableness is not judged solely at the time of the agreement, because "the occurrence of events not contemplated by the parties at the outset of the representation may also be relevant to the reasonableness of the fee").

In applying these standards, courts reach varying conclusions based on the facts.

Some courts and bars find a particular contingent fee reasonable.

- **[E 1623]** In re Abrams & Abrams, P.A. v. National Union Fire Insurance Company of Pittsburgh, Pennsylvania, 2010 U.S. App. LEXIS 10071 (4th Cir. May 18, 2010) (reversing a lower court's reduction in attorneys fees in a contingent fee case; explaining that "[a]fter winning their disabled client an $ 18 million personal injury settlement that will pay for his care for the rest of his

life, the attorneys in this case saw their compensation slashed by the district court from the thirty-three percent provided in their contingency fee agreement to a mere three percent. While a district court does possess discretion in approving fee awards, particularly when its power to protect minors or the disabled is involved, we hold that the court here abused that discretion by improperly applying the standards we have established for determining whether an attorney's fee is reasonable. As a result, we vacate and remand."; further explaining the background; "Because Pellegrin was incompetent, National Union and Jerry Pellegrin jointly moved for court approval of the settlement. The district court questioned Pellegrin's attorneys about their work, demanding to know how many hours they had spent on the case. At first, Douglas Abrams of Abrams & Abrams, P.A. replied that the firm did not keep hourly records because it only took contingency cases. When pressed, he guessed that 'our firm alone has a thousand hours' and that Bourque's firm 'has at least a thousand hours.' Bourque estimated his firm's time as 'something well in excess of a thousand hours.' No other evidence about hours was presented."; "In spite of this request, the district court reduced the lawyers' compensation from $ 6 million to $ 600,000, or from thirty-three percent down to three percent of the settlement. . . . The $ 5.4 million balance reverted to Pellegrin. The court reached this number by taking what it termed counsel's 'pure speculation' as to the number of hours worked and multiplying it by $ 300 per hour rate that it believed was 'a high hourly rate for a similarly-situated lawyer in North Carolina.'. . ."; holding that the district court erred; "The chief error in the district court's analysis was its failure to recognize the significance of the contingency fee in this case. . . . Fixing a lodestar fee in this contingency case was error and threatens to nullify the considerable advantages of contingency arrangements."; "The facts of this case illustrate precisely the type of situation in which a contingency fee may be the only way an individual can protect his interests. Yet the district court's analysis made no mention of the role that contingent compensation played in providing the Pellegrins with access to court. . . . The contingency agreement was, as the saying goes, the key to the courthouse door that allowed Jerry Pellegrin to retain the attorneys who eventually provided for his son's ongoing needs. The district court erred in failing to consider the access to the legal system that contingency fees like the ones herein provide."; "[I]t may be necessary to provide a greater return than an hourly fee offers to induce lawyers to take on representation for which they might never be paid, and it makes sense to arrange these fees as a percentage of any recovery."; "[A]n attorney compensated on a contingency basis has a strong economic motivation to achieve results for his client, precisely because of the risk accepted. . . . Because the district court's ruling failed to recognize that contingency fees provide attorneys due consideration for the risk they undertake, it reduced counsel's fee to a level that few attorneys would have accepted at the outset of litigation, when success was by no means assured and the size of any settlement or judgment was unpredictable."; "Indeed, there were a number of sticky problems with the present suit when counsel

undertook the representation, problems which Pellegrin's attorneys managed to overcome. The difficulties included National Union's reservation of rights letter to McKiernan based on his violation of KCI's alcohol policy and the prospect of securing a verdict against a judgment-proof defendant once coverage was denied. Additionally, North Carolina is a contributory negligence state where the failure to exercise due care by plaintiff operates as a complete bar to recovery. . . . Contributory negligence was an obvious defense in a case involving an intoxicated plaintiff who ran in front of a moving vehicle driven by a friend he knew had also been drinking. . . . Finally, Pellegrin's attorneys faced the task of triggering coverage under a company insurance policy that only covered company-authorized travel without transforming the suit into an exclusive worker's compensation claim under the North Carolina co-employee immunity doctrine, which prevents employees injured during employment from suing co-workers."; "Nor was the district court correct in discounting the obstacles Pellegrin's attorneys faced and ultimately overcame. Because the suit against McKiernan was undefended and because National Union settled quickly once it was sued, the district court concluded that '[t]he uncontested nature of this action strongly implies that Plaintiff's Counsel did not expend a great deal of time in the handling of this case and that a fee in the amount Plaintiff's Counsel seeks would be an unjustified windfall. . . .'"; "By the time mediation and settlement occurred, the case may well have appeared open and shut, but that was only because Pellegrin's attorneys had spent almost two years laying the ground work to secure their client's interests. . . . Successful outcomes often make risks seem less risky in hindsight than they were at the time, and the court should not have ignored those risks merely because at some later point in litigation the defendant found it in its interest to settle."; "It should be apparent from our discussion of the above facts and circumstances that the district court's reduction of attorney's fees from thirty-three percent to a mere three percent was much too steep a decrease. Upon remand, the district court's discretion must be guided by a more rigorous analysis of the applicable Barber/Allen [Barber v. Kimbrell's, Inc., 577 F.2d 216, 226 (4th Cir. 1978) and Allen v. U.S., 606 F.2d 432, 435 (4th Cir. 1979)] factors, and especially by a recognition of the important role played by contingency fees in this type of litigation.").

Lawyers must do more than simply point to the contingent-fee contract -- they must establish the reasonableness of the fee.

- **[E 181 N 1/08]** Hauptman, O'Brien, Wolf & Lathrop, P.C. v. Turco, 735 N.W.2d 368, 374, 374-75 (Neb. 2007) (finding that a lawyer seeking fees under an unambiguous fee contract nevertheless had to establish the fee was reasonable; "We conclude that an attorney fee computed pursuant to a contingent fee agreement is subject to the same standard of reasonableness as any other attorney fee. To hold otherwise would require us to ignore the

ethical principle which prohibits a lawyer from making an agreement for, charging, or collecting an unreasonable fee."; noting that the law firm had not put on any evidence "of the extent and value of the professional services which it performed during the period from July 8, 2004, when the contingent fee agreement was executed until September 14, 2004, when Louis terminated the representation. Without such evidence, there is no factual basis upon which to determine whether or not the claimed fee computed pursuant to the contingent fee agreement is reasonable. The district court erred in sustaining the law firm's motion for summary judgment because the firm did not meet its initial burden, as the moving party, of showing that there is no genuine issue of material fact and that it is entitled to judgment as a matter of law."; reversing summary judgment for the law firm and remanding).

Other courts dealing with other arrangements have found contingent fees unreasonable.

- **[E 1648 B 4/11]** In re Solis, 610 F.3d 969, 970, 972, 974 (7th Cir. 2010) (analyzing a situation in which a debtor's lawyer sought to recover contingent fees on an amount of money that the debtor had already recovered, but which the lawyer claims to have confirmed was the debtor's; providing the background; "The legal profession has not treated debtor Luis Solis well. The secretary of an attorney who settled Solis' workers' compensation claim stole nearly half of the amount he was owed. Then a second attorney whom Solis had hired to recover the rest of the stolen settlement -- appellant Joseph O'Callaghan -- asserted an attorney fee claim for a percentage of the entire amount of the settlement, including the portion that Solis had already been paid before he hired that second attorney. The legal issue in this appeal is whether the second attorney 'recovered' money for his client when he established the client's entitlement to the sum of money already in the client's possession. Appellant O'Callaghan insists that the answer is yes. We disagree. Under the terms of the contingent fee agreement in this case, O'Callaghan is entitled to a percentage of only the money he actually recovered from other parties, not a percentage of the money Solis had received earlier."; explaining that "Solis retained a second attorney, appellant O'Callaghan, to recover the rest of the settlement that was owed to him. O'Callaghan took the case on a contingent fee basis. Under the written contingent fee agreement, O'Callaghan would receive 40 percent of 'any gross amount recovered in the event of suit being filed.' 'Gross amount' was defined as 'the total amount of money received on [the] case before deduction of any expenses.'"; explaining what the term "recovered" means in the contingent fee arrangement: "Read in context -- as part of a contingent fee agreement -- the term 'recovered' most naturally encompasses situations in which the client actually receives cash or property from some other parties as a result of the attorney's efforts. That the Illinois court read contingent fee agreements strictly in favor of the client support this interpretation. This

contingent fee agreement cannot fairly be read as an agreement by Solis to pay O'Callaghan 40 percent of the $ 62,410 that Solis had already received. Nor can it fairly be read as a promise to pay O'Callaghan 40 percent of that sum for securing Solis' title to the money or for defending him against any claims for that money. The agreement makes no mention of any such claims having been asserted against Solis at the time he and O'Callaghan entered the agreement."; ultimately holding that "[t]he problem here is that O'Callaghan did not actually recover that money for Solis, as required by the fee agreement. Rather, as the bankruptcy court observed, O'Callaghan at best clarified Solis' title to that money through a binding legal judgment.").

- **[E 1398]** Maynard Steel Casting Co. v. Sheedy, 2008 WI App 27, 307 Wis. 2d 653 (Wis. Ct. App. 2008) (concluding that a lawyer operating under a contingent-fee agreement was not entitled to the contingent-fee amount of $136,995.13, but instead should recover only $4,200.00 -- because the contingent fee was unreasonable; "[A] contingent fee agreement is only a guide on the question of whether an attorney has charged a reasonable fee. . . . In this case, the trial court properly refused to rubber-stamp the contingent fee agreement and, after examining the appropriate factors to measure the reasonableness of the fee, it concluded that, under all of the circumstances, the contingency fee amount was unreasonable. We affirm, since the trial court applied the correct burden of proof, examined the relevant factors bearing on reasonableness, and correctly incorporated its knowledge of local practices and billing norms."; "The court found that the only effort Sheedy expended to assist Maynard Steel recover its claim was to mail claim information and supplemental claim information to the claims administrator. In one paragraph, the court summarized the extent of Sheedy's involvement: 'Mr. Sheedy did nothing more than monitor the lawsuit, seek status reports from class counsel and report on the status of the case to Maynard [Steel]. Mr. Sheedy did not conduct any factual investigation of claims against any of Maynard [Steel]'s suppliers . . . nor did he conduct any legal research, nor did he prepare any pleadings or prosecute any legal action. He did not negotiate the settlement, he did not participate in any of the proceedings in the class action and he offered Maynard [Steel] no counsel on the steps it needed to take to prevail in the litigation.'"; finding that the lawyer would have required only about twelve hours to perform the listed services; "By the time Maynard Steel signed the contingent fee agreement in November 1998, UCAR had settled the class action suit. In fact, Maynard Steel executed a proof of claim form concurrently with its execution of the contingent fee agreement."; finding that the court did not need expert testimony to conclude that the contingent fee was unreasonable, and that Sheedy should be awarded only $4,200.00.).

- **[E 133 N 2/07]** Hoover Slovacek LLP v. Walton, 206 S.W.3d 557 (Tex. 2006) (a lawyer's contingent-fee arrangement may not allow a terminated lawyer to collect the present value of a 30 percent contingent fee based on the settlement offer, when the fee exceeded the client's actual recovery).

- **[E 69 N 12/06]** In re Van Sickle, No. 99-O-12923, 2006 WL 2465633 (Cal. State Bar Ct. Review Dep't Aug. 24, 2006) (suspending for one year a lawyer who arranged for a 35% contingent fee without accounting for fees that the client owed his previous lawyer; noting that the lawyer claimed he had advised the client that the client would have to pay the former lawyer out of the recovery; finding that the lawyer charged an inappropriately high fee).

- Virginia LEO 1696 (3/7/97) (a lawyer may collect a contingent fee in arranging for a client to recover medical payments under the tortfeasor's insurance as long as "the services of an attorney are reasonably necessary to secure the payments from the insurance company")

- Virginia LEO 1641 (11/28/95) (a 10% "administrative fee" a lawyer proposes to charge clients in collecting Med Pay would be improper because such collection matters normally are "purely ministerial" and involve no risk that the lawyer would earn no fee at all (such a possibility is one of the justifications for a contingent-fee arrangement); an hourly rate or flat fee would not be improper in such circumstances).

- Virginia LEO 1461 (4/13/92) (it is per se unreasonable for a lawyer to take a contingent fee for obtaining medical expenses from an insurance company when the client could have obtained the expenses without the lawyer's help).

- Committee on Legal Ethics of W. Va. State Bar v. Gallaher, 180 W. Va. 332, 335, 376 S.E.2d 346, 349 (1988) ("Many cases . . . hold that a contingent fee is clearly excessive if the skill and labor required of the lawyer are grossly disproportionate to the fee."; noting that after deduction of the contingent fee the client received less than her uncontested special damages).

- Committee on Legal Ethics of W. Va. State Bar v. Tatterson, 177 W. Va. 356, 352 S.E.2d 107 (1986) (finding that a contingent fee was clearly excessive, citing cases in which "layman could have performed same services as attorney [because] major funds passed to client by operation of law;" group insurance carrier "paid proceeds routinely without question;" annulling lawyer's license to practice law).

- In re Teichner, 104 Ill.2d 150, 470 N.E.2d 972 (1984) (disciplining a lawyer for accepting a contingent fee for collection of insurance proceeds).

The Restatement provides an explanation of this principle in several settings.

> Fees based on a percentage of the value of the property involved in a decedent's estate or in a real-estate transaction

> often are predicated on an assumption by the lawyer of the risk that more work than usual will be required. The same might be true of a lump-sum fee. Such fees should therefore be judged in light of the range of lawyer time that matters of the sort and size in question are likely to take. However, unlike contingent fees, percentage fees in such matters usually do not require the lawyer to forgo compensation when the result is unfavorable to the client. If the lawyer does not bear the risk of not being paid, compensation for such a risk is irrelevant in assessing the reasonableness of the fee.

Restatement (Third) of Law Governing Lawyers § 34 cmt. d (2000).

The Restatement provides a general explanation of how a court or bar should judge the reasonableness of a contingent-fee arrangement.

> A contingent fee may permissibly be greater than what an hourly fee lawyer of similar qualifications would receive for the same representation. A contingent-fee lawyer bears the risk of receiving no pay if the client loses and is entitled to compensation for bearing that risk. Nor is a contingent fee necessarily unreasonable because the lawyer devoted relatively little time to a representation, for the customary terms of such arrangements commit the lawyer to provide necessary effort without extra pay if a relatively large expenditure of the lawyer's time were entailed. However, large fees unearned by either effort or a significant period of risk are unreasonable . . . .
>
> A tribunal will find a contingent fee unreasonable due to a defect in the calculation of risk in two kinds of cases in particular: those in which there was a high likelihood of substantial recovery by trial or settlement, so that the lawyer bore little risk of nonpayment; and those in which the client's recovery was likely to be so large that the lawyer's fee would clearly exceed the sum appropriate to pay for services performed and risks assumed. A lawyer's failure to disclose to the client the general likelihood of recovery, the approximate probable size of any recovery, or the availability of alternative fee systems can also bear upon whether the fee is reasonable.

Restatement (Third) of Law Governing Lawyers § 35 cmt. c (2000).

The Restatement later reiterates that

> Contingency fees may not be used when the lawyer bears little risk of nonpayment and the fee is otherwise unreasonable in amount when measured on a noncontingent basis.

Restatement (Third) of Law Governing Lawyers § 35 cmt. c, reporter's notes (2000).

- **[E 1364]]** Restatement (Third) of Law Governing Lawyers § 35 cmt. c, illus. 1 (2000) ("Client seeks Lawyer's help in collecting life-insurance benefits under a $15,000 policy on Client's spouse and agrees to pay a one-third contingent fee. There is no reasonable ground to contest that the benefits are due, the claim has not been contested by the insurer, and when Lawyer presents it the insurer pays without dispute. The $5,000 fee provided by the client-lawyer contract is not reasonable.").

**[used in previous hypo]**

> In addition to unreasonableness due to lack of risk, a contingent fee can also be unreasonable because either the percentage rate is excessive or the base against which the percentage is applied is excessive or otherwise unreasonable. If different from the customary base -- the plaintiff's recovery -- a contingent base will be unreasonable if it is an inappropriate measure of the lawyer's work and risk and the benefit the client derived from the lawyer's services. Contingent-fee contracts typically contemplate that the client, if successful, will receive a lump-sum award, a stated percentage of which will constitute the lawyer's fees. A client entering a contingent-fee contract reasonably expects that the lawyer will be paid only if and to the extent that the client recovers. For example, when a judgment for the client is entered but not collected, no fee is due unless the contract so provides.
>
> The rule stated in Subsection (2) also requires that, unless the contract indicates otherwise, a contingent-fee

> lawyer is to receive the specified share of the client's actual-damages recovery. For that purpose, recovery includes damages, restitution, back pay, similar equitable payments, and amounts received in settlement. Unless the contract with the client indicates otherwise, the lawyer is not entitled to the specified percentage of items such as costs and attorney fees that are not usually considered damages. In the absence of prior agreement to the contrary, the amount of the client's recovery is computed net of any offset, such as a recovery by an opposing party on a counterclaim.

Restatement (Third) of Law Governing Lawyers § 35 cmt. d (2000).

## Best Answer

The best answer to this hypothetical is **PROBABLY NO**.

# Effect of Termination -- The "Substantial Completion" Rule

## Hypothetical 13

You were lucky enough to arrange for a job in a large law firm after graduation. Your husband was not so fortunate, and had to "hang out a shingle" in a nearby suburb. It begins to look as if your husband's career choice might have been better than yours when he starts to develop a very lucrative plaintiff's personal injury practice.

However, two recent incidents have both of you very upset. In one, a badly injured plaintiff who had retained your husband in a high-profile case fired him after just two months, and retained in his place a nationally-known plaintiff's firm from Cincinnati. In an even more frustrating incident, a plaintiff fired your husband just two weeks before trial, and then settled the case with the insurance company himself -- for a six-figure amount. Needless to say, you and your husband want to determine his rights to some share of these profitable cases.

**(a)** Is your husband entitled to a percentage of whatever amount is ultimately recovered by the plaintiff who is now represented by the Cincinnati law firm?

**NO (PROBABLY)**

**(b)** Is your husband entitled to a percentage of the six-figure amount paid by the insurance company to the other former client?

**YES (PROBABLY)**

## Analysis

Determining the rights of a discharged lawyer who had been representing a client under a contingent-fee arrangement depends on the context and timing of the discharge.

> If a client-lawyer relationship ends before the lawyer has completed the services due for a matter and the lawyer's fee has not been forfeited . . .:
>
> (1) a lawyer who has been discharged or withdraws may recover the lesser of the fair value of the lawyer's services as determined under § 39 and the ratable proportion of the compensation provided by any otherwise enforceable

> contract between lawyer and client for the services performed; except that
>
> (2) the tribunal may allow such a lawyer to recover the ratable proportion of the compensation provided by such a contract if:
>
> (a) the discharge or withdrawal is not attributable to misconduct of the lawyer;
>
> (b) the lawyer has performed severable services; and
>
> (c) allowing contractual compensation would not burden the client's choice of counsel or the client's ability to replace counsel.

Restatement (Third) of Law Governing Lawyers § 40 (2000).

Clients are always free to discharge their lawyer at any time and for any reason. This right (which comes from fiduciary principles) obviously complicates the analysis of what would otherwise be purely contractual rights and obligations under a contingent-fee contract.

Lawyers who voluntarily withdraw generally forfeit their right to recover a fee.

> We hold that when an attorney withdraws from representation upon his own volition, and the contingency has not occurred, the attorney forfeits all rights to compensation.

Faro v. Romani, 641 So.2d 69, 71 (Fla. 1994).

Withdrawal for cause could produce a different result.

> A lawyer may properly withdraw on various grounds, for example because the client insists that the lawyer perform services in a manner that would violate a lawyer code or refuses to pay the lawyer's proper fees. If the requirements of Subsection (2) are not met and there is no forfeiture, the withdrawing lawyer's compensation is limited to the lesser of the contractual fee for the services performed or the fair value of the lawyer's services. Were that not so, lawyers would be encouraged to withdraw before being discharged in order to avoid the rule of Subsection (1).

Restatement (Third) of Law Governing Lawyers § 40 cmt. d (2000).

> A lawyer who withdraws has the burden of persuading the trier of fact that the withdrawal is not attributable to a clear and serious violation of the lawyer's duty . . . to render loyal and competent service . . . .

Restatement (Third) of Law Governing Lawyers § 40 cmt. e (2000).

**(b)** An exception to the general quantum meruit recovery approach generally arises if a client discharges (without cause) a lawyer after the lawyer has "substantially completed" the work on the matter. In that circumstance, some courts allow the lawyer to recover the entire contingent fee rather than limit the lawyer's recovery to the value of the work performed to date.

States also recognize this general principle.

- **[E 286 10/08]** King & King v. Harbert Int'l, Inc., 503 F.3d 153, 156-57 (D.C. Cir. 2007) (addressing the implications of a client deciding after eleven years of litigation to drop a lawsuit, which his lawyer claimed "spoiled the firm's chance to follow through on work already done and win the case," which would have entitled the firm to a contingent fee; "The District of Columbia, like other jurisdictions, wants clients to 'compensate attorneys reasonably,' as a matter of 'fundamental fairness.' . . . Therefore, a contingent-fee attorney may seek reasonable compensation when his client terminates the representation without cause. . . . (unless a contingent-fee attorney was discharged for cause, he is entitled to reasonable compensation); . . . If the attorney substantially performed his tasks before being terminated, he may receive the agreed proportion of the client's eventual recovery. . . . Even if he performed negligible services, of little actual benefit to the client, he is entitled to quantum meruit compensation. . . . Conversely, an attorney terminated for good cause cannot recover a contingent fee. . . . A similar rule should preclude quantum meruit compensation when the client chooses to discontinue a case because of his reasonable assessment that there is 'no chance of recovery.' . . . Otherwise, a contingent-fee client, convinced he had no chance of success, would have to continue his case just to avoid quantum meruit liability. Such a policy would encourage litigants to take unwarranted risks and prolong litigation simply to avoid paying attorney fees -- a predicament that mocks the ideal of client control."; rejecting law firm's claim for quantum meruit recovery).

- **[E 1402]** King & King, Chartered v. Harbert Int'l, Inc., 503 F.3d 153, 2007 U.S. App. LEXIS 23934 (D.C. 2007) (refusing to award a quantum meruit recovery to a lawyer under circumstances in which the clients abandoned the claim; noting that the clients' dispute with the government had extended for eleven years, and that the clients were eventually indicted and therefore involved in a criminal litigation; "A client has the ultimate authority to control his affairs; thus, he may settle a claim, regardless of his attorney's efforts to prosecute it. . . . A client may also, in good faith, choose to withdraw a claim despite having expressly promised his attorney otherwise. . . . In addition, a client may discharge his attorney, with or without cause, and such a discharge will not constitute a breach of any agreement between them."; "[A] contingent-fee attorney may seek reasonable compensation when his client terminates the representation without cause. . . . If the attorney substantially performed his tasks before being terminated, he may receive the agreed proportion of the client's eventual recovery. . . . Even if he performed negligible services, of little actual benefit to the client, he is entitled to quantum meruit compensation."; "Conversely, an attorney terminated for good cause cannot recover a contingent fee. . . . A similar rule should preclude quantum meruit compensation when the client chooses to discontinue a case because of his reasonable assessment that there is 'no chance of recovery.'. . . Otherwise, a contingent-fee client, convinced he had no chance of success, would have to continue his case just to avoid quantum meruit liability. Such a policy would encourage litigants to take unwarranted risks and prolong litigation simply to avoid paying attorneys fees -- a predicament that mocks the ideal of client control."; "Given their situation, it would be eminently reasonable for the appellees to believe they had no chance to prevail at the ASBCA; to concentrate their efforts on defending the more dangerous fraud cases; and even to abandon the ASBCA case as part of a compromise with the Government. These are the kinds of difficult decisions a client must have the autonomy to make. The appellees tried to free their hands by putting the ASBCA case on a contingent-free basis; in such extremely adverse circumstances, the law will not handcuff them by requiring quantum meruit compensation.").

- **[E 180 N 1/08]** McCullough v. Waterside Assocs., 925 A.2d 352, 356, 357 (Conn. App. Ct.) (assessing lawyer's right to recover under a contingency fee arrangement; explaining that the client terminated the lawyer after "a favorable settlement had been reached" in the underlying claim; "In the present case, by continuing to represent the defendants through the settlement, the plaintiff fully performed his obligation under the agreement, which was to represent the defendants to the completion of the lawsuit or to settlement. Because the plaintiff was discharged after settlement had been reached, he had a contractual means of recovery, and quantum meruit was not applicable. Regardless of the plaintiff's less than exemplary performance, he was entitled to collect the one third contingency fee as set forth in the agreement." (footnote omitted); finding that the lawyer's ability to recover was

not diminished by the lower court's finding that the lawyer had delayed filing the lawsuit, made no effort to obtain experts or learn about the case, never became familiar with the insurance policy, and took no pretrial depositions), appeal denied, 931 A.2d 264 (Conn. 2007).

- Barr v. Day, 124 Wash..2d 318, 329, 879 P.2d 912, 918 (1994) ("The purpose of the substantial performance exception is to prevent clients from firing their attorneys immediately prior to the occurrence of the contingency in order to avoid the contingency fee."), modified, 1994 Wash. LEXIS 579 (Oct. 6, 1994).

- Kaushiva v. Hutter, 454 A.2d 1373 (D.C. Ct. App. 1983) (a client discharged his lawyer after the hearing that which it appeared that the client would win his case; holding that the lawyer was entitled to the full contingent fee rather than a quantum meruit recovery because the lawyer had substantially performed).

- Farrar v. Kelly, 440 So.2d 939, 941 (La. Ct. App. 1983) ("A client has the absolute right to discharge his attorney and after being discharged the attorney cannot recover in full measure the contracted-for fee provided in a contingency contract without providing all or substantially all of the services contemplated by the contract. . . . In the instant case, the plaintiff attorneys had performed substantially all of the services contemplated by the contract. . . . The only thing that remained to be done at the time the attorneys were discharged was to have the formal judgment signed, and this was substantially accomplished. Having done subsequently all of the work contemplated by the contract, plaintiffs are entitled to the full fee provided by the contract").

> Allowing a discharged or withdrawing lawyer to recover compensation under a fee contract with the client is sometimes more appropriate than fee forfeiture or recovery of the lesser of fair value and contractual compensation. The most common situation calling for such treatment is where the client discharges a contingent-fee lawyer without cause just before the contingency occurs, perhaps in order to avoid paying the contractual percentage fee. The reasons for the usual restrictions on contractual recovery then do not apply.

Restatement (Third) of Law Governing Lawyers § 40 cmt. c (2000).

## Best Answer

The best answer to **(a)** is **PROBABLY NO**; the best answer to **(b)** is **PROBABLY YES**.

# Calculating the Fee a Client Owes after Terminating a Contingent-Fee Lawyer without Cause

## Hypothetical 14

Your firm has experienced a string of bad luck lately, because several clients have terminated (without cause) potential lucrative contingent-fee arrangements about half way through your handling of those cases. You are trying to sort out what fees you can recover from those seemingly ungrateful former clients.

**(a)** How do you calculate what fees you can collect from the former clients?

**(INSERT NARRATIVE ANSWER)**

**(b)** Is you are using a quantum meruit calculation, can you be reimbursed for adding value to the client's cause above and beyond the hours you spent multiplied by your normal hourly rate?

**YES (PROBABLY)**

**(c)** In the future, can you include in your standard contingent-fee contract a provision specifying the hourly rate you will use when determining a quantum meruit fee amount?

**YES**

## Analysis

**(a)** Most quantum meruit assessments begin with determining the reasonable amount of time that a lawyer spent on a matter, multiplied by a reasonable hourly rate. However (as explained below), lawyers can bring value to a case above and beyond this simple calculation.

Courts and bars have assessed whether a contingent-fee arrangement can include the hourly rate that the client agrees to use in such a scenario. Some authorities uphold such arrangements.

- See, e.g., **[E 1396]** Herr v. Carter Lumber, Inc., 888 N.E. 2d 853, 2008 Ind. App. LEXIS 1330 (Ind. Ct. App. 2008) (noting that the Indiana Supreme Court "'has approved the use of termination clauses that provide for an hourly rate in the event of a pre-contingency termination, holding that they are 'presumptively enforceable, subject to the ordinary requirement of reasonableness.'"; citing Four Winds, LLC [Four Winds, LLC v. DeBonis, LLC, 854 N.E. 2d 70 (Ind. Ct. App. 2006)].).

On the other hand, some authorities invalidate such provisions, usually because the lawyer has not adequately explained their meaning to the client.

- **[NEW VA LEO]**

- **[E 1290 B 9/11]** Columbus Bar Ass'n v. Klos, 692 N.E.2d 565, 565, 567, 568 (Ohio 1998) (analyzing the following situation: "In April 1994, Klos agreed to represent Lilly Clay in a wrongful termination matter against her former employer. Klos charged Clay $500 for an investigation letter and then, when the letter did not resolve the situation, Klos and Clay entered into a 'Fee Agreement.' The agreement provided for 'a retainer of $4,000 and or $150 per hour' (with credit for the previously paid $500) 'and or a sum equal to 33 percent of any sum which may be received by a compromise settlement of said claim recovered through prosecution of said claim to judgment in any court."; noting that lawyer spent only 34.54 hours on the Clay matter; publicly reprimanding the lawyer; "[T]he fee agreement used by Klos in the Clay matter was deficient. The portion of the contract covering the investigative phase of the case involved a retainer that was nonrefundable should the attorney withdraw for any reason. It further provided that if the attorney withdrew because of the acts of the client, the attorney would be entitled to compensation at $150 per hour. The actual wording was, 'If the Attorney withdraws * * * without the fault or against the desire of the Client, * * * there shall be nothing due * * * to the Attorney for attorney's fees other than the retainer, court costs, and expenses * * *. If the withdrawal of the Attorney shall be due to the acts or conduct of the Client * * *, the attorney shall be reimbursed for services at an hourly rate of $150.00.'"; "The contingent fee portion of the contract covering the litigation phase of the Clay case was also flawed. It provided that should the attorneys be discharged or withdraw prior to settlement, they would be compensated at $150 per hour. . . . [A] liquidated hourly fee arrangement upon termination of a contingent fee contract precluded the application of DR 2-106(B), which sets out the elements to be considered in the calculation of a reasonable fee. We disapprove also of this portion of the Clay contract."; also finding the language ambiguous; "[T]he contract language provided for a $ 4,000 retainer, 'and or' $150 per hour, 'and or' a contingent fee equal to thirty-three percent of any settlement or judgment. This language is ambiguous. It is impossible to determine from the four corners of this document whether one, two, or all

three methods of fee determination apply. In practice, Klos did not apply any of these methods. He applied the fee agreement of the Clay case by charging Clay the retainer and the to that sum adding one-third of the recovery after the recovery was reduced by the retainer. This method of application of the fee agreement was not clearly expressed at the outset of the representation and is certainly not apparent in the document.").

Not surprisingly, courts analyzing this scenario generally require lawyers to have kept adequate records of the time that they spent and the tasks that they undertook.

- See, e.g., **[E 376 B 1/09]** Barry Mallin & Assocs. P.C. v. Nash Metalware Co., 849 N.Y.S.2d 752, 757 (N.Y. Civ. Ct. 2008) (holding that a lawyer could not recover a quantum meruit fee recovery from a client because the law firm's billing record "are too imprecise to deduce the reasonable amount of attorney's fees").

Plaintiffs' contingent-fee lawyers who might face this situation often keep hourly records for this reason, even though a successful contingent-fee representation normally does not depend on such records.

In contrast, some courts are fairly forgiving of contingent-fee lawyers who do not keep precise records.

- See, e.g., **[E 249]** Mardirossian & Assocs., Inc. v. Ersoff, 62 Cal. Rptr. 3d 665, 669 & 671 (Cal. Ct. App. 2007) (certified for partial publication pursuant to Cal. R. Ct. 8.100 and 8.1110) (allowing a lawyer retained under a contingent fee-agreement to seek quantum meruit damages; noting that the retainer agreement included a lawyer's lien, which was based on a specified hourly rate, which the client agreed to pay if the client discharged the lawyer or terminated the claim; explaining that the client settled the case on the same day that the client terminated the lawyer; also acknowledging that the retainer agreement allowed the lawyer to "elect compensation based upon the agreed contingency for any offer to Client to settle the matter prior to the Attorney's discharge," but noting that "there had been no settlement offer prior to its discharge"; not dealing with the enforceability of such a clause; upholding the jury's damage award in the lawyer's favor of approximately $650,000; noting that the jury could rely on the lawyers' own testimony about the time they spend and expert testimony, even though the lawyer had not maintained careful time records), review denied, No. S155663, 2007 Cal. LEXIS 11053 (Cal. Oct. 10, 2007). **Tom -- How do you want to show this ?** **NOTICE:** CERTIFIED FOR PARTIAL PUBLICATION** Pursuant to California Rules of

Court, rules 8.1100 and 8.1110, this opinion is certified for publication with the exception of parts 4 and 6 of the Discussion.

**(b)** Although it can be very difficult for terminated contingent-fee lawyers to win such an argument, they theoretically can assert that a proper quantum meruit recovery should exceed the number of hours they spent multiplied by a reasonable hourly rate. For instance, the Ninth Circuit held that a terminated lawyer could recover a larger quantum meruit amount because the lawyer arranged for the involvement of an excellent lawyer as co-counsel (bringing value to the client).

- **[E 1399]** Crockett & Myers, Ltd. v. Napier, Fitzgerald & Kirby, LLP, 583 F.3d 1232, 2009 U.S. App. LEXIS 23005 (9th Cir. Ct. App. 2009) (addressing a situation in which a client pursuing a medical malpractice case retained a New York lawyer (Fitzgerald), who in turn arranged for a Nevada lawyer (Crockett) to become involved in the case; noting that the client fired Fitzgerald, and proceeded to trial represented only by Crockett; explaining that Fitzgerald's hourly rate times the number of hours spent resulted in a quantum meruit fee of only $4,300.00 -- but that Fitzgerald should be paid $33,333.33 as a quantum meruit recovery, because Fitzgerald had arranged for Crockett's involvement, and also convinced Crockett to reduce his normal contingent-fee percentage; rejecting Fitzgerald's argument that he was entitled to the contingent fee; "We reject Fitzgerald's argument that he was entitled to 50% of the fees as contemplated by the Retainer Agreement. Although a court may consider the contract price, the originally agreed upon fee 'cannot be held to be the controlling or dominant consideration' in an action under quantum meruit. . . . 'Quantum meruit contemplates that the true reasonable value is to be substituted for the agreed terms.'. . . Because Fitzgerald was terminated over a year before the case ultimately settled, the district court properly departed from the original contract price."; "Although the district court recognized that Nostro benefitted from Fitzgerald's careful selection of a local attorney well-versed in Nevada medical malpractice law, it failed to account for the value, in and of itself, of the referral. Instead, it focused solely on the value of the reduced contingency fee, calculating the fee as a percentage of the fee savings. We agree that the reduction conferred a benefit upon Nostro. The district court, however, erred in failed to account for the 'reasonable value' to Crockett for the referral itself, apart from the fee reduction. Accordingly, we vacate the lower court's order and remand

> for a recalculation of the award. We further note that a court may also consider 'established customs' when calculating an award under quantum meruit.").

**(c)** Authorities and the case law have addressed four different scenarios in which a lawyer might not complete a contingent-fee representation.

First, the client might fire the lawyer -- with or without cause. Second, the lawyer might withdraw from the representation -- with or without cause.

## Lawyers Terminated by the Client

The Restatement deals with the scenario in which the client terminates the lawyer.

> **[E 1378]** A client might discharge a lawyer before substantial completion of the services. The discharge might occur in circumstances not justifying forfeiture of the lawyer's compensation, for example because the client decides unreasonably that the lawyer's approach to the matter is inappropriate. Some older decisions reason that such a lawyer, not having violated the contract, is entitled to receive the contractual fee less the value of any services the lawyer avoided by being discharged. Alternatively, it could be argued that the lawyer should be able to treat the contract as revoked and recover in quantum meruit . . . the fair value of whatever services the lawyer rendered, even if that recovery exceeds the contractual price. . . Those approaches are incorrect except in the circumstances in which contractual recovery is appropriate. . . . The discharged lawyer has not completed the work for which the contractual fee was due. Noncompletion results not from any improper act of the client, but from the client's exercise of the right to discharge counsel. . . . That right should not be encumbered by permitting the lawyer the option of either recovery at the contractual rate or in quantum meruit without appropriate adjustment for work yet to be performed.

Restatement (Third) of Law Governing Lawyers § 40 cmt. b (2000).

Most authorities indicate that a contingent-fee lawyer terminated for cause generally is not entitled to any compensation.

- **[E 1394]** ABA Model Rules 1.5(b) ("The scope of the representation and the basis or rate of the fee and expenses for which the client will be responsible shall be communicated to the client, preferably in writing, before or within a reasonable time after commencing the representation, except when the lawyer will charge a regularly represented client on the same basis or rate. Any changes in the basis or rate of the fee or expenses shall also be communicated to the client.").

- **[E 1204 B 10/11]** Nabi v. Sells, 892 N.Y.S.2d 41, 43-44, 44 (N.Y. App. Div. 2009) (allowing a lawyer to obtain quantum meruit recovery of fees although the contingency fee retainer agreement did not comply with New York ethics rules; "We need not decide whether any of the alleged defects in the retainer agreement, alone or in combination, bar recovery in contract. Provided that defendant attorneys were not discharged for cause, in which case they would not be entitled to any fee. . . , their recovery would be limited to the fair and reasonable value of their services, computed on the basis of quantum meruit . . . . The rationale for the rule is that, due to the special relationship of the utmost trust and confidence between a client and an attorney, the client has the right to discharge the attorney at any time, for any reason, or for no reason, regardless of any particularized retainer agreement, and the client should not be compelled to pay damages for exercising the absolute right to cancel the contract . . . . Against the client's unqualified right to terminate the attorney-client relationship is balanced the notion that a client should not be unjustly enriched at the attorney's expense to take undue advantage of the attorney, and therefore the attorney is entitled to recover the reasonable value of services rendered . . . . After the termination of the relationship, the client and attorney of course remain free to reach a new agreement that, in lieu of a fixed dollar amount for the quantum meruit value of services rendered, the discharged attorney shall receive as compensation a contingent percentage of the recovery, determined either at the time of substitution or the conclusion of the case . . . . However, such an arrangement of payment cannot be compelled by the attorney; it can only be reached with the consent of the client."; explaining that different rules applied when lawyers were fighting over fees; "By contrast, where the dispute is between successive lawyers, rather than between the client and the attorney, a different set of rules applies . . . . In that situation, the outgoing attorney may elect, even over the objections of the incoming attorney, either quantum meruit compensation in a fixed dollar amount at the time of discharge, or a contingent percentage fee, determined either at the time of substitution or the conclusion of the case . . . . Even then, however, in the absence of an agreement between the outgoing and incoming attorneys, the contingent percentage fee is measured by quantum meruit, based on the discharged attorney's proportionate share of the work performed

on the whole case, in addition to the amount of recovery . . . . Indeed, the additional option of contingent percentage compensation that a discharged attorney has against incoming attorneys, not available as against the former client, sounds in quantum meruit: the incoming attorneys should not unjustly enriched at the expense of the outgoing attorney."; ultimately concluding that the dispute before the court was "between only the client and the discharged attorney," so that the "if it is established that defendants were discharged without cause, their recovery is limited to quantum meruit in a fixed dollar amount, which may be more or less than that provided in the rescinded contract that had existed between them and plaintiff, and which may be presently payable or secured by lien.").

- **[E 1402]** King & King, Chartered v. Harbert Int'l, Inc., 503 F.3d 153, 2007 U.S. App. LEXIS 23934 (D.C. 2007) (refusing to award a quantum meruit recovery to a lawyer under circumstances in which the clients abandoned the claim; noting that the clients' dispute with the government had extended for eleven years, and that the clients were eventually indicted and therefore involved in a criminal litigation; "A client has the ultimate authority to control his affairs; thus, he may settle a claim, regardless of his attorney's efforts to prosecute it. . . . A client may also, in good faith, choose to withdraw a claim despite having expressly promised his attorney otherwise. . . . In addition, a client may discharge his attorney, with or without cause, and such a discharge will not constitute a breach of any agreement between them."; "[A] contingent-fee attorney may seek reasonable compensation when his client terminates the representation without cause. . . . If the attorney substantially performed his tasks before being terminated, he may receive the agreed proportion of the client's eventual recovery. . . . Even if he performed negligible services, of little actual benefit to the client, he is entitled to quantum meruit compensation."; "Conversely, an attorney terminated for good cause cannot recover a contingent fee. . . . A similar rule should preclude quantum meruit compensation when the client chooses to discontinue a case because of his reasonable assessment that there is 'no chance of recovery.'. . . Otherwise, a contingent-fee client, convinced he had no chance of success, would have to continue his case just to avoid quantum meruit liability. Such a policy would encourage litigants to take unwarranted risks and prolong litigation simply to avoid paying attorneys fees -- a predicament that mocks the ideal of client control."; "Given their situation, it would be eminently reasonable for the appellees to believe they had no chance to prevail at the ASBCA; to concentrate their efforts on defending the more dangerous fraud cases; and even to abandon the ASBCA case as part of a compromise with the Government. These are the kinds of difficult decisions a client must have the autonomy to make. The appellees tried to free their hands by putting the ASBCA case on a contingent-free basis; in such extremely adverse circumstances, the law will not handcuff them by requiring quantum meruit compensation.").

The issue becomes much more complicated if the client terminates a contingent-fee lawyer without cause (and before the lawyer has "substantially completed" his or her work). Most authorities hold that a lawyer in that setting can recover under a quantum meruit theory.

- **[E 1204 B 10/11]** Nabi v. Sells, 892 N.Y.S.2d 41, 43-44, 44 (N.Y. App. Div. 2009) (allowing a lawyer to obtain quantum meruit recovery of fees although the contingency fee retainer agreement did not comply with New York ethics rules; "We need not decide whether any of the alleged defects in the retainer agreement, alone or in combination, bar recovery in contract. Provided that defendant attorneys were not discharged for cause, in which case they would not be entitled to any fee. . . , their recovery would be limited to the fair and reasonable value of their services, computed on the basis of quantum meruit . . . . The rationale for the rule is that, due to the special relationship of the utmost trust and confidence between a client and an attorney, the client has the right to discharge the attorney at any time, for any reason, or for no reason, regardless of any particularized retainer agreement, and the client should not be compelled to pay damages for exercising the absolute right to cancel the contract . . . . Against the client's unqualified right to terminate the attorney-client relationship is balanced the notion that a client should not be unjustly enriched at the attorney's expense to take undue advantage of the attorney, and therefore the attorney is entitled to recover the reasonable value of services rendered . . . . After the termination of the relationship, the client and attorney of course remain free to reach a new agreement that, in lieu of a fixed dollar amount for the quantum meruit value of services rendered, the discharged attorney shall receive as compensation a contingent percentage of the recovery, determined either at the time of substitution or the conclusion of the case . . . . However, such an arrangement of payment cannot be compelled by the attorney; it can only be reached with the consent of the client."; explaining that different rules applied when lawyers were fighting over fees; "By contrast, where the dispute is between successive lawyers, rather than between the client and the attorney, a different set of rules applies . . . . In that situation, the outgoing attorney may elect, even over the objections of the incoming attorney, either quantum meruit compensation in a fixed dollar amount at the time of discharge, or a contingent percentage fee, determined either at the time of substitution or the conclusion of the case . . . . Even then, however, in the absence of an agreement between the outgoing and incoming attorneys, the contingent percentage fee is measured by quantum meruit, based on the discharged attorney's proportionate share of the work performed on the whole case, in addition to the amount of recovery . . . . Indeed, the additional option of contingent percentage compensation that a discharged attorney has against incoming attorneys, not available as against the former client, sounds in quantum meruit: the incoming attorneys should not unjustly

enriched at the expense of the outgoing attorney."; ultimately concluding that the dispute before the court was "between only the client and the discharged attorney," so that the "if it is established that defendants were discharged without cause, their recovery is limited to quantum meruit in a fixed dollar amount, which may be more or less than that provided in the rescinded contract that had existed between them and plaintiff, and which may be presently payable or secured by lien.").

- **[E 1402]** King & King, Chartered v. Harbert Int'l, Inc., 503 F.3d 153, 2007 U.S. App. LEXIS 23934 (D.C. 2007) (refusing to award a quantum meruit recovery to a lawyer under circumstances in which the clients abandoned the claim; noting that the clients' dispute with the government had extended for eleven years, and that the clients were eventually indicted and therefore involved in a criminal litigation; "A client has the ultimate authority to control his affairs; thus, he may settle a claim, regardless of his attorney's efforts to prosecute it. . . . A client may also, in good faith, choose to withdraw a claim despite having expressly promised his attorney otherwise. . . . In addition, a client may discharge his attorney, with or without cause, and such a discharge will not constitute a breach of any agreement between them."; "[A] contingent-fee attorney may seek reasonable compensation when his client terminates the representation without cause. . . . If the attorney substantially performed his tasks before being terminated, he may receive the agreed proportion of the client's eventual recovery. . . . Even if he performed negligible services, of little actual benefit to the client, he is entitled to quantum meruit compensation."; "Conversely, an attorney terminated for good cause cannot recover a contingent fee. . . . A similar rule should preclude quantum meruit compensation when the client chooses to discontinue a case because of his reasonable assessment that there is 'no chance of recovery.'. . . Otherwise, a contingent-fee client, convinced he had no chance of success, would have to continue his case just to avoid quantum meruit liability. Such a policy would encourage litigants to take unwarranted risks and prolong litigation simply to avoid paying attorneys fees -- a predicament that mocks the ideal of client control."; "Given their situation, it would be eminently reasonable for the appellees to believe they had no chance to prevail at the ASBCA; to concentrate their efforts on defending the more dangerous fraud cases; and even to abandon the ASBCA case as part of a compromise with the Government. These are the kinds of difficult decisions a client must have the autonomy to make. The appellees tried to free their hands by putting the ASBCA case on a contingent-free basis; in such extremely adverse circumstances, the law will not handcuff them by requiring quantum meruit compensation.").

- **[E 249]** Mardirossian & Assocs., Inc. v. Ersoff, 62 Cal. Rptr. 3d 665, 669 & 671 (Cal. Ct. App. 2007) (certified for partial publication pursuant to Cal. R. Ct. 8.100 and 8.1110) (allowing a lawyer retained under a contingent-fee agreement to seek quantum meruit damages; noting that the retainer

agreement included a lawyer's lien, which was based on a specified hourly rate, which the client agreed to pay if the client discharged the lawyer or terminated the claim; explaining that the client settled the case on the same day that the client terminated the lawyer; also acknowledging that the retainer agreement allowed the lawyer to "elect compensation based upon the agreed contingency for any offer to Client to settle the matter prior to the Attorney's discharge," but noting that "there had been no settlement offer prior to its discharge"; not dealing with the enforceability of such a clause; upholding the jury's damage award in the lawyer's favor of approximately $650,000; noting that the jury could rely on the lawyers' own testimony about the time they spend and expert testimony, even though the lawyer had not maintained careful time records), review denied, No. S155663, 2007 Cal. LEXIS 11053 (Cal. Oct. 10, 2007). **Tom -- How do you want to show this ?** **NOTICE:** CERTIFIED FOR PARTIAL PUBLICATION** Pursuant to California Rules of Court, rules 8.1100 and 8.1110, this opinion is certified for publication with the exception of parts 4 and 6 of the Discussion.

- **[E 137 N 2/07]** Baker v. Shapero, 203 S.W.3d 697 (Ky. 2006) (a contingent-fee lawyer terminated by the client may only recover under quantum meruit).

- **[E 1395]** Universal Acupuncture Pain Servs., P.C. v. Quadrino & Schwartz, P.C., 370 F.3d 259, 2004 U.S. App. LEXIS 10721 (2nd Cir. App. 2004) (holding that a lawyer working under a contingent fee who is fired by the client can recover under a quantum meruit theory even if the client ultimately did not recover on the case -- although the failure to recover is a factor in determining the proper quantum meruit amount; "Under New York law, a client may discharge his or her lawyer at any time, with or without cause. . . . If a lawyer is discharged for cause, he or she is not entitled to legal fees. . . . If the lawyer is discharged without cause and prior to the conclusion of the case, however, he or she may recover either (1) in quantum meruit, the fair and reasonable value of the services rendered, or (2) a contingent portion of the former client's ultimate recover, but only if both of the parties have so agreed. . . . In this case, immediately after the clients discharged Q&S and before the litigation was resolved, Q&S requested compensation in quantum meruit. Therefore, unless the clients discharged Q&S for cause, it was entitled to receive such compensation."; holding that the court did not abuse its discretion in waiting until the case concluded before analyzing the appropriate quantum meruit recovery; "Under New York law, a lawyer's right to recover in quantum meruit occurs immediately upon discharge. . . . As a result, New York courts ordinarily calculate quantum meruit compensation at that time. . . . We do not think, however, that a court necessarily abuses its discretion by postponing the determination of the fair and reasonable value of an attorney's services either in order to avoid unnecessary delay in the underlying litigation, or if, under the particular circumstances of the case, a more accurate determination can be made later.").

## Lawyers Withdrawing from the Representation

If a client discharges a lawyer for cause, courts disagree about the fees to which the discharged lawyer is entitled. Depending on the severity of the misconduct that resulted in the discharge, such a lawyer might or might not be entitled to a quantum meruit recovery based on the lawyer's services before being discharged.

> Whether the discharge or withdrawal is attributable to the lawyer's misconduct is relevant to whether contractual compensation should be allowed . . . . The claim to contractual compensation of a lawyer discharged without reasonable grounds, or forced to withdraw by a client's misconduct . . . , is stronger than that of a lawyer whose acts have provided such grounds, even if not warranting forfeiture of the entire fee . . . , or civil liability . . . . In the context of Subsection (2), misconduct of the lawyer is not limited to conduct that would warrant professional discipline . . . , fee forfeiture . . . , or civil liability . . . . It also includes other conduct that would cause a reasonable client to discharge the lawyer, for example, a series of errors that reasonably leads the client to doubt the lawyer's competence although they cause no damage and do not constitute incompetence subjecting the lawyer to discipline.

Restatement (Third) of Law Governing Lawyers § 40 cmt. c (2000).

- See also Dudding v. Norton Frickey & Associates, 11 P.3d 441 (Colo. Oct. 10, 2000) (a discharged contingent-fee lawyer may not recover on a quantum meruit basis unless that possibility was disclosed in the retainer agreement).

If the client discharges the lawyer without cause, the client's action normally ends the contractual relationship and the lawyer's entitlement to a percentage of the recovery.

Under most states' approach, a lawyer in this circumstance must normally proceed under a quantum meruit theory to recover the value of the lawyer's work before the contract ended.

- Virginia LEO 1606 (11/22/94) (because the client "retains the absolute right to discharge the lawyer at any time for any reason or without reason," a discharged lawyer may only recover in quantum meruit for services

rendered -- valued by looking at the "reasonable value of the services rendered, not to the benefit received by the client").

- Illinois LEO 92-22 (5/93) ("A discharged attorney is entitled to be compensated on a quantum meruit basis for the services rendered prior to the termination of employment").

- Morris v. Detroit, 189 Mich. App. 271, 472 N.W.2d 43 (1991) (a lawyer discharged without cause from a contingent-fee contract is entitled to quantum meruit compensation).

- Clerk of Superior Court v. Guilford Builders Supply Co., 87 N.C. App. 386, 361 S.E.2d 115 (1987) (a lawyer discharged without cause from a contingent-fee contract is entitled to quantum meruit compensation).

- Heinzman v. Fine, Fine, Legum & Fine, 217 Va. 958, 234 S.E.2d 282 (1977) ("Having in mind the special nature of a contract for legal services, we hold that when, as here, an attorney employed under a contingent fee contract is discharged without just cause and the client employs another attorney who effects a recovery, the discharged attorney is entitled to a fee based upon quantum meruit for services rendered prior to discharge and, as security for such fee, to the lien granted by Code § 54-70." (emphasis in original; footnote omitted)).

One court has approved an odd arrangement under which a client and a lawyer entered into a fee agreement in which the lawyer was allowed a percentage-based quantum meruit fee if the lawyer was discharged without cause.

> While inclusion of a written clause in fee contracts which allows a percentage-based quantum meruit fee on the amount later recovered is not per se unethical, such clauses may be allowed if (1) after examination of the results obtained and whether two or more lawyers were required in order to obtain such results, the recovery is based on the work substantially performed by contracting counsel, (2) the fee is otherwise reasonable in light of MRPC 1.5's sight factors and the work actually performed by all counsel involved in the case, (3) counsel is not discharged for cause or due to a conflict of interest, and (4) the contract otherwise meets requirements of Kansas law.

Kansas LEO 93-03 (5/10/93).

Lawyers withdrawing for cause might be able to recover under a quantum meruit theory.

- See, e.g., **[E 1737]** Lofton v. Fairmont Specialist Ins. Managers, Inc., 2010 Ky. App. LEXIS 193 (Ky. Oct. 15, 2010) ("We think it beyond cavil that Lofton [lawyer] may not recover attorney's fees under the contingency fee agreement after voluntarily withdrawing from the case. In his brief, Lofton does not even argue that he is entitled to a contingency fee under the agreement but only argues entitlement to a fee under the doctrine of quantum meruit. Lofton effectively concedes that he has no claim for fees under the contract with Maxey [client]. Thus, the troublesome question presented with whether Lofton may recover attorney's fees per quantum meruit from Fairmont."; "The prevailing view is that an attorney who voluntarily withdraws from representing a client under a contingency fee agreement is entitled to remuneration for services rendered under the doctrine of quantum meruit if the withdrawal was with just cause. . . . Conversely, if the withdrawal was without just cause, the attorney is not entitled to fee compensation under quantum meruit or otherwise."; "While a client's failure to follow an attorney's advice concerning acceptance of a settlement offer may constitute just cause under some circumstances, it is our opinion that Lofton's voluntary withdrawal does not constitute just cause under the facts sub judice."; "The contract executed by Lofton and Maxey provides that 'no settlement will be made without the consent of the CLIENT.' In light thereof, Lofton was contractually bound to accept Maxey's decision as to any possible settlement offer. It is simply incongruous for Lofton to agree to such contractual provision and then to withdraw when Maxey exercised her right under the contract. Lofton could easily have included language reserving his right to withdraw if the client refused to accept a reasonable offer. Hence, considering the particular facts herein, we conclude that Lofton's withdrawal was without just cause that that he was not entitled to any fee compensation.").

## Best Answer

The best answer to **(a)** is **(insert narrative)**; the best answer to **(b)** is **PROBABLY YES**; the best answer to **(c)** is **YES**.

# Contingent-Fee Arrangements Based on Contingencies Other than Success

## Hypothetical 15

Having been "burned" in several earlier contingent-fee arrangements, you are considering whether to add certain provisions to your standard contingent-fee retainer letter.

**(a)** May a contingent-fee arrangement base the lawyer's fee on a percentage of the other side's offer (even if the client decides to turn down that offer)?

**MAYBE**

**(b)** May a contingent-fee arrangement include a provision under which the lawyer could recover under a quantum meruit approach if the client drops the claim because there is no chance for success?

**NO (PROBABLY)**

## Analysis

**(a)** Although not many authorities have dealt with a contingent-fee arrangement based on the other side's offer rather than the amount received by the client, one court implied that such an arrangement would be acceptable (although found it inapplicable in the situation addressed by the court).

- **[E 249]** Mardirossian & Assocs., Inc. v. Ersoff, 62 Cal. Rptr. 3d 665, 669 & 671 (Cal. Ct. App. 2007) (certified for partial publication pursuant to Cal. R. Ct. 8.100 and 8.1110) (allowing a lawyer retained under a contingent-fee agreement to seek quantum meruit damages; noting that the retainer agreement included a lawyer's lien, which was based on a specified hourly rate, which the client agreed to pay if the client discharged the lawyer or terminated the claim; explaining that the client settled the case on the same day that the client terminated the lawyer; also acknowledging that the retainer agreement allowed the lawyer to "elect compensation based upon the agreed contingency for any offer to Client to settle the matter prior to the Attorney's discharge," but noting that "there had been no settlement offer prior to its discharge"; not dealing with the enforceability of such a clause; upholding the jury's damage award in the lawyer's favor of approximately $650,000; noting

> that the jury could rely on the lawyers' own testimony about the time they spend and expert testimony, even though the lawyer had not maintained careful time records), review denied, No. S155663, 2007 Cal. LEXIS 11053 (Cal. Oct. 10, 2007). **Tom -- How do you want to show this ?** **NOTICE:** CERTIFIED FOR PARTIAL PUBLICATION** Pursuant to California Rules of Court, rules 8.1100 and 8.1110, this opinion is certified for publication with the exception of parts 4 and 6 of the Discussion.

**(b)** One court has found that a lawyer could not recover under a quantum meruit theory "when the client chooses to discontinue a case because of his reasonable assessment that there is 'no chance of recovery.'" As the court explained it,

> **[E 1402]** Otherwise, a contingent-fee client, convinced he had no chance of success, would have to continue his case just to avoid quantum meruit liability. Such a policy would encourage litigants to take unwarranted risks and prolong litigation simply to avoid paying attorneys fees -- a predicament that mocks the ideal of client control.

King & King, Chartered v. Harbert Int'l, Inc., 503 F.3d 153, 2007 U.S. App. LEXIS 23934 (D.C. 2007).[1]

[1] **[E 1402]** King & King, Chartered v. Harbert Int'l, Inc., 503 F.3d 153, 2007 U.S. App. LEXIS 23934 (D.C. 2007) (refusing to award a quantum meruit recovery to a lawyer under circumstances in which the clients abandoned the claim; noting that the clients' dispute with the government had extended for eleven years, and that the clients were eventually indicted and therefore involved in a criminal litigation; "A client has the ultimate authority to control his affairs; thus, he may settle a claim, regardless of his attorney's efforts to prosecute it. . . . A client may also, in good faith, choose to withdraw a claim despite having expressly promised his attorney otherwise. . . . In addition, a client may discharge his attorney, with or without cause, and such a discharge will not constitute a breach of any agreement between them."; "[A] contingent-fee attorney may seek reasonable compensation when his client terminates the representation without cause. . . . If the attorney substantially performed his tasks before being terminated, he may receive the agreed proportion of the client's eventual recovery. . . . Even if he performed negligible services, of little actual benefit to the client, he is entitled to quantum meruit compensation."; "Conversely, an attorney terminated for good cause cannot recover a contingent fee. . . . A similar rule should preclude quantum meruit compensation when the client chooses to discontinue a case because of his reasonable assessment that there is 'no chance of recovery.'. . . Otherwise, a contingent-fee client, convinced he had no chance of success, would have to continue his case just to avoid quantum meruit liability. Such a policy would encourage litigants to take unwarranted risks and prolong litigation simply to avoid paying attorneys fees -- a predicament that mocks the ideal of client control."; "Given their situation, it would be eminently reasonable for the appellees to believe they had no chance to prevail at the ASBCA; to concentrate their efforts on defending the more dangerous fraud cases; and even to abandon the ASBCA case as part of a compromise with the Government. These are the kinds of difficult decisions a client must have the autonomy to make. The appellees tried to free their hands by putting the ASBCA case on a contingent-free basis; in such extremely adverse circumstances, the law will not handcuff them by requiring quantum meruit compensation.").

## Best Answer

The best answer to **(a)** is **MAYBE**; the best answer to **(b)** is **PROBABLY NO**.

# Clients' Possible Liability to a Terminated/Withdrawn Lawyer and the Lawyer's Replacement

## Hypothetical 16

Your neighbor just came to you with a tricky issue he would like to discuss. He had signed up with a personal injury plaintiff's lawyer he found on the Internet, but was very dissatisfied with that lawyer's services. Your neighbor fired that lawyer, and now wants to hire a lawyer who has a great track record on similar cases and comes highly recommended. However, the would-be replacement lawyer has warned your neighbor that she might have to pay both the terminated lawyer and the replacement lawyer. Your neighbor can't believe that this is true, and wants your opinion.

Can a client owe both a terminated contingent-fee lawyer and the replacement lawyer in the same case?

## YES

## Analysis

Depending on the grounds of the termination (or withdrawal) and other factors, clients might well owe compensation both to a former contingent-fee lawyer and replacement counsel. A 2009 New York decision dealt with this issue in depth.

> **[E 1204 B 10/11]** [W]here the dispute is between successive lawyers, rather than between the client and the attorney, a different set of rules applies . . . . In that situation, the outgoing attorney may elect, even over the objections of the incoming attorney, either quantum meruit compensation in a fixed dollar amount at the time of discharge, or a contingent percentage fee, determined either at the time of substitution or the conclusion of the case . . . . Even then, however, in the absence of an agreement between the outgoing and incoming attorneys, the contingent percentage fee is measured by quantum meruit, based on the discharged attorney's proportionate share of the work performed on the whole case, in addition to the amount of recovery . . . . Indeed, the additional option of contingent percentage compensation that a discharged attorney has against incoming attorneys, not available as against the former client, sounds in quantum meruit: the incoming attorneys

> should not unjustly enriched at the expense of the outgoing attorney.

Nabi v. Sells, 892 N.Y.S.2d 41, 43-44, 44 (N.Y. App. Div. 2009).[1]

In fact, replacement lawyers who do not explain this possibility might face discipline.

- See, e.g., **[E 69 N 12/06]** In re Van Sickle, No. 99-O-12923, 2006 WL 2465633 (Cal. State Bar Ct. Review Dep't Aug. 24, 2006) (suspending for one year a lawyer who arranged for a 35% contingent fee without accounting for fees that the client owed his previous lawyer; noting that the lawyer claimed he had advised the client that the client would have to pay the former lawyer out of the recovery; finding that the lawyer charged an inappropriately high fee).

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[1] **[E 1204]** Nabi v. Sells, 892 N.Y.S.2d 41, 43-44, 44 (N.Y. App. Div. 2009) (allowing a lawyer to obtain quantum meruit recovery of fees although the contingency fee retainer agreement did not comply with New York ethics rules; "We need not decide whether any of the alleged defects in the retainer agreement, alone or in combination, bar recovery in contract. Provided that defendant attorneys were not discharged for cause, in which case they would not be entitled to any fee. . . , their recovery would be limited to the fair and reasonable value of their services, computed on the basis of quantum meruit . . . . The rationale for the rule is that, due to the special relationship of the utmost trust and confidence between a client and an attorney, the client has the right to discharge the attorney at any time, for any reason, or for no reason, regardless of any particularized retainer agreement, and the client should not be compelled to pay damages for exercising the absolute right to cancel the contract . . . . Against the client's unqualified right to terminate the attorney-client relationship is balanced the notion that a client should not be unjustly enriched at the attorney's expense to take undue advantage of the attorney, and therefore the attorney is entitled to recover the reasonable value of services rendered . . . . After the termination of the relationship, the client and attorney of course remain free to reach a new agreement that, in lieu of a fixed dollar amount for the quantum meruit value of services rendered, the discharged attorney shall receive as compensation a contingent percentage of the recovery, determined either at the time of substitution or the conclusion of the case . . . . However, such an arrangement of payment cannot be compelled by the attorney; it can only be reached with the consent of the client."; explaining that different rules applied when lawyers were fighting over fees; "By contrast, where the dispute is between successive lawyers, rather than between the client and the attorney, a different set of rules applies . . . . In that situation, the outgoing attorney may elect, even over the objections of the incoming attorney, either quantum meruit compensation in a fixed dollar amount at the time of discharge, or a contingent percentage fee, determined either at the time of substitution or the conclusion of the case . . . . Even then, however, in the absence of an agreement between the outgoing and incoming attorneys, the contingent percentage fee is measured by quantum meruit, based on the discharged attorney's proportionate share of the work performed on the whole case, in addition to the amount of recovery . . . . Indeed, the additional option of contingent percentage compensation that a discharged attorney has against incoming attorneys, not available as against the former client, sounds in quantum meruit: the incoming attorneys should not unjustly enriched at the expense of the outgoing attorney."; ultimately concluding that the dispute before the court was "between only the client and the discharged attorney," so that the "if it is established that defendants were discharged without cause, their recovery is limited to quantum meruit in a fixed dollar amount, which may be more or less than that provided in the rescinded contract that had existed between them and plaintiff, and which may be presently payable or secured by lien.").

This issue sometimes arises when a lawyer leaves a firm originally retained to him on a contingent-fee matter, and takes the matter with him or her.

- See, e.g., **[E 1218 B 10/11]** Delapaz v. Selectbuild Constr., Inc., 917 N.E.2d 93, 94-95, 95, 96, 96-97, 97, 98 (Ill. App. Ct. 2009) (analyzing a situation in which a personal injury plaintiff hired a lawyer to handle a contingent-fee case; explaining that the lawyer worked on the case while at the law firm, and then left the law firm to start his own firm; ultimately concluding that the original law firm was entitled to the benefit of the original contingent-fee arrangement, while the individual lawyer could recover only under quantum meruit; explaining the factual background; "Zouras was the only attorney at Touhy & Touhy who communicated with DeLapaz. Touhy & Touhy did not maintain time records for personal injury cases, which would recover attorney fees on a contingency basis."; "During the time Zouras worked at Touhy & Touhy and on DeLapaz's case, he met with the client, prepared the complaint, appeared at status hearing, modified discovery answers and exchanged correspondence with defense counsel and plaintiffs."; noting that "Stephan Zouras maintains that the proper standard that should have been used to compute the attorney fees was to award Stephan Zouras the contract contingent fee and require Touhy & Touhy as discharged attorneys to prove its sees on a quantum meruit basis instead of applying the comparison/apportionment approach."; analyzing the law on this issue; "A client may discharge his attorney with or without cause at any time, even in a contingency fee based agreement. . . . When the attorney is discharged, the contingent fee contract no longer exists and the contingency term is no longer operative. . . . A discharged attorney, however, is entitled to payment for the services rendered prior to discharge on a quantum meruit basis. . . . The term 'quantum meruit' literally means 'as much as he deserves.'. . . Several factors are considered in determining the quantum meruit amount for services rendered, which include 'the time and labor required, the attorney's skill and standing, the nature of the cause, the novelty and difficulty of the subject matter, the attorney's degree of responsibility in managing the case, the usual and customary charge for that type of work in the community, and the benefits resulting to the client.'" (citation omitted); noting that "[t]he trial court ruled that 'because most of the work performed in this case prior to settlement was done by Touhy employees while Touhy was the attorney of record, Touhy is entitled to the contract fee of one third of the settlement amount less the amount of attorney fees Stephan Zouras is entitled to on a quantum meruit basis.'"; ultimately affirming the lower court's analysis; "The trial court also considered the services provided by attorneys employed by Touhy & Touhy before the firm was discharged and concluded that the professionals employed by the firm performed most of the work prior to settlement of the case. . . . Having decided that Touhy & Touhy performed the bulk of the work prior to discharge based on the amount and nature of the work performed, the trial court ruled that Touhy & Touhy should receive the contingent fee less the

fees allocable to Stephen Zouras based upon a quantum meruit computation.").

## Best Answer

The best answer to this hypothetical is **YES**.

# Terminated/Withdrawn Contingent-Fee Lawyer's Entitlement to Quantum Meruit if the Client Loses

## Hypothetical 17

Your neighbor just sheepishly asked you a question about a matter he had raised with you several months earlier. She had terminated a personal injury contingent-fee lawyer with whom she had grown dissatisfied, and retained a new lawyer who had come highly recommended. However, yesterday she lost her case, despite the replacement lawyer's best efforts. She now wonders whether she will owe the terminated lawyer any amount of money even though she ultimately lost her case.

**(a)** May a terminated/withdrawn contingent-fee lawyer recover under a quantum meruit theory even if the client ultimately loses the case.

**MAYBE**

**(b)** If the terminated lawyer can seek a quantum meruit fee award, must he wait until the end of the case rather than seek an immediate payment of such fees?

**MAYBE**

## Analysis

**(a)** A Restatement illustration indicates that a terminated lawyer cannot recover any quantum meruit amount if the client does not ultimately recover anything in the case.

> **[E 1380]** Client retained Lawyer to bring a tort suit for a contingent fee of one-third of any recovery. Client discharged Lawyer after Lawyer had worked 100 hours, because Client found Lawyer's manner overbearing. The fair value of Lawyer's time is $100 per hour. Until Client prevails in the suit, Lawyer has no right to a fee, because under the contract no fee was due unless and until Client recovered. . . . If Client recovers $60,000, Lawyer is entitled to $10,000, which is the lesser of the contractual fee ($20,000) and the fair value of Lawyer's services (100 hours at $100 per hour, or $10,000).

Restatement (Third) of Law Governing Lawyers § 40 cmt. b, illus. 4 (2000).

Some authorities and courts take this approach.

- **[E 1330]** Ohio LEO 2010-2 (4/9/10) ("In Ohio, the law is settled that upon discharging a lawyer in a contingent fee case, a client is entitled to the file and that the lawyer is entitled to quantum meruit compensation but not until the successful occurrence of the contingency.").

- **[E 333 B 1/09]** Liss v. Studeny, 879 N.E.2d 676 (Mass. 2008) (holding that a lawyer was not entitled to either a contingent fee or a quantum meruit recovery after withdrawing from representing a client, because the client ultimately lost the case -- meaning that the contingency had not occurred).

In contrast, several cases have indicated that a contingent-fee lawyer terminated without cause can recover under a quantum meruit theory even if the client ultimately loses.

- **[E 225 B 10/08]** Levy v. Laing, 843 N.Y.S.2d 542 (N.Y. App. Div. 2007) (allowing a discharged lawyer to obtain quantum meruit recovery from the former client; rejecting the client's argument that the lawyer was limited to a fee-sharing agreement with the lawyer's replacement; noting that the replacement lawyer had botched the case, so there was no recovery).

- **[E 511 B 2/09, N]** Universal Acupuncture Pain Servs., P.C. v. Quadrino & Schwartz, P.C., 370 F.3d 259 (2d Cir. 2004) (holding that a lawyer who was terminated by the client from a contingent-fee arrangement may be paid on a quantum meruit basis even if the plaintiff loses the case and there is no recovery; explaining that the outcome would be different if the client had fired the lawyer for cause).

Other courts take what could be seen as a middle ground -- considering the client's ultimate success as one of the factors in determining the availability or amount of a contingent-fee award in such a setting.

- **[E 1401]** Liss v. Studeny, 450 Mass. 473, 2008 Mass. LEXIS 17 (Mass. 2008) (holding that a lawyer who withdrew from a contingent-fee arrangement when the client refused to provide additional funds for expenses could not recover under a quantum meruit theory, because the client lost the case while proceeding pro se after the lawyer's withdraw; explaining that the fee arrangement "provided that Studeny [client] 'shall not be liable to pay compensation otherwise than from amounts collected for him by [Liss], except as follows: Payment of [Liss's reasonable] [lawyer] expenses and disbursements . . . ; otherwise None except from amounts collected.'";

concluding that the lawyer had provided some benefit to the client, although the lawyer eventually withdrew before the trial; "Studeny argues that Liss is not entitled to recover in quantum meruit because Liss conferred to 'measurable benefit' on Studeny, that is, because he recovered nothing in his lawsuit against his former employer. Assuming that one must confer a 'measurable benefit' to be entitled to quantum meruit recovery, we conclude that Liss provided such a benefit. Even if ultimately unsuccessful, an attorney's competent efforts to advance his client's cause are a measurable benefit to the client. They are a benefit in that the attorney performs a service on behalf of the client, and they are measurable in that the court may determine the fair and reasonable charge for an attorney's services by considering, among other things, the time spent on the matter and the prices usually charged by other attorneys for similar services . . . (setting forth factors to determine fair and reasonable charge for attorney's services). Here, Liss's efforts were a benefit to Studeny because they provided a basis on which he was able to take his claim to trial."; ultimately concluding that the lawyer was not entitled to a quantum meruit recovery; "While a party does not recover on the contract itself under quantum meruit, a court may look to the terms of the underlying contract to help determine appropriate recovery under quantum meruit."; "In the present case, the terms of the contract would not have led a reasonable person to believe that Studeny would be liable under quantum meruit where the contingency did not occur in the underlying case. The contract explicitly stated that Studeny would not be liable to pay compensation 'except from amounts collected.' Furthermore, the contract nowhere stated that Studeny may be liable to Liss even where no amounts are collected. It would, therefore, run counter to the reasonable expectations of the parties to require compensation where no amounts are collected."; "A contingent fee contract, by contrast, does not require any certain amount of labor or hours worked to reach its desired goal. It only requires the occurrence of the contingency. If the client discharges the attorney after the attorney has worked for eighty hours and the case is ultimately unsuccessful, the fact finder will not have a practicable method to determine the attorney's recovery under quantum meruit because it cannot fairly be determined how close to the desire goal (i.e., a successful outcome in the case) the attorney brought the matter."; "As a general rule, the court will not grant quantum meruit recovery arising from a contingent fee contract where the contingency has not occurred. We do not, however, foreclose the possibility that an attorney may recover in quantum meruit in certain particularly compelling situations where the contingency does not occur."; "In the present case, there is no evidence that Studeny used Liss's services without intending that the contingency occur. This is, Studeny did not defeat Liss's reasonable expectation that he was using Liss's services to bring about the contingency on which Liss might be compensated. . . . His attorney may have wished to Studeny to invest more money and effort in the litigation of the case, but the fact that Studeny expected to pursue his claim at the least possible cost does not establish that he intended the contingency not to occur. Given these

facts, Liss's right to recover in quantum meruit would not have accrued until the occurrence of the contingency. Because the contingency did not occur, his right to recover never accrued. Liss may not recover in quantum meruit.").

- **[E 1393]** Universal Acupuncture Pain Servs., P.C. v. Quadrino & Schwartz, P.C., 370 F.3d 259, 2004 U.S. App. LEXIS 10721 (2nd Cir. 2004) (holding that a lawyer working under a contingent fee who is fired by the client can recover under a quantum meruit theory even if the client ultimately did not recover on the case -- although the failure to recover is a factor in determining the proper quantum meruit amount; finding that District Judge Shira Scheindlin had abused her discretion in concluding that the lack of recovery in a case precluded a quantum meruit award; "We conclude, however, that the district court did abuse its discretion by deciding that the clients' lack of a monetary recovery in the underlying litigation precluded Q&S from being awarded compensation for its services in quantum meruit. A fee based on quantum meruit is for the reasonable value of the services rendered before discharge, which, as noted, is typically determined immediately after discharge. . . . It follows that a discharged attorney's recovery in quantum meruit for a fee is not limited by the former client's ultimate recovery, which might be determined after -- sometimes long after -- the time of discharge. . . . [I]t follows that a court ought not to consider the former client's actual recovery in determining quantum meruit fees."; "Nevertheless, under New York law, in determining such amount, a court may consider, inter alia, (1) the contingent nature of the representation . . . (2) the results achieved by the attorney before discharge . . . (3) the client's actual chance of success at the time the attorney was discharged. . . . The client's chance of success at the time of discharge is thus not irrelevant to the amount of a quantum meruit award.").

**(b)** The Restatement indicates that

> Unless the contract construed in the circumstances indicates otherwise, when a lawyer has contracted for a contingent fee, the lawyer is entitled to receive the specified fee only when and to the extent the client receives payment.

Restatement (Third) of Law Governing Lawyers § 35(2) (2000).

Of course, in a normal contingent-fee setting the lawyer would expect to (and will have agreed to) wait until the client recovers something before taking his or her fee out of the recovery. However, a different situation presents itself if a terminated lawyer seeks a quantum meruit recovery before the client has received any money in the case.

After all, the lawyer has already provided the services, and might demand immediate payment for reason, and in a "sour grapes" mood.

**[MAYBE COMBINE THIS HYPO WITH LAST HYPO]**

The few cases which have dealt with this issue have indicated that a terminated lawyer seeking recovery under quantum meruit must wait until the end of the case before making a claim for fees.

- **[E 1397]** Herr v. Carter Lumber, Inc., 888 N.E. 2d 853, 2008 Ind. App. LEXIS 1330 (Ind. Ct. App. 2008) (holding that a lawyer working on their contingent fee that is fired by the client can recover the fee only at the conclusion of the case; "Herr should receive his attorney fees pursuant to the contingency fee agreement only when Carter Lumber receives payment. . . . [A]lthough Herr seeks to receive compensation based upon his hourly fee and the number of hours that he worked on each case, that result would be inconsistent with Galanis [Galanis v. Lyons & Truitt, 715 N.E. 2d 858 (Ind. 1999)]. Under Galanis, the terminated attorney receives compensation based upon the 'contribution of the discharged lawyer's efforts to the ultimate result' under quantum meruit. . . . This compensation is not necessarily 'equal to a standard rate multiplied by the number of hours of work on the case.'. . . Without a final result in the cases, a court is unable to determine an appropriate compensation for Herr. We conclude that, under Galanis [Galanis v. Lyons & Truitt, 715 N.E. 2d 858 (Ind. 1999)] and Four Winds [Four Winds, LLC v. DeBonis, LLC, 854 N.E. 2d 70 (Ind. Ct. App. 2006)], Herr may not receive compensation for his attorney fees until Carter Lumber receives payment. The trial court's order denying Herr's request for immediate payment of his attorney fees was not clearly erroneous.").

- **[E 1395]** Universal Acupuncture Pain Servs., P.C. v. Quadrino & Schwartz, P.C., 370 F.3d 259, 2004 U.S. App. LEXIS 10721 (2nd Cir. App. 2004) (holding that a lawyer working under a contingent fee who is fired by the client can recover under a quantum meruit theory even if the client ultimately did not recover on the case -- although the failure to recover is a factor in determining the proper quantum meruit amount; "Under New York law, a client may

discharge his or her lawyer at any time, with or without cause. . . . If a lawyer is discharged for cause, he or she is not entitled to legal fees. . . . If the lawyer is discharged without cause and prior to the conclusion of the case, however, he or she may recover either (1) in quantum meruit, the fair and reasonable value of the services rendered, or (2) a contingent portion of the former client's ultimate recover, but only if both of the parties have so agreed. . . . In this case, immediately after the clients discharged Q&S and before the litigation was resolved, Q&S requested compensation in quantum meruit. Therefore, unless the clients discharged Q&S for cause, it was entitled to receive such compensation."; holding that the court did not abuse its discretion in waiting until the case concluded before analyzing the appropriate quantum meruit recovery; "Under New York law, a lawyer's right to recover in quantum meruit occurs immediately upon discharge. . . . As a result, New York courts ordinarily calculate quantum meruit compensation at that time. . . . We do not think, however, that a court necessarily abuses its discretion by postponing the determination of the fair and reasonable value of an attorney's services either in order to avoid unnecessary delay in the underlying litigation, or if, under the particular circumstances of the case, a more accurate determination can be made later.").

## Best Answer

The best answer to **(a)** is **MAYBE**; the best answer to **(b)** is **MAYBE**.

# Malpractice Damage Calculation

## Hypothetical 18

A frustrated former client recently sued your law firm for malpractice. You had represented the client under a contingent-fee arrangement, so you have a number of questions about your firm's damage exposure.

**(a)** Can the plaintiff suing your firm for malpractice recover the fee he paid to another law firm who allegedly "cleaned up the mess" your firm left?

**YES**

**(b)** If the plaintiff wins his malpractice case against your firm, can you deduct from the award the contingent fee you would have earned had you successfully handled the underlying case?

**NO (PROBABLY)**

## Analysis

Although malpractice damages generally involve law other than ethics rules, states' approach to the damage calculation reflect the heightened duties that lawyers owe their clients under both the ethics rules and fiduciary principles.

**(a)** Several courts have indicated that clients may seek recovery of fees that they have paid replacement counsel.

- **[E-554 B 3/09]** Nettleton v. Stogsdill, 899 N.E.2d 1252, 1261 (Ill. App. Ct. 2008) ("[W]e hold that a legal malpractice plaintiff may recover as actual damages the attorney fees incurred as a result of the defendant's malpractice, so long as the plaintiff can demonstrate she would not have incurred the fees in the absence of the defendant's negligence. Thus, the trial court's decision that the attorney fees plaintiff alleged could not constitute actual damages in a legal malpractice case was erroneous, as was its decision that plaintiff was required to present evidence that but for defendants' alleged malpractice, she would have received a larger share of the marital estate.").

- **[E-555 B 3/09]** Leach v. Bailly, 870 N.Y.S.2d 138, 140 (N.Y. App. Div. 2008) ("Unearned fees may be recovered in a malpractice action, and 'plaintiff damages may include "litigation expenses incurred in an attempt to avoid,

minimize, or reduce the damage caused by the attorney's wrongful conduct.'"" (citation omitted)).

This seems to be a minor exception to the so-called "American Rule" -- in which both parties nearly always pay their own fees.

**(b)** Although states disagree about the crediting of the fees that a defendant lawyer would have earned in the underlying case, one decision forcefully prohibited lawyers from offsetting malpractice damages in that way.

- See, e.g., **[E-352** B 1/09**]** Shoemake v. Ferrer, 182 P.3d 992, 997 (Wash. Ct. App. 2008) (holding that a lawyer found liable for malpractice may not reduce the damages by the amount that the lawyer would have earned as a contingent fee had the lawyer been successful; "Because Washington cases are unambiguous that legal malpractice damages should fully compensate plaintiffs injured by attorney malpractice, we hold that the modern majority rule adopted by the Restatement is the best rule for Washington. Reducing a successful malpractice plaintiff's damages by the amount that the attorney would have earned had the attorney not been negligent necessarily fails to put the injured plaintiff in the position he or she would have occupied in the absence of negligence. In virtually every case, the injured plaintiff will be required to hire a second attorney to prosecute the malpractice action against the negligent attorney and will be required to pay that second attorney. Crediting the negligent attorney with fees through a mechanistic application of the 'American rule' fails to account for the fact that both the negligent attorney's fees and the fees of replacement counsel are being incurred for the same service. The replacement attorney is required to prove precisely what the negligent lawyer failed to prove -- that the plaintiff is entitled to recover on the underlying claim. That this must be done through the vehicle of a malpractice action does not change the fact that the plaintiff's damages are limited to a single recovery on that underlying claim. By definition, reducing that recovery by two sets of attorney's fees leaves the plaintiff in a worse position than the client would have been in absent the malpractice.").

## Best Answer

The best answer to **(a)** is **YES**; the best answer to **(b)** is **PROBABLY NO**.

# Requirement of a Writing

## Hypothetical 19

You just moved from another state, and you are trying to familiarize yourself with your new state's ethics rules.

**(a)** Must all fee agreements be in writing?

**MAYBE**

**(b)** Must all contingent-fee agreements be in writing?

**YES**

## Analysis

In addition to requiring that all fees be reasonable, the ethics rules also contain several essentially logistical requires.

First, lawyers must explain to their clients how the lawyer's fees will be calculated.

The ABA Model Rules contain this common-sense requirement.

> **[E 1304]** The scope of the representation and the basis or rate of the fee and expenses for which the client will be responsible shall be communicated to the client, preferably in writing, before or within a reasonable time after commencing the representation, except when the lawyer will charge a regularly represented client on the same basis or rate. Any changes in the basis or rate of the fee or expenses shall also be communicated to the client.

ABA Model Rules 1.5(b). A comment provides a further explanation.

> **[E 1309]** When the lawyer has regularly represented a client, they ordinarily will have evolved an understanding concerning the basis or rate of the fee and the expenses for which the client will be responsible. In a new client-lawyer relationship, however, an understanding as to fees and expenses must be promptly established. Generally, it is

> desirable to furnish the client with at least a simple memorandum or copy of the lawyer's customary fee arrangements that states the general nature of the legal services to be provided, the basis, rate or total amount of the fee and whether and to what extent the client will be responsible for any costs, expenses or disbursements in the course of the representation. A written statement concerning the terms of the engagement reduces the possibility of misunderstanding.

ABA Model Rules 1.5 cmt. [2].

The Restatement takes the same basic approach.

> **[E 1375]** Before or within a reasonable time after beginning to represent a client in a matter, a lawyer must communicate to the client, in writing when applicable rules so provide, the basis or rate of the fee, unless the communication is unnecessary for the client because the lawyer has previously represented that client on the same basis or at the same rate.")

Restatement (Third) of Law Governing Lawyers § 38 (2000). A comment provides an additional explanation.

> Subsection (1) sets forth the lawyer's duty to inform a client of the basis or rate of the fee. Noncompliance with that duty is enforceable through professional discipline and by limiting the lawyer's remuneration to the fair-value standard described in § 39. When the client is already aware of the basis or rate of the fee, for example because the client's letter states that the client will pay a specified hourly fee for specific services, the lawyer need not further inform the client. The client should also be informed if the lawyer proposes to use a different basis or rate in the event of settlement, trial, or appeal.
>
> The lawyer should inform the client early enough so that the client will not be inconvenienced unnecessarily if, upon considering the information, the client decides to seek another lawyer. The basis or rate might be a specified hourly charge, a percentage, or a set of factors on which the fee will be based. If the fee is based on a percentage of recovery (or other base), the client should also be informed if a different percentage applies in the event of settlement,

> trial, or appeal. For a client sophisticated in retaining lawyers, a statement that "we will charge our usual hourly rates" ordinarily will suffice. The less specific the notice, the less it should control a tribunal passing on the propriety of the fee. Thus, a lawyer's statement "I will charge what I think fair, in light of the hours expended and the results obtained," even if deemed part of a valid contract, does not bind the client or tribunal to accept whatever fee the lawyer thinks fair. The level of information imparted to the client might comply with disciplinary rules but not give rise to an enforceable contract.
>
> The information should indicate the matter for which the fee will be due, for example, "preparing and trying (but not appealing) your auto injury suit." If the services are not specifically described, the lawyer will be held under § 18 to provide the services that a reasonable client would have expected.

Restatement (Third) of Law Governing Lawyers § 38 cmt. b (2000).

The same basic rules apply to an amended fee arrangement. As the ABA Model Rules explain, "[a]ny changes in the basis or rate of fee or expenses shall also be communicated to the client." ABA Model Rule 1.5(b).

Thus, lawyers can raise their rates during a fee arrangement, as long as the increase complies with the contractual arrangement.

- See, e.g., **[E 469 B 2/09; N]** McGuire, Craddock, Strother & Hale, P.C. v. Transcon. Realty Investors, Inc., 251 S.W.3d 890, 896 (Tex. App. 2008) (holding that a law firm did not violate its fiduciary duties to client by raising its rates; "[T]he evidence at trial shows that Craddock informed Alan Goodrich, associate general counsel for Basic Capital, that the firm periodically raised its rates. Goodrich indicated to Craddock that he understood that firms periodically raise their rates. Flegle [expert witness] testified that an attorney complies with its duty of full disclosure when he raises his rates after notifying the client verbally. In light of the conflicting evidence with regard to the parties' fee agreement and McGuire, Craddock's billing methods, we conclude the trial court erred in concluding that such practices amounted to a

> breach of fiduciary duty as a matter of law. Accordingly, the trial court erred in granting JNOV on this ground.").

Courts do not hesitate to invalidate fee agreements for which the lawyer has not provided a reasonable explanation to the client.

- See. e.g., **[E 439 B 2/09]** Sheresky Aronson & Mayefsky, LLP v. Whitmore, 861 N.Y.S.2d 44, 45 (N.Y. App. Div. 2008) (invalidating a retainer agreement provision in a divorce case that included an unspecified "premium fee").

If the fee agreement becomes extremely complicated, some courts apply the stringent rules governing a lawyer's business arrangements with a client.

- See, e.g., **[E 732]** In Re: Robert Lee Curry, III, No. 08-B-2557, 2009 La. LEXIS 2183 (La. July 1, 2009) (disciplining a lawyer for entering into a complicated contingent-fee arrangement; "Much discussion in the parties' briefs and the brief of the amici centers on whether Louisiana law recognizes a so-called 'hybrid' or 'mixed' fee arrangement which allows a lawyer to seek recovery from sources other than a traditional contingency fee. However, we need not resolve that question in order to decide the case at bar. Rather, we find that to the extent respondents attempted to enter into a business arrangement with their client, they did not follow the appropriate ethical strictures."; the "1996 fee arrangement had the effect of placing respondents in a better position than they had been in under the 1992 fee agreement. Additionally, the firm's decision to guarantee the $950,000 loan made to Gulf States impacted the representation by causing the firm to consider its own interests as well as those of the client. Under these circumstances, we conclude respondents' representation of their client was materially limited by their own interests, thereby violating Rule 1.7(b).").

The ABA Model Rules do not explicitly require written fee agreements, although ABA Model Rule 1.5(b) indicates that it would be "preferable" for fee agreements to be in writing. **[CHECK THIS]**

The Restatement acknowledges that most states require written fee agreements.

> Most states require that contingent-fee contracts be in writing. Even when there is no such requirement, tribunals

> are reluctant to uphold oral contingent-fee contracts. Tribunals adjudicating fee disputes are free to reject a lawyer's testimony concerning the fee when the client testifies more credibly to the contrary. The statute of frauds might render unenforceable some unwritten client-lawyer contracts . . . .

Restatement (Third) of Law Governing Lawyers § 38 cmt. b (2000).

Putting fee agreements in writing has several advantages. First, it forces the lawyer to check the agreement's compliance with various ethics rules -- which can be quite specific in the case of some types of fee agreements. Second, it assures that the lawyer will comply with the pre-existing duty to explain the fee agreement to the client. Third, it can provide valuable (and perhaps even dispositive) evidence supporting the lawyer if the client later claims not to have understood the fee agreement.

Although most lawyers seem to oppose the requirement that all fee agreements be in writing, one could view such a requirement as essentially forcing lawyers to help themselves.

**Best Answer**

The best answer to **(a)** is **MAYBE**; the best answer to **(b)** is **YES**.

# Charging Interest on Unpaid Bills

## Hypothetical 20

You have represented a local developer through good times and bad. Lately times have been bad, and the developer has been unable to easily pay all of your bills on a timely basis. Your client realizes that this creates a financial hardship for you, and is willing to pay interest on any unpaid balances.

May you charge interest on the unpaid balances owed by your real estate developer client?

## YES (UNDER CERTAIN CIRCUMSTANCES)

## Analysis

The ABA Model Rules do not address the possibility of lawyers charging clients interest on unpaid bills.

The Restatement would permit such an arrangement.

> A client and lawyer may agree for the payment of a reasonable amount in interest on past-due and unpaid charges of the lawyer . . . . In the absence of contract, the lawyer's entitlement to interest is determined by other law. Similarly, a lawyer's right to receive interest on cost and similar advances . . . is determined either by contract or other law.

Restatement (Third) of Law Governing Lawyers § 38 cmt. h (2000).

Most states allow lawyers to charge interest on unpaid bills, as long as they adequately explain in advance that the client will owe that amount.

- Virginia LEO 1595 (6/14/94) (a lawyer may charge interest on unpaid cost and expense balances as long as: the costs and expenses are reasonable and adequately explained to the client; the lawyer and the client agreed to the interest arrangement before the interest is imposed; any deferment of payment is for the client's convenience; the interest rate complies with state law; and the client may prepay the balance without penalty.).

- Georgia LEO 45 (11/15/85) ("The Board is of the opinion that an attorney can comply with EC 2-19 and unilaterally charge interest without a prior specific agreement with a client if notice is given to the client in advance that interest will be charged on fee bills which become delinquent after a stated period of time, but not less than 30 days. The Board recommends that notice be provided on the bill at the time it is sent and that the notice be conspicuous and printed in type size no smaller than the largest type size used in the body of the bill. The notice must specify the amount of interest to be charged and the period of time after which it will be imposed").

## Best Answer

The best answer to this hypothetical is **YES (UNDER CERTAIN CIRCUMSTANCES)**.

# Contract Lawyers

## Hypothetical 21

You have recently expanded your work in assisting clients in large privilege reviews and document productions -- using contract or temporary lawyers working off site. Not surprisingly, several fee-related issued have arisen.

May you charge the client an hourly rate for such lawyers that exceeds what you pay them per hour (without advising the client of the difference)?

**YES**

## Analysis

The ABA has repeatedly analyzed a lawyer's ability to charge fees for a contract lawyer's services. In essence, the lawyer may choose to: (1) bill for contract lawyers as a disbursement (based on what the lawyer directly pays the contract lawyer or the lawyer pays some service who arranges for contract lawyers' participation), in which case the lawyer may not charge the client more than the lawyer pays as a disbursement unless the client consents to the extra amount; or (2) charge the client an hourly rate for the contract lawyer's time without advising the client of the profit the lawyer earns on the contract lawyer's time -- as long as the contract lawyer works under the direct supervision of the lawyer.

**[copy from memo to Virginia bar]**

Other state bars take the same approach.

- **[E 1661 B 4/11]** Philadelphia LEO 2010-4 (5/2010) (explaining that a law firm's "contract attorney" may have to make disclosures to the client about his or her role, if the lawyer is not supervised by law firm lawyers as the client would expect; "Under the circumstances where a contract lawyer is working under the direct supervision of an attorney associated with the retaining firm, therefore, the responsibility to disclose and obtain informed consent for the contract lawyer's participation generally lies with the firm utilizing the services

of the contract lawyer ('the retaining firm'.)"; "The Committee is aware that retaining firms can and do engage other lawyers from time to time on an ad hoc basis for certain specific tasks: oral argument, a discrete deposition, expert witness discovery, brief-writing, etc. Such engagements, by their very nature, often contemplate that the contract lawyer will not be under the direct supervision of a lawyer associated with the retaining firm. If tasks of this stand-alone nature are simply delegated by the retaining firm to a contract lawyer, certain duties of disclosure under the Rules may attach, as for example where: (a) Circumstances are such that the attorney does not 'function as a part of the legal services delivery group and reports to a retaining lawyer'; or (b) Circumstances are such that the client's reasonable expectation [arising from the manner of billing or otherwise] that the retaining lawyer has supervised the working of the attorney or adopted that work as her own is not met; or (c) The attorney has reason to believe that there is a confusion about his/her role in the case vis-à-vis the client."; ultimately concluding that "the Committee counsels that a lawyer must address his/her responsibilities under the Rules without assuming that the retaining firm/attorney has disclosed and secured consent for the contract lawyer's participation in the matter. Initially, therefore, a lawyer whose services are contracted for by a retaining firm on some sort of one-off basis would have a duty to confirm with that firm that the client has been informed about and given knowledgeable approval for the lawyer's discrete participation in the matter. In default of such a confirmation, a lawyer would have an affirmative duty to determine the level of awareness and approval directly from the client. If, in the judgment of the lawyer, his/her role is in any way unclear or doubtful from the perspective of the client, the lawyer should either reject the engagement or undertake it with the understanding that at least in the interim, an attorney-client relationship exists and must be consented to by the client."; also holding that "if the retaining firm has not disclosed the contract lawyer's participation and obtained client consent or the degree of supervision by the retaining firm is less than the client should reasonably expect, duties on the part of the contract lawyer to disclose to and obtain consent directly from the client that do not otherwise exist under the Rules are likely to arise."; explaining how the law firm can handle charging a client for such a contract lawyer's efforts; "The Committee also notes that even where the contract lawyer's charges to the client can be billed by the firm as fees for legal services (rather than as costs) it is understood that 'the client's reasonable expectation is that the retaining lawyer has supervised the work of the contract lawyer or adopted that work as her own.' ABA Formal Opinion No. 00-420. The Committee advises, therefore, that notwithstanding the absence of any general duty of disclosure, if the Inquirer has reason to believe that the firm has not disclosed his status as a contract lawyer to the client under the circumstances discussed above -- billing, advance approval or some degree of supervision materially less than the client's 'reasonable expectations' -- he should (a) bring this to the attention of the retaining firm and seek confirmation that the necessary disclosures and approval will be made and

obtained or (2) in the absence of confirmation, the contract lawyer should disclose his status and role in the matter.").

- **[E 480 B 2/09; N]** Newby v. Enron Corp. (In re Enron Corp. Sec., Derivative & "ERISA" Litig.), No. MDL-1446, 2008 U.S. Dist LEXIS 84708 (S.D. Tex. Sept. 8, 2008) (holding that plaintiff's counsel in the Enron case could recover fees for a contract lawyers at the market rate rather than the rate that the plaintiff's law firm paid the contract lawyers; relying on ABA LEO 420 for the analysis of how lawyers can charge for services performed by contract lawyers).

- **[E 368 B 1/09; 2/11]** Ohio LEO 2008-1 (2/8/08) ("A lawyer in a law firm may be 'of counsel' to another law firm if the requisite continuing relationship exists between the lawyer and the law firm. The requisite continuing relationship is other than as a partner or associate or its equivalent and is more than a mere forwarder or receiver of legal business, more than a one-time advisor/consultant relationship, and more than a one-case relationship. The 'of counsel' relationship is continuing, close, regular, and personal. A lawyer who enters an 'of counsel' relationship must be aware of the accompanying ethical implications. A lawyer who serves as 'of counsel' must have an active license to practice law. A law firm may continue to include in the firm name the name of a lawyer who was already a name partner or name shareholder but who becomes 'of counsel' to the law firm. A law firm may not include in the firm name the name of an 'of counsel' lawyer who was not already a name partner or name shareholder of the law firm. The listing of an out-of-state lawyer as 'of counsel' to an Ohio law firm must include the jurisdictional limitation of the 'of counsel' lawyer on the letterhead. An 'of counsel' lawyer is considered a lawyer in the same firm for purposes of division of fees under Rule 1.5(e); therefore, the restrictions on division of fees with a lawyer not in the same firm do not apply to a lawyer who is properly designated as 'of counsel.' A lawyer may serve as 'of counsel' to more than one law firm. Conflicts of interest are attributed in an 'of counsel' relationship. 'Of counsel' relationships may be entered into between Ohio lawyers and law firms and out-of-state lawyers and law firms.").

- **[E 515 B 2/09]** Illinois LEO 98-02 (9/97) ("Payment to an independent or temporary lawyer on an hourly basis does not require disclosure to a client if there is close supervision. If work is delegated without close supervision then disclosure to a client is necessary.").

- **[Add VA. LEOs]**

## Best Answer

The best answer to this hypothetical is **YES**.

# Part-Time Lawyers

## Hypothetical 22

Several of your newest lawyers have decided to stay home and handle child rearing while their spouses attend graduate or medical school. You are trying to determine how to bill for their time.

**(a)** Without advising the client of the difference, may you charge an hourly rate that exceeds what you pay per hour to one of the young lawyers, who plans to work out of his basement several hours a day using your firm's computer system and library resources?

**YES**

**(b)** Without advising the client of the difference, may you charge an hourly rate that exceeds what you pay per hour to one of the young lawyers, who plans to take research assignments and work on them independently (without using any of your firm's resources)?

**NO (PROBABLY)**

**(c)** Without advising the client of the difference, may you charge an hourly rate that exceeds what you pay per hour to one of the young lawyers, who plans to independently prepare trust agreements which your firm will adopt as its own and use with clients?

**MAYBE**

## Analysis

**[repeat analysis from hypo 19 or combine with hypo 19]**

## Best Answer

The best answer to **(a)** is **YES**; the best answer to **(b)** is **PROBABLY NO**; the best answer to **(c)** is **MAYBE**.

# Outsourcing

## Hypothetical 23

Your firm is considering working with a business in Singapore who would conduct "Blue Sky" research at a fraction of the cost of a U.S. lawyer. Among the other considerations, you are wondering how you would bill for such services.

Without advising the client of the difference, may you charge an hourly rate that exceeds what you pay per hour to one of the Singapore lawyers?

**NO**

## Analysis

- **[E 1744 N 1/12] [be sure to add this to Ethics of Email and Corporate Counsel outsourcing]** Virginia LEO 1850 (12/28/10) (in a compendium opinion, providing advice about lawyers outsourcing, defined as follows: "Outsourcing takes many forms: reproduction of materials, document retention database creation, conducting legal research, drafting legal memoranda or briefs, reviewing discovery materials, conducting patent searches, and drafting contracts, for example."; explaining that, among other things, a lawyer engaging in such outsourcing must: (1) "exercise due diligence in the selection of lawyers or nonlawyers"; (2) avoid the unauthorized practice of law (explaining that the Rules: "do not permit a nonlawyer to counsel clients about legal matters or to engage in the unauthorized practice of law, and they require that the delegated work shall merge into the lawyer's completed work product" and direct that "the initial and continuing relationship with the client is the responsibility of the employing lawyer," ultimately concluding that "in order to avoid the unauthorized practice of law, the lawyer must accept complete responsibility for the nonlawyer's work. In short, the lawyer must, by applying professional skill and judgment, first set the appropriate scope for the nonlawyer's work and then vet the nonlawyer's work and ensure its quality."); (3) "obtain the client's informed consent to engage lawyers or nonlawyers who are not directly associated with or under the direct supervision of the lawyer or law firm that the client retained"; (4) assure client confidentiality; noting that "if payment is billed to the client as a disbursement," the lawyer must pass along any cost without mark-up unless the client consents (although the lawyer may also pass along any overhead costs -- which in the case of outsourced services "may be minimal or nonexistent"), and that "if the firm plans to bill the client on a basis other than the actual cost which can include a reasonable allocation of overhead charges associated with the work," the client must consent to such a billing arrangement "in cases where the nonlawyer is

working independently and outside the direct supervision of a lawyer in the firm"; explaining that a lawyer contemplating outsourcing at the start of an engagement "should" obtain "client consent to the arrangement" and provide "a reasonable explanation of the fees and costs associated with the outsourced project." [The remainder of the opinion appears to allow a law firm hiring outsourced service providers working under the direct supervision of a lawyer associated with the firm to treat them as if they were lawyers in the firm -- both for client disclosure and consent purposes, as well as for billing purposes.]; acknowledging that a lawyer can treat as inside the firm for disclosure and billing purposes an outsourced service provider who handles "specific legal tasks" for the firm while working out of her home (although not meeting clients there), who has "complete access to firm files and matters as needed" and who "works directly with and under the direct supervision" of a firm lawyer, but that a law firm may not treat (for consent and billing purposes) outsourced service providers as if they are in the firm who are working in India and, who conduct patent searches and prepare applications for firm clients, but who "will not have access to any client confidences with the exception of confidential information that is necessary to perform the patent searches and prepare the patent applications"; explaining that the same is true of lawyers whom the law firm occasionally hire, but who also work "for several firms on an as needed contract basis"; noting that a lawyer does not need to inform the client when a lawyer outsources "truly tangential, clerical or administrative" legal supports services, or "basic legal research or writing" services (such as arranging for a "legal research 'think tank' to produce work product that is then incorporated into the work product" of the firm). [The Bar's hypotheticals do not include the possibility of an overseas lawyer or a lawyer working for several U.S. law firms on an "as needed contract basis" -- but who work under the "direct supervision" of a lawyer associated with the firm.]; concluding that lawyers "must advise the client of the outsourcing of legal services and must obtain client consent anytime there is disclosure of client confidential information to a nonlawyer who is working independently and outside the direct supervision of a lawyer in the firm, thereby superseding any exception allowing the lawyer to avoid discussing the legal fees and specific costs associated with the outsourcing of legal services").

## Best Answer

The best answer to this hypothetical is **NO**.

# General Fee-Sharing Rules

## Hypothetical 24

You are trying to develop a loose network of law firms around your state with whom you plan to work under the right circumstances. In addition to the various conflicts and "culture" issues, you are exploring how you and the other firms might share fees.

**(a)** Do you need the client's consent to share your fees with another law firm?

**YES**

**(b)** Must your fee sharing be in proportion to the amount of work that you handle on the matter?

**NO**

**(c)** To share in another law firm's fees, must your firm assume ethical and malpractice responsibility for a matter?

**MAYBE**

**(d)** May your firm earn a "referral fee" without handling any of the work on the matter?

**MAYBE**

## Analysis

### ABA Model Rules

The ABA Model Rules permit fee sharing under certain circumstances.

> **[E 1307]** A division of a fee between lawyers who are not in the same firm may be made only if: (1) the division is in proportion to the services performed by each lawyer or each lawyer assumes joint responsibility for the representation; (2) the client agrees to the arrangement, including the share each lawyer will receive, and the agreement is confirmed in writing; and (3) the total fee is reasonable.

ABA Model Rules 1.5(e)(1)-(3). A comment provides an additional explanation.

> **[E 1314]** A division of fee is a single billing to a client covering the fee of two or more lawyers who are not in the same firm. A division of fee facilities association of more than one lawyer in a matter in which neither alone could serve the client as well, and most often is used when the fee is contingent and the division is between a referring lawyer and a trial specialist. Paragraph (e) permits the lawyers to divide a fee either on the basis of the proportion of services they render or if each lawyer assumes responsibility for the representation as a whole. In addition, the client must agree to the arrangement, including the share that each lawyer is to receive, and the agreement must be confirmed in writing. Contingent fee agreements must be in writing signed by the client and must otherwise comply with paragraph (c) of this Rule. Joint responsibility for the representation entails financial and ethical responsibility for the representation as if the lawyers were associated in a partnership. A lawyer should only refer a matter to a lawyer whom the referring lawyer reasonably believes is competent to handle the matter. See Rule 1.1.

ABA Model Rules 1.5 cmt. [7].

**Restatement**

The Restatement takes essentially the same approach.

> **[E 1386]** A division of fees between lawyers who are not in the same firm may be made only if:
>
> > (1) (a) the division is in proportion to the services performed by each lawyer or (b) by agreement with the client, the lawyers assume joint responsibility for the representation;
> >
> > (2) the client is informed of and does not object to the fact of division, the terms of the division, and the participation of the lawyers involved; and (3) the total fee is reasonable.

Restatement (Third) of Law Governing Lawyers § 47(1), (2) (2000). A comment explains the basis for this rule.

> The traditional prohibition of fee-splitting among lawyers is justified primarily as preventing one lawyer from recommending another to a client on the basis of the referral fee that the recommended lawyer will pay, rather than that lawyer's qualifications. The prohibition has also been defended as preventing overcharging that may otherwise result when a client pays two lawyers and only one performs services. Beyond that, the prohibition reflects a general hostility to commercial methods of obtaining clients.
>
> Those grounds do not warrant a complete ban on fee-splitting between lawyers. It is often desirable for one lawyer to refer a client to another, either because the services of two are appropriate or because the second lawyer is more qualified for the work in question. Allowing the referring lawyer to receive reasonable compensation encourages such desirable referrals. Lawyers are more able than other referral sources to identify other lawyers who will best serve their client. Even if a referring lawyer is compensated for the referral, that lawyer has several reasons to refer the client to a good lawyer rather than a bad one offering more pay. The referring lawyer will wish to satisfy the client, will to an extent remain responsible for the work of the second lawyer . . . , and, because fee-splitting arrangements most commonly occur in representations in which only a contingent fee is charged, will usually receive no fee at all unless the second lawyer helps the client to prevail. The reasonable-fee requirement of Subsection (3), moreover, reduces the likelihood that fee-splitting will lead to client overcharging. The balance between the dangers and advantages of fee-splitting is sufficiently close that informed clients should be able to agree to it, provided the safeguards specified in this Section are followed.

Restatement (Third) of Law Governing Lawyers § 47 cmt. b (2000).

The Restatement provides additional guidance on a number of issues that might come up in fee-sharing arrangements.

First, the Restatement explains that a fee-sharing arrangement can either be based on the proportion of the work performed by each lawyer, or on assumption of responsibility by each lawyer.

> There are two bases on which fee division is permissible. The division recognized by Subsection (1)(a) requires that each lawyer who participates in the fee have performed services beyond those involved in initially being engaged by the client. The lawyers' own agreed allocation of the fee at the outset of the representation will be upheld if it reasonably forecasts the amount and value of effort that each would expend. If allocation is not made until the end of the representation, it must reasonably correspond to services actually performed.

Restatement (Third) of Law Governing Lawyers § 47 cmt. c (2000).

> **[E 1387]** The second basis for fee-splitting . . . allows fee-splitting between lawyers in any agreed proportion when each agrees with the client to assume responsibility for the representation. (Some jurisdictions may impose an upper limit on the total fee, absent explicit client consent.) That means that each lawyer can be held liable in a malpractice suit and before disciplinary authorities for the others' acts to the same extent as could partners in the same traditional partnership participating in the representation . . . . Such assumption of responsibility discourages lawyers from referring clients to careless lawyers in return for a large share of the fee.

Restatement (Third) of Law Governing Lawyers § 47 cmt. d (2000). A comment explains that

> [i]n the large majority of jurisdictions permitting, as an alternative method of validating a fee-splitting arrangement, that the lawyers allocate the fee in proportion to the services each provides, a much-litigated issue is the extent of proportionality required and the means of testing it.

Restatement (Third) of Law Governing Lawyers § 47 cmt. c, reporter's note (2000). The next comment explains the other possibility.

> Almost every jurisdiction permits assumption of joint responsibility as an alternative basis on which a permissible fee-splitting arrangement can be made with another lawyer.

Restatement (Third) of Law Governing Lawyers § 47 cmt. d, reporter's note (2000).

Second, the Restatement emphasizes the lawyer's obligation to explain the arrangement to the client.

> Because of the hazards of fee-splitting arrangements, they are not permissible unless the client consents as provided in subsection (1)(a) to joint responsibility of the lawyers when the division is not in proportion to the services each lawyer performs, and unless the client is informed and does not object to the fact and terms of the division and the participation of the lawyers involved as provided in Subsection (2). On the lawyer's duty to respond to client inquiries, see § 20. If disclosure and client consent do not occur at the outset of the representation, a fee-splitting arrangement constitutes a mid-representation fee agreement subject to § 18(1)(a).

Restatement (Third) of Law Governing Lawyers § 47 cmt. e (2000). A comment explains that

> [a] substantial majority of jurisdictions, following the ABA Model Rules of Professional Conduct (1983), require disclosure to the client only of the participation of all the lawyers involved.

Restatement (Third) of Law Governing Lawyers § 47 cmt. e, reporter's note (2000).

Third, the Restatement highlights the requirement (found elsewhere in the Restatement) that all fees must be reasonable -- including fees shared by lawyers.

> Under § 34, a lawyer's compensation for any representation must be reasonable. Under this Section, the total fee for all lawyers involved in a fee-splitting arrangement, not just the individual fee of each lawyer, must be reasonable. That requirement discourages fee-splitting arrangements that increase what the client must pay. It follows that what is a reasonable fee should be determined without reference to the value of the referring lawyer's services as a broker. Time devoted to conferences between the lawyers may be taken into account to the extent the case reasonably required the consultation. Even after applying those safeguards, it is still possible that the total fee under a fee-splitting arrangement will be larger than what the client might have had to pay to a single lawyer handling the same matter, since there will

> usually be a range of total fees satisfying the reasonableness requirements of § 34 and this Section. The remedy of the client, who must be informed of fee-splitting arrangements . . . , lies in rejecting the arrangement and retaining a single lawyer at a lower fee. As with other fee arrangements, fees agreed to by clients sophisticated in entering into such arrangements should almost invariably be found reasonable . . . .

Restatement (Third) of Law Governing Lawyers § 47 cmt. f (2000).

Fourth, the Restatement analyzes fee sharing in what it calls "borderline arrangements."

> Many arrangements between lawyers are similar to but diverge to some extent from the usual fee-splitting arrangement. Whether this Section applies to them depends on whether they pose the dangers that the Section is meant to address. When a client discharges one lawyer and retains another who is not recommended by the first, the danger of biased referral is absent, and any danger of excessive fees results from the substitution rather than from any referral agreement between the lawyers. An agreement in which the lawyers settle what part of the client's fee each will receive is therefore not forbidden by this Section, and may serve the useful purpose of resolving fee disputes between them that could delay and burden the client. The client is entitled to disclosure of such agreements between past and present counsel . . . , and the client's own liability for legal fees cannot be increased by an agreement to which the client is not a party. . . .
>
> In class actions, a court usually awards attorney fees and other expenses to the prevailing plaintiff class. When lawyers from different firms work together to represent the interests of the class, those lawyers often agree who will perform certain services or advance required funds, subject to payment if the action succeeds. Such arrangements ordinarily do not violate this Section. Likewise, agreements governing how any fee award will be divided ordinarily do not violate this Section, provided that the division is in proportion to the services performed by each firm or each firm assumes joint responsibility for the representation. When an agreement provides for payments that are disproportionate to the services performed or funds advanced, or for a

> distribution differing from the tribunal's award, it should be disclosed to the tribunal, which may invalidate it in whole or in part if it undermines the proper representation of the class and its members. A tribunal considering whether to do so should consider the justifications for the arrangement, the probable effects on the independent professional judgment of the lawyers involved, and the timeliness of disclosure to the tribunal.

Restatement (Third) of Law Governing Lawyers § 47 cmt. h (2000).

After analyzing the basic rule and all of these complicated factors, the Restatement discusses the lawyer's liability for any misconduct in this context, and the enforceability of such arrangements.

> A fee-splitting agreement that violates this Section renders the participating lawyers subject to professional discipline . . . . It also cannot be enforced against the client, may lead to partial or total forfeiture of the lawyers' fee claim . . . , and may form the basis for a claim by the client of restitution of the portion of the fee paid to the forwarding lawyer . . . . Some urge that lawyers who enter into an improper fee-splitting arrangement should be able to enforce it against each other, reasoning that neither may charge the other with an impropriety to which both agreed, and that the prohibition on fee-splitting protects clients rather than lawyers. Enforcement, however, encourages lawyers to continue entering into improper fee-splitting agreements. Accordingly, a lawyer who has violated a regulatory rule or statute by entering into an improper fee-splitting arrangement should not obtain a tribunal's aid to enforce that arrangement, unless the other lawyer is the one responsible for the impropriety. On the other hand, although most lawyer codes on the subject require that a fee-splitting agreement be in writing (and the absence of a writing is a disciplinary violation), when the fact of such agreement is clearly established, the absence of a writing by itself should not affect the rights of the lawyers between themselves.
>
> It is appropriate for the tribunal in which is pending either a separate suit between the lawyers or a suit to which the fee dispute is ancillary . . . to require notification to the client so that the client, if so disposed, may assert a claim to a refund of all or part of the fee.

Restatement (Third) of Law Governing Lawyers § 47 cmt. i (2000).

States generally follow the ABA Model Rules and the Restatement approach to fee sharing.

- **[E 655 N 12/09]** Samuel v. Druckman & Sinel, LLP, 906 N.E.3d 1042, 1045 (N.Y. 2009) (upholding a fee-split agreement in a medical malpractice case, under which the original law firm was to receive one third of the ultimate legal fee recovered; explaining that it "is of no moment" that the law firm "did not contribute to that part of the work that resulted in the award of the enhanced fee").

- **[E 1200 B 9/11]** Ohio LEO 2009-9 (12/4/09) ("If a plaintiff's personal injury lawyer retains an outside law firm to provide health care lien resolution services in a settled matter, the plaintiff's lawyer may use professional judgment as to whether to charge the client for the service as part of the contingent fee or as an expense of litigation. Either way, the client's consent to the outsourcing and the fee arrangement must be obtained prior to outsourcing the service. Either way, the fees and expenses must be reasonable, not excessive. Either way, the nature and basis for the fee arrangement must be communicated to the client and pursuant to Rule 1.5(c) a contingency fee agreement must be in writing. If the outsourced legal fee is included as part of a contingency fee, there is a division of fee among lawyers not in the same firm and that triggers the requirements of Rule 1.5(e). If the outsourced service is charged to the client as a litigation expense, the contingency fee rate must be appropriately set to not result in a duplicative and excessive legal fee charged to a client for a service that is billed separately as an expense.").

- **[E 434 B 2/09]** New York County Law. Ass'n LEO 739 (07/10/08) ("It is ethically permissible for a plaintiff's personal injury attorney to retain a specialty firm to handle the resolution of a Medicare, Medicaid or private healthcare lien on a settled lawsuit. Under the following conditions, the fee for said outside service may be charged as a disbursement against the total proceeds of the settlement: (a) at the outset of the representation, the Retainer Agreement with the client provides that the attorney may do so, and the client has given informed consent thereto; (b) the actual charges are passed on to the client at cost (without any overage or surcharge) and must be reasonable; (c) the transaction results in a net benefit to the client on each lien negotiated; (d) the transaction complies with all principles of substantive law, including the fee limitations on contingent fees in the New York Judiciary Law and Appellate Division rules; and (e) the referring attorney remains responsible for the overall work product.").

**(d)** The requirement in the ABA Model Rules and the Restatement that lawyers sharing in a fee actually provide services or (in the alternative) assume "joint responsibility" for the matter generally prohibits a lawyer earning a pure "referral fee."

Some states take this approach.

- **[E 1510]** Washington LEO 2189 (2008) ("Paying a pure referral fee to anyone is generally prohibited by RPC 7.2(b). Also, because the referral fee proposed by the inquirer is not in proportion to services rendered, and the referring lawyer is not assuming any responsibility for the representation, payment and receipt of the fee is prohibited under RPC 1.5(e). As Professor Robert Aronson noted when the RPCs were first adopted in Washington.").

- **[E 1644 B 4/11]** Arizona LEO 04-02 (3/2004) ("Arizona, unlike some other states, does not allow a lawyer to be paid a fee merely for recommending another lawyer or referring a case. Instead, Arizona allows 'referral fees' only in the sense that lawyers who are not in the same firm may divide a fee as provided in ER 1.5(e). That rule allows lawyers to divide a single billing to a client if three conditions are met: (1) each lawyer receiving any portion of the fee assumes joint responsibility for the representation; (2) the client agrees, in a signed writing, to the participation of all the lawyers involved; and (3) the total fee is reasonable. 'Joint responsibility; requires, at the least, that the referring attorney accept vicarious liability for any malpractice that occurs in the representation. Although the client must consent to the respective roles of the lawyers in the ongoing representation, ER 1.5(e) does not require that the client consent to the particular division of the total fee among the lawyers."; explaining the meaning of "joint responsibility"; "The 'joint responsibility' that a referring lawyer must assume in order to share a single fee is not limited merely by the duties to refer matters only to another lawyer believed to be competent and to take appropriate steps if the referring lawyer learns the other lawyer has violated the ethical rules. These obligations, after all, would exist whether or not the referring lawyer also assumed 'joint responsibility' for the ongoing representation."; "Other jurisdictions disagree whether 'joint responsibility' must entail substantive involvement by the referring attorney, such as supervision of the other lawyer's work, or merely financial responsibility. Compare ABA Informal OP. 85-1514, supra; McFarland v. George, 316 S.W. 2d 662, 671-72 (Mo. Ct. App. 1958) ('responsibility' under Missouri's ethical rules means substantive involvement); Ohio Bd. Comm'rs of Grievance and Discipline Op. 2003-3 (concluding that 'responsibility' means referring lawyer must be available to other lawyer and client throughout the representation and remain knowledgeable about progress of matter); Wis. State Bar, Formal Op. E-00-01 (same, with Aiello v. Adar, 750 N.Y.S. 2d at 465 [750 N.Y.S.2d 457 (N.Y. Sup. Ct. 2002)] (joint responsibility is synonymous with joint and several liability; vicarious liability

for any act of malpractice is sufficient assumption of responsibility). See also N.Y. Count Lawyers' Association Comm. Professional Ethics Opinion 715 (1996) (referring attorney who assumes joint responsibility in exchange for legal fees is ethically obligated to accept vicarious liability for any act of malpractice that occurs during the course of the representation, but not required to supervise the activities of the receiving lawyer); I[ll]. Jud. Ethics Comm. Op. 94-16 ('acceptance of legal responsibility' required by Illinois professional ethics rule 'consists solely of potential financial responsibility for any malpractice action against the recipient of the referral'); Chicago Bar Association Professional Responsibility Comm. Op. 87-2 at 4 (same)."; "Under Arizona's recently revised ER 1.5(e), the requisite 'joint responsibility' exists if the referring attorney assumes financial responsibility for any malpractice that occurs during the course of the representation. This conclusion comports with the amendments to ER 1.5(e), which delete the prior reference in the comments to ER 5.1 and do not otherwise suggest that a referring attorney must have a relationship comparable to a 'partnership' with the recipient of the referral. It also would be somewhat illogical to require a referring attorney to 'supervise' the handling of a matter by another attorney believed to be more experienced or capable in a particular area. See Aiello, 750 N.Y.S. 2d at 465. Interpreting 'joint responsibility' as synonymous with joint liability allows flexibility in structuring the relationship among the attorneys and client involved. A referred attorney may, but is not necessarily required, to have ongoing supervisory responsibilities or other substantive involvement in the matter.'").

Although generally not using the phrase "referral fee," some states' ethics rules implicitly permit referral fees by not requiring that lawyers provide services or assume "joint responsibility" for a case.

- See, e.g., Va. Rule 1.5 Committee Commentary ("Paragraph (e) eliminates the requirement in the Virginia Code that each lawyer involved in a fee-splitting arrangement assume full responsibility to the client, regardless of the degree of the lawyer's continuing participation. The requirement in the Virginia Code was deleted to encourage referrals under appropriate circumstances by not requiring the lawyer making the referral to automatically assume ethical responsibility for all of the activities of the other lawyers involved in the arrangement. However, such an arrangement is acceptable only if the client consents after full disclosure, which must include a delineation of each lawyer's responsibilities to the client.").

Bars have dealt with the meaning of the phrase "joint responsibility."

The ABA explains that

> [j]oint responsibility for the representation entails financial and ethical responsibility for the representation as if the lawyers were associated in a partnership.

ABA Model Rule 1.5 cmt. [7].

Similarly, the Restatement explains that the phrase

> means that each lawyer can be held liable in a malpractice suit and before disciplinary authorities for the others' acts to the same extent as could partners in the same traditional partnership participating in the representation.

Restatement (Third) of Law Governing Lawyers § 47 cmt. d (2000).

State bars tend to take the same approach.

- See, e.g., Arizona LEO 10-4 (6/10) (explaining that in Arizona the term "joint responsibility" does not necessarily require "substantive involvement in a matter").

## Best Answer

The best answer to **(a)** is **YES**; the best answer to **(b)** is **NO**; the best answer to **(c)** is **MAYBE**; the best answer to **(d)** is **MAYBE**.

# Fee Sharing with a Suspended or Disbarred Lawyer

## Hypothetical 25

You have entered into a fee-sharing arrangement with a lawyer in a neighboring county. Although he seemed like a decent person, you just learned that he was disbarred for drug use. Now you wonder about the enforceability of the fee-sharing arrangement.

**(a)** Must you honor a fee-sharing arrangement with a lawyer who is disbarred before any fees are recovered in a contingent-fee case?

**??**

**(b)** May you honor a fee-sharing arrangement with a lawyer who is disbarred before any fees are recovered in a contingent-fee case?

**??**

## Analysis

Courts and bars have dealt with the freedom of lawyers or former lawyers to share in another lawyer's fee even if the lawyer seeking the fee is not authorized to practice law in the state, or generally.

**[MAYBE ADD QUESTION BASED ON UPL ISSUE]**

In 2010, the Arizona Bar explained that any lawyers involved in a fee-sharing arrangement must be eligible to practice in Arizona under the Arizona MJP provisions.

- **[E 1660 B 4/11]** Arizona LEO 10-04 (6/2010) ("An Arizona lawyer may divide a fee with a lawyer admitted in another United States jurisdiction if the client consents to the arrangement in writing, each lawyer receiving any portion of the fee assumes joint responsibility for the representation, and the total fee is reasonable. In addition to complying with these general rules regarding fee division, the out-of-state lawyer must be in good standing, admitted in a United States jurisdiction, and providing services to the Arizona client in association with a lawyer who is admitted to practice in Arizona and who actively participates in the matter. The client must consent in writing to the fee division, acknowledge the out-of-state lawyer is not admitted in Arizona,

> and consent to the out-of-state lawyer's representation. The out-of-state lawyer must either ensure that he or she is admitted pro hac vice in order to provide legal services that require pro hac vice admission or be eligible to provide temporary legal services in Arizona pursuant to ER 5.5."; explaining that in Arizona the term "joint responsibility" does not necessarily require "substantive involvement in the matter"; "Arizona fee division rules do not require that a lawyer have substantive involvement in the matter on which the fee is divided. . . . The client must, however, consent to the fee division arrangement in writing and the lawyers must assume joint responsibility for the representation. . . . Therefore, in response to the first question, a fee may not be divided with the out-of-state lawyer due to non-compliance with ER 1.5(e).").

Several years earlier, the Ohio Bar pointed to the MJP issue in suspending a lawyer for engaging in a fee-sharing arrangement.

- **[E 359 B 1/09]** Columbus Bar Ass'n v. Willette, 884 N.E.2d 581 (Ohio 2008) (suspending for one year an Ohio lawyer who worked with a Michigan law firm to sell living trusts and other services in Ohio; finding that the arrangement violated the prohibition on paying a fee to another lawyer for referring clients and recommending the lawyer's services; also noting that the arrangement violated the fee-split rule because none of the lawyers in the Michigan law firm were licensed in Ohio; also finding that the lawyer failed to disclose to the client his business arrangement with the Michigan law firm).

The issue becomes more acute if the lawyer seeking to share in another lawyer's fee is not eligible to practice law anywhere.

The Restatement has flat prohibition on disbarred or suspended lawyers sharing in any fee.

> One corollary of the justification for fee division is that a lawyer who may not represent clients, for example because of disbarment or conflict of interest, also may not receive part of the fee.

Restatement (Third) of Law Governing Lawyers § 47 cmt. b (2000).

Somewhat surprisingly, some state bars take a much more lenient approach to this issue.

- **[E 306 N 10/08]** Eichen, Levinson & Crutchlow, LLP v. Weiner, 938 A.2d 947 (N.J. Super. Ct. App. Div. 2008) (citing a New Jersey rule in refusing to allow a plaintiff's law firm to keep a referral fee that would have been owed to a lawyer who was since suspended, and therefore cannot accept the fee; demanding that the plaintiff's firm pay the referral fee to the trustee for the suspended lawyer), certification denied, 949 A.2d 847 (N.J. 2008).

- **[E 211]** Somers & Assocs., P.C. v. Busch, 927 A.2d 832, 840, 842 (Conn. 2007) (holding that a lawyer who was disbarred before finishing a case may recover the value that the lawyer's client received from the lawyer's services, rather than quantum meruit; explaining that the lawyer could not recover fees under the retainer contract because he was unable to perform due to his own actions; also holding that the lawyer could not recover under a quantum meruit theory "because the services that he had rendered had been performed under a valid express contract"; explaining that this allowed recovery only under a theory of unjust enrichment; "[w]e conclude that if an attorney fails to perform fully under a contract that has been terminated because of his or her own disbarment, the disbarred attorney may recover, under the doctrine of unjust enrichment, for partial performance of services rendered in furtherance of the contract's objective, the measure of which is the benefit derived by the client. As the trial court properly found that the amount of benefit afforded to the defendant, as a result of plaintiff's services, was less than the amount the defendant already had paid to the plaintiff, we conclude that the plaintiff may not recover restitutionary relief for legal services rendered to the defendant." (footnote omitted)). Nancy's note -- Tom – I read this that Court was agreeing with the trial court, but if that is a holding, ok.

- **[E 272 N 2/09]** Pennsylvania LEO 2007-400 (2007) ("Payment of referral fees to an inactive, suspended or disbarred attorney, provided the attorney was in good standing at the time of the referral fee agreement, does not conflict with the ethical considerations underlying Rules 1.5 and 5.4. These rules were intended to prevent an attorney from continuing to earn legal fees for services rendered after the disbarment, suspension or transfer to inactive status, whereas under the circumstances relevant to this Formal Opinion, the fees were earned by the referring attorney at the time of the referral. This Committee therefore concludes that, assuming that the total fee is not illegal or clearly excessive, and the client is advised of and does not object to the payment of the referral fee, an attorney may ethically make payment of a referral fee to a referring attorney provided the referring attorney was in good standing at the time the referral was made.").

- **[E 34 N 12/06]** Padilla v. Sansivieri, 815 N.Y.S.2d 173, 176 (N.Y. App. Div. 2006) (allowing a disbarred lawyer to recover legal fees for services he performed before his disbarment; rejecting the definition of quantum meruit payment as limited to "attorney compensation calculated by hourly rates," and

remanding to determine what portion of a contingent fee the disbarred lawyer should receive).

Not surprisingly, courts sometimes deal with disputes or even lawsuits among lawyers who had entered into fee-sharing arrangements.

- **[E 1649 B 4/11]** Eng v. Cummings, McClorey, Davis & Acho, PLC, 611 F.3d 428, 433 & n.8, 434, 435 & n.11 (8th Cir. 2010) (analyzing a fee-sharing situation, in which the Missouri law firm of Eng & Woods successfully sought a declaratory judgment holding that it did not owe a portion of its fees to the other law firm which referred a personal injury client to Eng & Woods, but did not comply with Missouri's fee-sharing rules; explaining that the plaintiff law firm only provided the referring law firm ten percent of its ultimate attorneys' fees recovered in the case, not the one-third that the defendant law firm claims it was owed; "We agree with the district court that, assuming there was a fee-splitting agreement between Acho [referring lawyer] and Eng [plaintiff lawyer, which handled the case], this agreement did not comply with Rule 4-1.5(e). First, there is no written agreement between CMDA [referring law firm which sought additional fees from the plaintiff law firm] and either Richina or MitRahina [clients]. CMDA has produced no representation agreement with Richina or MitRahina, and Acho is 'not certain if [Richina] returned a signed employment agreement or not.'. . . Moreover, it appears that CMDA had no direct contact with MitRahina whatsoever, thus any argument that CMDA is entitled to a share of the attorney's fees from her recovery finds no support in Rule 4-1.5(e)."; "Due to this lack of communication with MitRahina, it appears that any alleged agreement to share the fee from her recovery also runs afoul of Rule 4-1.5(e)(2), which requires that 'the client is advised of and does not object to the participation of all the lawyers involved.'"; "To be sure, the evidence demonstrates that Richina was aware of the fee-splitting arrangement, and while we might agree with CMDA that the underlying purpose of Rule 4-1.5(e) -- to advise the client that each lawyer will assume joint responsibility for the case and ensure the client does not object -- was satisfied here, the letter of the Rule was not."; explaining that the referring law firm had not complied with Missouri's fee-sharing rules; "[T]he record clearly shows the lack of any signed agreement between CMDA and Richina or MitRahina."; "[E]ven if the December 1 letter qualifies as a written agreement, it does not meet Rule 4-1.5(e)(1)'s joint responsibility requirement. By its terms, Rule 4-1.5(e)(1) requires that the written agreement itself inform the client that each lawyer will assume joint responsibility for the case, not just that the lawyers will split the fee between them. . . . Rule 4-1.5(e) requires that the written agreement itself state that each lawyer is jointly

responsible. . . . The fact that CMDA was in touch with one of the clients or could have been liable for malpractice if Richina or MitRahina were unhappy with their representation is not enough to show joint representation."; "[E]ven if CMDA's actions show the exercise of some level of professional responsibility, they do not amount to 'joint responsibility' as that term is used in Rule 4-1.5(e)(1)."; "Nothing that Acho did rises to this level. He did not file an appearance in the wrongful death action; he did not pay any portion of the court fees; he did not take depositions (although it appears at one point he offered to); and he did not assist Eng & Woods in formulating a trial strategy. Indeed, he appears to never have actually met Richina, MitRahina, or Eng. Acho's role appears to have been limited to occasional telephone conversations with one of the clients and with that client's uncle. . . . While Acho's actions might amount to more than a mere referral, it is little more. Thus, we hold that any fee-splitting agreement between Acho and Eng did not comply with Rule 4-1.5(e). As such, the agreement is unenforceable as a matter of law."; noting that other authorities disagree with this position; "Although we are bound to apply settled Missouri law on this point, we note that other federal courts have come to different conclusions when interpreting rules similar to Rule 4-1.5(e). See Freeman v. Mayer, 95 F.3d 569, 574-75 (7th Cir. 1996) (holding that a technical violation of the written-agreement requirement of Indiana Rule of Professional Conduct 1.5(e) did not operate to invalidate a fee-splitting agreement that was otherwise valid); Sanders v. Mueller, 133 F. App'x 37, 43 (4th Cir. 2005) (unpublished) ('A court must not declare invalid a fee-sharing agreement for violations [of the Maryland Rules of Professional Conduct] that are merely technical, incidental, or insubstantial or when it would be manifestly unfair and inequitable not to enforce the agreement.' (quotation omitted)). As in Freeman and Sanders, it appears that, if a fee-splitting agreement existed between Acho and Eng, Acho's violations of Rule 4-1.5(e) were merely technical, at least as to Richina. However, the fact remains that the agreement runs afoul of Rule 4-1.5(e) and is, therefore, unenforceable under Missouri law."; affirming judgment for the plaintiff law firm, and denying the referring law firm's claim for more fees)

- **[E 852 N 1/10; 4/10]** Fitzpatrick v. Allen & Assocs., P.C., 913 N.E.2d 255, 261, 265 n.4, 266, 268 (Ind. Ct. App. 2009) (analyzing an action by a lawyer seeking to enforce a fee-sharing contract with other lawyers; noting that three lawyers agreed to split a one-third contingency fee for money recovered on behalf of a plaintiff pursuing both a product liability and a malpractice action based on treatment at a hospital; explaining that one of the lawyers had agreed to pursue a medical malpractice case while the other lawyers were handling a product liability case; noting that the client terminated the plaintiff lawyer from any participation in the product liability case, but not the malpractice case; also explaining that after being terminated from any participation in the product liability case, the lawyer "cited an irretrievable breakdown of the attorney-client relationship and withdrew as counsel in the medical malpractice case as well"; concluding that the plaintiff's entitlement to

a portion of the fee had been established because the defendant lawyer had not responded to the plaintiff's lawsuit and therefore had a default judgment entered against him; explaining that the plaintiff lawyer was justified in withdrawing; "Although whether Allen [plaintiff lawyer] performed his portion of the contract is no longer at issue because of the default judgment, we observe that Allen's withdrawal from that case was the result of actions taken, in part, by Fitzpatrick [defendant lawyer] that caused the breakdown of the attorney-client relationship. Namely, as settlement in the products liability suit neared, Fitzpatrick sought to change the terms of the fee-sharing agreement. After Allen refused, the Hills immediately fired him from that suit. Fitzpatrick then refused to disclose the case's settlement amount to Allen, forcing Allen to choose between asking enforcement of the fee-sharing contract or continuing his representation of the Hills."; rejecting defendant's argument that the plaintiff should only recover under a quantum meruit theory; pointing to the express written fee agreements between the lawyers, which dictated allocation of fees even if the client terminated one of the lawyers; also noting that the policy considerations underlying the quantum meruit approach are not implicated here; "In no way does enforcing a fee-sharing contract between lawyers impact a client's right to discharge an attorney, hold clients responsible for unbargained-for attorney fees, or hinder an attorney's right to be compensated for services rendered."; also rejecting the defendant lawyer's argument that the Indiana fee-sharing rule prohibited the arrangement because the plaintiff lawyer had "'joint responsibility'" for the product liability case that resulted in the large verdict (citation omitted); explaining that the lawyers had agreed to a fee-sharing contract for a "broader scope" of representation that encompassed both the product liability and the medical malpractice case, which "arose from the same set of facts" -- thus "allowing the attorneys to share the risk that neither, one, or both of the suits would generate any contingency fees"; awarding the plaintiff lawyer over $1,000,000 in fees).

- **[E 360 B 1/09]** Brown & Bain, P.A. v. O'Quinn, 518 F.3d 1037 (9th Cir. 2008) (holding that a Texas law firm was obligated to pay an Arizona law firm to which the Texas firm had agreed to pay an hourly rate while working on a case; rejecting the Texas firm's argument the Arizona firm had abandoned the joint effort; noting that the Texas firm had hired Professor Hazard as its expert, but rejecting his conclusions).

- **[E 139 N 2/07]** Mazon v. Krafchick, 144 P.3d 1168, 1172 (Wash. 2006) (holding that one co-counsel may not sue another co-counsel for the loss of an expected contingent fee based on the latter's errors; "We agree with the Court of Appeals' reasoning and adopt a bright-line rule that no duties exist between cocounsel [sic] that would allow recovery for lost or reduced prospective fees. As cocounsel [sic], both attorneys owe an undivided duty of loyalty to the client. The decisions about how to pursue a case must be based on the client's best interests, not the attorneys'. The undivided duty of

loyalty means that each attorney owes a duty to pursue the case in the client's best interests, even if that means not completing the case and forgoing a potential contingency fee.").

## Best Answer

The best answer to **(a)** is **??**; the best answer to **(b)** is **??**.

# Fee Sharing with a Withdrawn Lawyer

## Hypothetical 26

One of your associates just announced that she is leaving your firm. It looks like the split will be fairly ugly, and you expect very difficult negotiations with the associate (who has shown a knack for bringing in business), and you wonder whether you will need all of the associate's clients' consent to whatever deal you reach with the associate about the firm's reimbursement to her for the work she has undertaken in pending cases.

Must a client consent to a split of fees between a law firm and a withdrawing lawyer?

**NO**

## Analysis

On its face, the fee-sharing rule applies only to a sharing of fees among lawyers "who are not in the same firm." ABA Model Rule 1.5(e)(1).

An ABA Model Rule comment explicitly excludes from the general fee-sharing provision lawyers who are in the same firm when they performed the work.

> **[E 1315]** Paragraph (c) does not prohibit or regulate division of fees to be received in the future for work done when lawyers were previously associated in a law firm.

ABA Model Rules 1.5 cmt. [8].

The Restatement also limits the fee-split rule to lawyers "who are not in the same firm." Restatement (Third) of Law Governing Lawyers § 47 b (2000).

A comment provides an additional explanation.

> This Section does not prevent a law firm, of whatever form, from dividing income among its lawyers (including lawyers who are of counsel and temporarily employed) in any lawful way provided in the firm agreement or by an ad hoc arrangement. Principals of a partnership take responsibility for matters handled by any lawyer in it . . . , and the firm's fee must, of course, be reasonable . . . . Clients dealing with a

> firm usually know that the work and payment will probably be divided. In some firms, much of the fee will go to the lawyer who secures the case rather than to the lawyers doing the work. Under this Section, law-firm members may also share fees in making payments to former partners or associates under a separation or retirement agreement and may distribute fees among members of a dissolved firm for postdissolution work arising from matters entrusted to the firm before its dissolution . . . .

Restatement (Third) of Law Governing Lawyers § 47 b cmt. g (2000).

In some situations, this involves more than an academic issue. Lawyers and their former partners or associates sometimes litigate against each other over such a fee sharing.

- See, e.g., **[E 47 N 12/06]** Guggenheimer v. Bernstein Litowitz Berger & Grossman LLP, 810 N.Y.S.2d 880 (N.Y. Sup. Ct. 2006) (allowing an associate to sue her firm for failing to pay a promised "discretionary" bonus if the lawyer brought in business).

## Best Answer

The best answer to this hypothetical is **NO**.

# Lawyers Sharing Their Fees with an Organization for Whom the Lawyer Works

## Hypothetical 27

Because your parents were concentration camp victims, you have always devoted part of your practice to pro bono work designed to assure that the world does not tolerate such horrors again. Your latest project involved ferreting out the American assets of an Asian dictatorship that has repeatedly engaged in genocidal conduct. After one recent court victory, you were awarded substantial attorneys' fees. You would like to share some of the fees with the pro bono organization under whose auspices you work.

May you share some of your fees with the pro bono organization?

## YES

## Analysis

Both state bars and the ABA have addressed the propriety of lawyers sharing court-awarded fees with organizations for whom or with whom the lawyers work.

In addition to the fee-split issues, this situation also implicates the unauthorized practice of law rules. An organization which receives compensation for a representation that one of its lawyers undertakes could be seen as engaged in the practice of law. Of course, only certain institutions may do so.

The ABA has addressed fee-splitting with pro bono and for-profit organizations. The ABA has endorsed the former,[1] but condemned the latter.[2]

Courts disagree about this issue. One state bar permitted such fee sharing.

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[1] ABA LEO 374 (6/7/93) (a lawyer may share court-awarded fees with a pro bono organization the lawyer is representing).

[2] ABA LEO 392 (4/24/95) (a for-profit corporate employer may not share in fees generated by one of its in-house lawyers (above the level required to reimburse the corporation for any expenses incurred) and may not share in any court-ordered fees above the level required to reimburse the corporation).

- Virginia LEO 1744 (6/27/00) (a lawyer employed by a non-profit organization and a private practitioner who sometimes handles cases pro bono for the non-profit organization may share court-awarded attorneys' fees with the organization (although it would be unethical for a lawyer who accepts a pro bono case to charge or collect a contingent fee for the representation); the court's review of the fees and the fact that the client is not paying the fees eliminate any worry about fee-sharing or overreaching by the lawyers).

Another state bar took the opposite approach.

- **[E 1287 B 8/11]** **[please combine next 2]** Rhode Island LEO 2000-05 (6/14/2000) ("It is ethically improper under both Rule 5.4(a) and Rule 7.2(c) for a lawyer who undertakes pro bono representation in RI-ACLU sponsored litigation to pay a percentage of court-awarded attorneys' fees to the RI-ACLU."; "[T]he Panel is constrained to conclude that Rule 5.4(a) as written prohibits the inquiring attorney from sharing court-awarded fees with the RI-ACLU. See Mass. Bar Comm. On Prof. Ethics. Op. 97-6 (1997) (law firm may not donate court-awarded fees in pro bono matter to non-profit organization that referred matter); Texas Prof. Ethics Comm. Op. 503 (1994) (cooperating attorney cannot ethically agree to share court-awarded fees in civil rights cases with non-profit public interest organization). Notwithstanding the public policy considerations that would justify an additional exception to Rule 5.4(a) which would permit fee-sharing in the situation presented in this inquiry, the Panel declines to interpret such an exception where the language of the rule is clear on its face.").

- **[E 560 N 5/09]** Rhode Island LEO 2000-05 (6/14/00) (describing the issue as follows: "The inquiring attorney represents plaintiffs as cooperating counsel for the Rhode Island Affiliate of the American Civil Liberties Union (RI-ACLU), a not-for-profit corporation. The RI-ACLU receives requests for litigation assistance from individuals and organizations who believe their civil rights have been violated. If the RI-ACLU determines that it will sponsor and support a case, it provides the legal representation and pays for the costs of litigation at no cost to the litigants. The RI-ACLU seeks out private attorneys to serve as 'cooperating counsel for the RI-ACLU' on behalf of clients. The cooperating attorneys, the clients, and the RI-ACLU enter into written retainer agreements. Under the retainer agreement, the clients agree 'that any such court award of fees and/or costs shall be paid in full to the ACLU and the ACLU-RI, for them to distribute among counsel consistent with their own agreements.' The RI-ACLU requires that a percentage of court-awarded attorneys' fees be retained by or paid to the RI-ACLU. The inquiring attorney currently represents plaintiffs in RI-ACLU-sponsored litigation who, having been successful on the merits of their claim, are entitled to an award of attorneys' fees."; finding that such proposed action was improper; "It is ethically improper under both Rule 5.4(a) and Rule 7.2(c) for a lawyer who

undertakes pro bono representation in RI-ACLU sponsored litigation to pay a percentage of court-awarded attorneys' fees to the RI-ACLU.").

## Best Answer

The best answer to this hypothetical is **YES**.

# Lawyers Sharing Their Fees with Nonlawyers Outside the Firm

## Hypothetical 28

You have been successful in developing a practice representing plaintiffs in pursuing employment discrimination cases. For several years, you have worked with a detective agency that has been remarkably successful in uncovering useful facts and helping you put together winning strategies.

Last week, the head of the agency told you that she has assessed the value her agency has brought to your practice and intends to dramatically increase her rates. As an alternative, she has proposed that you agree to pay the agency a relatively small percentage of the fees you generate in the employment discrimination cases. She explains that this arrangement will help your clients by making sure that her services are available for clients who are pursuing relatively small cases while rewarding her for what she correctly perceives to be valuable assistance in the larger matters.

**(a)** May you enter into the arrangement the head of the detective agency has proposed?

**NO**

**(b)** If you cannot enter into the arrangement, what alternatives do you have?

**PROPOSE A DIFFERENT RATE STRUCTURE FOR DIFFERENT SIZE CASES**

## Analysis

**(a)** The ABA Model Rules explicitly indicate that except for certain situations (not applicable here),

> [a] lawyer or law firm shall not share legal fees with a nonlawyer.

ABA Model Rule 5.4(a). Accord ABA LEO 1519 (4/18/86) (a lawyer may not share a contingent fee with a nonlawyer research service).

States unanimously take the same approach.

- See, e.g., **[E 561 N 5/09]** New York LEO 565 (10/1/84) ("May an attorney employ a public relations and marketing firm to solicit potential clients for whom the attorney will provide prepaid legal services and pay such firm as compensation either a salary, commission or percentage of the annual fee charged to such clients by the attorney for legal services where the public relations firm will handle all advertising, inquiries, and initial correspondence on behalf of the attorney as well as the presentation and marketing of the prepaid legal services and such public relations firm will seek out corporations, non-profit organizations and various groups?"; concluding that "any compensation in the form of a commission or percentage based upon the volume of business developed would be clearly improper. Such form of compensation would tend to give the marketing firm a pecuniary interest in the success of the solicitation, and may lead to the use of hard-sell tactics or other improprieties.").

In fact, one court has analyzed the amounts earned by a lawyer and a nonlawyer in a cooperative arrangement (which did not involve explicit fee sharing) concluding that the lawyer was assisting the nonlawyer in the unauthorized practice of law.

- **[E 1481]** State of Indiana v. United Financial Sys. Corp., 2010 Ind. LEXIS 262 (Ind. April 14, 2010) ("The disparity of fees earned, between the Estate Planning Assistants and Health Planning Assistants on the one hand (between $750 and $900 per sale of the most expensive estate plan package) and the panel attorneys on the other hand ($225 for drafting the documents and consulting with the client by phone), is indicative of an emphasis on sales and revenue rather than the provision of objective, disinterested legal advice. So too is the fact that an estate plan is sold to the client prior to any attorney involvement whatsoever.").

On the other hand, some arrangements pass muster although they might seem like the sharing of fees between lawyers and their clients.

For instance, there might be an issue about whether an issue amounts to a fee sharing with a client. For instance, a 2009 Los Angeles legal ethics opinion permitted a lawyer to include within the gross recovery (for contingent-fee calculation purposes) a lawyer's statutory fee award. The Los Angeles Bar permitted such an arrangement.

- **[E 728 B 2/10]** Los Angeles LEO 523 (6/15/09) ("This Opinion addresses whether it is permissible, in a contingency representation, for the attorney and client to include within the gross recovery the statutory award of attorney's fees which, absent an agreement to the contrary, would otherwise belong to the attorney. This issue is whether such an agreement that allocates the gross recovery between the attorney and the client constitutes 'fee splitting' with a non-lawyer. The Committee believes that it does not.").

More recently, the Philadelphia Bar allowed a lawyer to share fees with a Washington law firm who had a nonlawyer partner (noting that such an arrangement was permissible in Washington but not in Philadelphia).

- **[E 1713]** Philadelphia LEO 2010-7 (9/10) (holding that a Pennsylvania lawyer may enter into a fee-sharing agreement with a Washington, D.C. law firm that has a nonlawyer partner, even though such an arrangement is not permitted in Pennsylvania; ". . . the Pennsylvania Rules do not permit fee sharing with non-lawyers while the DC RPC do. Conversely the DC RPC impose additional requirements to those of the Pennsylvania Rules in order for a fee to be divided between lawyers. Notwithstanding these differences, this Committee has repeatedly concluded that a Pennsylvania lawyer may share a fee with a non-Pennsylvania lawyer in accordance with Rule 1.5 regardless of a prohibition or limitation thereon by the Rules of Professional Conduct of the state in which the receiving lawyer practices. . . . [i]t is the Committee's opinion that although the DC firm might under some arrangement ultimately share profits with a non-lawyer pursuant to the DC RPC, the propriety of this fee-sharing arrangement under the PA RPC is not vitiated. The D.C. Firm is a duly constituted law firm under the DC RPC and therefore fee sharing in accordance with Rule 1.5 is appropriate.").

The analysis would become more difficult if the agency head proposed that you pay the agency a yearly "bonus." A general bonus might be acceptable, but any extra amount tied to the results in particular cases would be questionable.

**(b)** One alternative to sharing fees with the detective agency is to propose a different rate structure for different size cases.

## Best Answer

The best answer to **(a)** is **NO**; the best answer to **(b)** is **PROPOSE A DIFFERENT RATE STRUCTURE FOR DIFFERENT SIZE CASES**.

# Lawyers Sharing Their Fees with NonLawyer Employees of Their Law Firm

## Hypothetical 29

Two years ago, a legal assistant at your firm suggested that his neighbor hire your firm to handle a personal injury case against an armored car company. Your firm just settled the case for $2 million, meaning that your firm's contingent fee will amount to over $500,000. You think that the firm should pay a hefty bonus to the legal assistant.

May your firm pay a bonus to the legal assistant for recommending that your firm handle the personal injury case?

**NO**

## Analysis

**[What changes to put in paralegal guide from this document??]**

Although legal assistants are treated like lawyers for purposes of most ethics rules,[1] they are traditionally treated as nonlawyers for purposes of other rules, such as ABA Model Rule 5.4(a)(3):

> (a) A lawyer or law firm shall not share legal fees with a nonlawyer, except that: . . . (3) a lawyer or law firm may include nonlawyer employees in a compensation or retirement plan, even though the plan is based in whole or in part on a profit-sharing arrangement.

ABA Model Rule 5.4(a)(3).

A law firm's nonlawyer employees are probably also covered by the prohibition on rewarding someone for recommending a lawyer.

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[1] With respect to a nonlawyer employed or retained by or associated with a lawyer: (a) a partner in a law firm shall make reasonable efforts to ensure that the firm has in effect measures giving reasonable assurance that the person's conduct is compatible with the professional obligations of the lawyer. . . .

ABA Model Rule 5.3(a).

(a) Subject to the requirements of Rules 7.1 and 7.3, a lawyer may advertise services through written, recorded or electronic communication, including public media.

(b) A lawyer shall not give anything of value to a person for recommending the lawyer's services except that a lawyer may

(1) pay the reasonable costs of advertisements or communications permitted by this Rule;

(2) pay the usual charges of a legal service plan or a not-for-profit or qualified lawyer referral service. A qualified lawyer referral service is a lawyer referral service that has been approved by an appropriate regulatory authority;

(3) pay for a law practice in accordance with Rule 1.17; and

(4) refer clients to another lawyer or a nonlawyer professional pursuant to an agreement not otherwise prohibited under these Rules that provides for the other person to refer clients or customers to the lawyer, if

(i) the reciprocal referral agreement is not exclusive, and

(ii) the client is informed of the existence and nature of the agreement.

(c) Any communication made pursuant to this rule shall include the name and office address of at least one lawyer or law firm responsible for its content.

ABA Model Rule 7.2.

These Model Rules presumably prevent a law firm from paying a bonus to a law firm staff member for recommending the law firm.[2] On the other hand, at least one state bar has approved a law firm's payment of bonuses to secretaries based on the firm's overall profitability.[3]

Of course, as a preliminary matter it is obvious nonlawyers employed by the law firm may not form partnerships with lawyers for the practice of law.

It is clear that the ABA Model Rule's prohibition on sharing fees with nonlawyers applies to nonlawyer within the firm.

> A lawyer may not split legal fees with a paralegal nor pay a paralegal for the referral of legal business. A lawyer may compensate a paralegal based on the quantity and quality of the paralegal's work and the value of that work to a law practice, but the paralegal's compensation may not be contingent, by advance agreement, upon the outcome of a particular case or class of cases.

ABA Model Guidelines for Paralegals, Guideline 9. This simple rule can be remarkably difficult to apply in situations involving paralegals.

**Employee Nonlawyer.** The difficulty in applying the fee-split prohibition in connection with employee paralegals arises from the reality that all or nearly all of law firm employees' salaries come from the law firm's fees -- because most law firms earn all or most of their profits from providing legal services.

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[2] See, e.g., Virginia LEO 1572 (2/8/94) (a lawyer may not engage in an arrangement with a non-lawyer under which the non-lawyer refers cases to the lawyer, assists in helping the lawyer for a fee and in personal injury cases receives a percentage of the client's recovery; the arrangement impermissibly involves a lawyer: (a) paying the non-lawyer a referral fee for soliciting clients and; (b) splitting fees with a non-lawyer).

[3] See, e.g., Virginia LEO 806 (6/25/86).

- **[E 1286 8/11]** Philadelphia LEO 2004-3 (6/2004) ("Clearly, any law firm profits are obtained from legal fees, and thus in its simplest sense, any compensation plan by definition is based on a share of fees paid by clients."; "[A] share of firm-wide net profits by a non-lawyer employee, tied to the total of firm profits, and not the gross proceeds of fees from cases brought in by the non-lawyer employee, nor tied to limited types of cases would not be prohibited."; "On the other hand, if the bonus plan by design is limited to a percentage of the profits generated from the fees earned just on cases referred by the Marketing Director, then the compensation plan would actually be a sophisticated fee sharing arrangement and hence prohibited. As the firm grows and different matters are referred through various sources, the profit sharing plan must be based on all the profit from all the cases handled by the firm. If for some reason none of the case [sic] referred by the Marketing Director produced any profit, but the firm was profitable because of other referral sources in other matters, the Marketing Director would still have to be entitled to his 20% of all the firm profits in order for the plan to be considered in compliance with Rule 5.4a3.").

- District of Columbia LEO 322 (2/17/04) ("in a sense, even paying nonlawyer employees a salary could be viewed as a sharing of fees, since fees are the firm's source of revenue").

To make matters more complicated, most ethics rules permit law firms to include their nonlawyer employees in profit-sharing arrangements. ABA Model Rule 5.4(a)(3) ("a lawyer or law firm may include nonlawyer employees in a compensation or retirement plan, even though the plan is based in whole or in part on a profit-sharing arrangement").

Lawyers can clearly also reward paralegals' good work.

> There is no general prohibition against a lawyer who enjoys a particularly profitable period recognizing the contribution of the paralegal to that profitability with a discretionary bonus so long as the bonus is based on the overall success of the firm and not the fees generated from any particular case.

ABA Model Guidelines for Paralegals, cmt. to Guideline 9.

The ABA has explained that lawyers can more generously reward the most productive paralegals.

> Likewise, a lawyer engaged in a particularly profitable specialty of legal practice is not prohibited from compensating the paralegal who aids materially in that practice more handsomely than the compensation generally awarded to paralegals in that geographic area who work in law practices that are less lucrative.

ABA Model Guidelines for Paralegals, cmt. to Guideline 9.

However lawyers cannot reward paralegals for bringing specific cases to the firm.

> In addition to the prohibition on fee splitting, a lawyer also may not provide direct or indirect remuneration to a paralegal for referring legal matters to the lawyer.

ABA Model Guidelines for Paralegals, cmt. to Guideline 9.

States generally permit law firms to share law firm profits with nonlawyers, as long as the profitability is measured on a firm-wide basis. However, law firms generally cannot share fees earned on a particular matter with specific nonlawyers.

In trying to balance these seemingly inconsistent principles, most bars have struck what at first blush seems like an artificial distinction.

- **[COMBINE NEXT THREE] [E 1471]** Formal Advisory Op. 05-4, 281 Ga. 749, 2007 Ga. LEXIS 239 (Ga. 2007) ("We agree with the board that under current Georgia Rule of Professional Conduct 5.4, the payment of a monthly bonus by a lawyer to nonlawyer employees based on the gross receipts of his or her law office in addition to the nonlawyer employees' regular monthly salary is permissible; and that it is ethically proper to compensate nonlawyer employees pursuant to a plan that is based in whole or in part on a profit-sharing arrangement."; explaining that in 2000 Georgia changed its ethics rules to "enlarge" [_____] the circumstances under which a lawyer or law firm may share legal fees with a nonlawyer," because the new rule permits a lawyer or law firm to include nonlawyers in a "compensation . . . plan, even though the plan is based in whole or in part of a profit-sharing arrangement").

- **[E 166 N 1/08]** Formal Adv. Op. 05-04, 642 S.E.2d 686, 686, 687 (Ga. 2007) (approving a law firm's payment of a nonlawyer employee "a monthly bonus from the gross proceeds of the lawyer's firm"; noting that under the old ethics rules a lawyer could share fees with a non-lawyer only as part of a retirement

plan, while the new ethics rules allow lawyers to share legal fees with non-lawyers as part of a "compensation or retirement plan").

- **[E 562]** Formal Advisory Opinion 05-4, 642 S.E.2d 686, 686 (Ga. 2007) ("[W]e agree with the board that under current Georgia Rule of Professional Conduct 5.4, the payment of a monthly bonus by a lawyer to nonlawyer employees based on the gross receipts of his or her law office in addition to the nonlawyer employees' regular monthly salary is permissible; and that it is ethically proper to compensate nonlawyer employees pursuant to a plan that is based in whole or in part on a profit-sharing arrangement."). **Nancy's comment -- this is probably cited in Tom's format Georgia LEO 05-04, but not here because of reporter cite. You could add it in brackets after the court/year parenthetical**

- **[E 1286 B 8/11]** Philadelphia LEO 2004-3 (6/2004) ("Clearly, any law firm profits are obtained from legal fees, and thus in its simplest sense, any compensation plan by definition is based on a share of fees paid by clients."; "[A] share of firm-wide net profits by a non-lawyer employee, tied to the total of firm profits, and not the gross proceeds of fees from cases brought in by the non-lawyer employee, nor tied to limited types of cases would not be prohibited."; "On the other hand, if the bonus plan by design is limited to a percentage of the profits generated from the fees earned just on cases referred by the Marketing Director, then the compensation plan would actually be a sophisticated fee sharing arrangement and hence prohibited. As the firm grows and different matters are referred through various sources, the profit sharing plan must be based on all the profit from all the cases handled by the firm. If for some reason none of the case [sic] referred by the Marketing Director produced any profit, but the firm was profitable because of other referral sources in other matters, the Marketing Director would still have to be entitled to his 20% of all the firm profits in order for the plan to be considered in compliance with Rule 5.4a3.").

- District of Columbia LEO 322 (2/17/04) (reviewing legal ethics opinions from other states, and concluding that the opinions nationwide "generally stand for the proposition that paying a percentage of firm net profits to nonlawyer employees is permissible, whereas paying a percentage of a fee in an identifiable case or series of cases is not").

- **[E 628 7/09]** Pennsylvania LEO 98-75 (12/4/98) ("Rule 5.4(a)(3) permits nonlawyers to share in a compensation or retirement plan, even though the plan is based in whole or in part on a profit-sharing arrangement. Thus, for example, it would be proper to compensate a law firm administrator on the basis of a fixed salary plus a percentage of the firm's net profits; he could similarly participate in a profit-sharing retirement plan.").

- **[E 1289 B 8/11; N 2/12]** New York County Law. Ass'n LEO 687 (11/11/91) ("A lawyer may employ a tax accountant to work with clients in accounting and tax matters and may pay such an employee a bonus over and above the employee's salary, as long as the bonus is not based on the billings of the accountant but rather is a fixed amount, a percentage of the employee's salary or is based on the profits of the firm.").

- **[E 1470]** Arizona LEO 90-14 (10/17/90) ("A law firm that pays a non-lawyer incentive compensation which is measured by a percentage of increased revenues is not in violation of the Arizona Rules of Professional Conduct."; ". . . the American Bar Association Committee on Ethics and Professional Responsibility, when faced with facts similar to those here opined that such a compensation scheme did not violate the Model Code. A.B.A. Informal Opinion 1440 (August 12, 1979)."; "That Opinion responded to an inquiry of a law firm which employed a non-lawyer administrator to manage the firm's nonprofessional business matters. The firm proposed to pay the administrator a fixed annual salary supplemented by a percentage of the firm's net profits. This compensation scheme was designed to encourage the administrator to increase the firm's operating efficiency and productivity. The A.B.A. Committee concluded that this proposal did not violate DR 3-102 because the compensation related to the net profits and business performance of the firm and not to any particular legal fees."; "[T]he Massachusetts Bar Committee concluded that it was not ethically proper for a law firm to compensate a non-lawyer employee based on a percentage of the firm's profits. . . . Apparently, the Massachusetts Bar Committee disagreed with the distinction made in Informal Opinion 1440 between sharing legal fees and sharing a law firm's revenues."; "Both of the above argument rest on the assumption that the marketing director has no influence over any lawyer's exercise of professional judgment. If this assumption is incorrect, the firm's proposal violates the ethical policy behind ER 5.4."; noting that three members of the Committee dissented from the majority opinion).

Several courts and bars have specifically condemned a lawyer's bonus payments to a nonlawyer based on the business that the nonlawyer generated.

- **[combine with three]** **[E 553 B 3/09]** Delaware LEO 2009-1 (2/2/09) (finding unethical a law firm's arrangement with a "Marketing Professional" that would provide incentive bonuses based on increases in the firm's revenues, and a "[p]ercentage of revenues received by the Firm from the new clients through the efforts of the Marketing Professional"; "This Committee is of the opinion that the method of compensation cannot be dependent upon a percentage of the fees of the firm, whether such fees are based upon total revenues, revenues from existing clients, revenues from new clients, or new clients generated by the marketing professional."; "Other opinions that would similarly prohibit payment to a nonlawyer employee, based upon a

percentage of fees, include: Florida Bar Association Ethics, Opinion 89-4 (Nonlawyer marketing director cannot be paid commissions representing a percentage of fees generated from business he has brought to the firm.); Committee on Ethics of the Maryland State Bar Association, Opinion 92-1) (Personal injury lawyer cannot award bonus to nonlawyer who generates fees.); New York County Lawyers' Association Committee on Professional Ethics, Opinion No. 687 (Law firm may employ tax accountant, provided compensation or bonus is not calculated upon the billings; however, such compensation or bonus may be based upon profits, a fixed amount, or a percentage of salary.); New York County Lawyers' Association Committee on Professional Ethics, Opinion No. 720. (A lawyer may use nonlawyer consultant to prepare advertising, provided he complies with the rules on advertising; but compensation may not be tied to success or failure of the solicitation; and compensation may not be on a contingent basis.)"; "In conclusion, compensation of a nonlawyer based upon a formula using a percent of total revenues, increased revenues generally, increased revenues from new clients, and revenues of new clients received by the efforts of the Marketing Professional, would be violative of DLRPC 5.4(a) and 7.2(b).").

- **[E 1490]** Delaware LEO 2009-01 (2/2/09) (holding that a law firm could not compensate a marketing professional with a percentage of increased revenues; explaining the factual background; "The Firm would provide the Marketing Professional with a compensation package that the Firm hopes will conform with the prohibition against fee sharing contained in Rule 5.4 of the Delaware Lawyers' Rules of Professional conduct (hereinafter 'DLRPC'). The compensation package would consist of three components: (i) salary, (ii) benefits, and (iii) incentive bonuses. The amount of incentive bonuses would be determined by a formula that would include the following four factors: (1) Increase in the Firm's total revenues; (2) Increase in revenues received by the Firm from existing clients; (3) Revenues received by the Firm from new clients; (4) Percentage of revenues received by the Firm from the new clients through the efforts of the Marketing Professional."; ultimately holding that "compensation of a nonlawyer based upon a formula using a percent of total revenues, increased revenues generally, increased revenues from new clients, and revenues of new clients received by the efforts of the Marketing Professional, would be violative of DLRPC 5.4(a) and 7.2(b).").

- **[E 1268 10/11]** Delaware LEO 2009-1 (2/2/09) (explaining the limits on how lawyers can reward nonlawyers for marketing the lawyers' services; "This Committee is of the opinion that the method of compensation cannot be dependent upon a percentage of the fees of the firm, whether such fees are based upon total revenues, revenues from existing clients, revenues from new clients, or new clients generated by the marketing professional.").

- **[E 563 N 5/09]** Bolen v. Crowe (In re Holmes), 304 B.R. 292, 295-96, 297-98 (N.D. Miss. 2004) ("There is no dispute that Crowe paid his non-attorney staff

$ 5.00 bonuses each time one of the following events occurred: a. When the clients paid at least $ 300.00 and executed a retainer agreement[;] b. When the clients completed and returned their bankruptcy questionnaires[;] c. When the clients signed the living wills/durable powers of attorney. Excepting the total amount of bonuses actually paid, the factual circumstances relevant to this question are undisputed. The question is, therefore, whether Crowe's practice of paying bonuses for the aforementioned events constitutes an impermissible 'fee-splitting' or 'fee-sharing' arrangement proscribed by § 504 of the Bankruptcy Code, Rule 2016(b) of the Federal Rules of Bankruptcy Procedure, and Rule 5.4(a) of the Mississippi Rules of Professional Conduct."; "The court is of the opinion that Crowe has indeed shared compensation with his non-lawyer staff. This practice is not identical to the payment of salaries. Rather, it is a payment to motivate and encourage specific events. The arrangement conveys a pecuniary interest to the non-lawyer employee that is directly dependent on a decision that the client is called upon to make. This practice violates § 504(a) of the Bankruptcy Code in addition to Rule 5.4(a) of the Mississippi Rules of Professional Conduct.").

- **[E 564 N 5/09]** Trotter v. Nelson, 684 N.E.2d 1150, 1151 & 1155, 1155 (Ind. 1997) (prohibiting a lawyer from paying a nonlawyer a bonus based on business that the nonlawyer brought to the firm; "Nelson [a law firm employee who 'began her employment in what was essentially a clerical capacity' and whose 'duties and responsibilities enlarged over time'] is attempting to escape the reach of the Rules simply by re-characterizing as a profit-sharing plan what is clearly a referral fee agreement. The alleged agreement, as Nelson herself describes it, ties her 'bonus' to 'certain personal injury cases directed by or through her' to Trotter."; "To the extent that Nelson's claims for remuneration rely upon the enforcement of the alleged agreement, we instruct the trial court to grant Trotter's motion for partial summary judgment. We do this despite the fact that, if Nelson is correct, Trotter has committed a gross violation of the Conduct Rules and would have essentially entered into a contract which he knew to be unenforceable and now seeks to escape. . . . We note in closing that Nelson is not entirely precluded from being remunerated for the work she believes she has done; she is precluded only to the extent that she relies upon the enforceability of the alleged referral fee agreement.").

- Kansas LEO 95-09 (10/25/95) ("It is a reasonable process to base an employee's bonus on the success of the firm overall. It is the case by case, collection by collection-based bonus that we opine is impermissible here. The frequency of such bonuses is not a consideration, so long as the bonus or other salary consideration is not based upon a fee-by-fee, case-by-case formula, but rather relies on the net profit of the firm formula.").

- North Carolina LEO 147 (1/15/93) (ruling as unethical a proposed compensation plan under which real estate paralegals would receive bonuses

"calculated on the firm's net income from the real estate closings which the legal assistant has worked on," even if the bonuses were discretionary and the calculations were used for "guidance only"; "[i]t is apparent from the inquiry that the paralegal's bonuses would be calculated based upon a percentage of the income the firm derives from legal matters on which the paralegal has worked" -- which violates the fee-split rules).

- State Bar of Texas v. Faubion, 821 S.W.2d 203 (Tex. App. 1991) (condemning an arrangement under which a paralegal/investigator was paid a percentage of gross fees calculated based upon [the paralegal's] time involvement in a particular case; explaining that bonuses do not constitute improper fee-splitting if the bonuses are not based on a percentage of the firm's profits or legal fees).

Somewhat surprisingly, some older legal ethics opinions seem to permit such case-specific compensation.

- Michigan LEO RI-143 (8/25/92) (approving a law firm's compensation arrangement under which paralegals working in the law firm's "sports and entertainment law practice area" would receive compensation based on "a percentage of the firm's net profits derived from the sports and entertainment law practice area"; concluding that Michigan's rule allowing nonlawyers to participate in a profit-sharing arrangement was not limited to calculations based on "net profits of the law firm's entire practice" rather than "net profits of a law practice area" (emphasis added); noting that "the result might be different if the compensation plan were based on the fees generated from a particular case or a particular client, rather than net profits of the law practice area of the firm").

- Connecticut LEO 93-1 (1/27/92) (approving a law firm's compensation arrangement under which a part-time paralegal receives a weekly salary and "periodic bonuses" amounting to $40.00 for "every set of Chapter 7 or Chapter 13 bankruptcy schedules drafted" and "$5.00 per hour for every billable hour recorded by the paralegal on client work other than Chapter 7 and Chapter 13 debtor clients" (internal quotations omitted)).

Some newer legal ethics opinions take the same liberal approach.

- Florida LEO 02-1 (1/11/02) (prohibiting a lawyer from paying paralegals and other nonlawyer employees "based on the number of hours the non-lawyer [sic] employee has worked on a case for a particular client" (internal

quotations omitted); explaining that a lawyer "may pay the firm's legal assistant a bonus, but that bonus cannot be based in any way upon a percentage of fees generated by the legal assistant or the firm and cannot be based upon generating clients for the firm. Bonuses to non-lawyer [sic] employees cannot be calculated as a percentage of the firm's fees or of the gross recovery in cases on which the non-lawyer [sic] worked."; concluding that "the inquiring attorney may pay the legal assistant a bonus based on the legal assistant's extraordinary efforts on a particular case or over a specific period of time. While the number of hours the legal assistant works on a particular case or over a specific period of time is one of several factors that can be considered in determining a bonus for the legal assistant, it is not the sole factor to be considered. . . . A bonus which is solely calculated on the number of hours incurred by the legal assistant on the matter is tantamount to a finding that every single hour incurred was an 'extraordinary effort,' and such a finding is very unlikely to be true. Therefore, unless every single hour incurred by the legal assistant was a truly extraordinary effort, it would be impermissible for the inquiring attorney to pay a bonus to his legal assistant calculated in the manner the inquiring attorney has proposed. However, the number of hours incurred by the legal assistant on the particular matter or over a specified time period may be considered by the lawyer as one of the factors in determining the legal assistant's bonus.").

- South Carolina Advisory Op. 97-02 (3/97) (approving a law firm's compensation arrangement under which paralegals receive monthly or semi-annual payments "calculated as a percentage of the amount that the paralegal has billed to clients for services rendered"; contrasting this arrangement with an impermissible plan under which "the bonus is based on a percentage of a particular fee earned").

Several courts have dealt with an interesting issue -- May a law firm's nonlawyer sue to enforce an agreement that amounts to an ethics violation by the lawyer?

One court prohibited such a lawsuit based on the agreement that was contradictory to pubic policy.

- **[E 1285 B 8/11]** Trotter v. Nelson, 684 N.E.2d 1150, 1151, 1152, 1155 (Ind. 1997) (analyzing an arrangement under which a nonlawyer employed by a lawyer sued the lawyer for his failure to pay her "money for referring clients" to the lawyer; explaining that Nelson "began her employment in what was essentially a clerical capacity," but acknowledging that "her duties and

responsibilities enlarged over time"; "The question which we must answer is whether a referral fee agreement between an attorney and a non-attorney employee is against public policy and, therefore, unenforceable. We earlier granted transfer and now hold that the alleged agreement is against public policy and is unenforceable." (footnote omitted); "Nelson initiated this suit because she believed that Trotter had not fully compensated her for the work that she had done. One of her allegations is that she and Trotter had an agreement, beginning in early 1987, whereby she was to receive five percent of any fees which resulted from a personal injury or worker's compensation case that she had a role in referring to Trotter. There is no written recording between the parties as to the alleged agreement."; "[A] profit-sharing plan with a nonlawyer may not be tied to the receipt of a particular legal fee. However, an attorney may fashion a profit-sharing plan for his or her nonlawyer employees so long as the measure of compensation 'relates to the net profits and business performance of the firm, and not to the receipt of particular fees.' ABA Comm. On Ethics and Professional Responsibility, Informal Op. 1440 (1979). . . . The agreement as alleged by Nelson is not based upon a percentage of the overall profits of the law office, nor is it intended to provide an incentive and reward for input which led to the greater overall efficiency and productivity of the law office. These are elements that are necessary for a profit-sharing plan to be permissible under Rule 5.4(a)(3)."; ultimately concluding that the alleged agreement was contrary to public policy and therefore unenforceable; noting "that Nelson is not entirely precluded from being remunerated for the work she believes she has done; she is precluded only to the extent that she relies upon the enforceability of the alleged referral fee agreement."; also explaining that the lawyer might have committed a "gross violation" of the ethics rules by entering into a contract "which he knew to be unenforceable").

A more recent opinion took the opposite position on this issue.

- **[E 350 B 1/09; N 1/10]** Patterson v. Law Office of Lauri J. Goldstein, P.A., 980 So. 2d 1234, 1237-38 (Fla. Dist. Ct. App. 2008) (allowing a paralegal to sue a law firm to enforce a lawyer's verbal agreement to pay the paralegal a percentage of fees earned in cases on which the paralegal worked; finding that the agreement violated the ethics rules, but nevertheless allowing the paralegal to enforce it; "In the instant case, Patterson [paralegal], who is not a member of the Florida Bar, is (a) not regulated by the Rules Regulating the Florida Bar and (b) did not have knowledge that Goldstein was breaking the Rules. We therefore find that Patterson was an innocent party and not in pari delicto to this fee-sharing agreement. We conclude that the agreement is enforceable by Patterson, who was not in pari delicto, notwithstanding the fact that it implicates Rule 4-5.4(a)(4). While we recognize generally that the Rules of Professional Conduct of the Rules Regulating the Florida Bar promote the public interest, we find that the public interest is not advanced if an attorney is permitted to promise a bonus arrangement that violates the fee-

sharing rule, and then invoke the Rules as a shield from liability under that arrangement. We specifically limit our holding to the factual circumstances of this case involving an employment relationship between an attorney and a paralegal. This opinion is not to be construed to apply to a proscribed referral fee arrangement, which is distinguishable because it raises a separate set of policy considerations.").

**Independent Contractor Nonlawyers.** Interestingly, one bar has found that independent contractor paralegals should be treated under a different approach.

- Utah LEO 02-07 (9/13/02) (lawyers may hire a paralegal on an "independent contractor basis" as long as the lawyer controls the work; explaining that a lawyer's employees may be compensated with a percentage of the gross or net income of the lawyer (as long as the compensation is "not tied to specific fees from a particular case"), but that an independent contractor legal assistant may not receive a percentage of a lawyer's gross or net income, and instead must be "totally independent from the lawyer's relationship with, and compensation from, the client"; explaining that "the apparent difference between the permissible sharing of fees for employee-paralegals and the impermissible sharing of fees with an independent contractor stems from the nature of the lawyer/paralegal relationship, the employee-paralegal, being an employee of the lawyer, is not in a position to exert undue influence on the lawyer. The independent paralegal would be in a less subordinate role.").

## Best Answer

The best answer to this hypothetical is **NO**.

# Nonlawyers Sharing Their Fees with Lawyers

## Hypothetical 30

For several years, you have referred clients to a financial planner whose office is just one floor above yours. All of your clients have been very pleased with her work. This morning the financial planner suggested entering into a more formal arrangement. Under her proposal, she would pay you ten percent of any fee that she generates from her work for a client you refer to her. Of course, both of you recognize that you would have to make full disclosure to the clients and obtain their consent to your sharing in the financial planner's fees.

If your clients consent, may you share in the fees earned by the financial planner for work she performs for the clients that you send to her?

## YES (PROBABLY)

## Analysis

The issue here is whether lawyers may share fees earned by a nonlawyer.

At first blush, it might seem that the prohibition against lawyers sharing their fees with nonlawyers should apply with equal force to nonlawyers sharing their fees with lawyers. However, there is no specific ethics rule that prohibits this practice, as long as the client consents after full disclosure, and the lawyer complies with all of the ethics requirements of doing business with a client. ABA Model Rule 1.8(a).

Some state bars have indicated that such an arrangement can pass ethical muster if the client consents after full disclosure.

- Michigan LEO RI-317 (2/14/00) ("A lawyer may accept a referral fee from an investment advisory firm, provided the client consents in writing following the lawyer's full disclosure of the lawyer's interest to the client, and the lawyer advises the client that the client is entitled to seek services from other investment advisory firms and to obtain independent counsel before deciding whether to seek services from that investment advisory firm."); Utah LEO 99-07 (12/3/99) (a lawyer referring a client to an investment adviser may share in the investment adviser's fees if the client consents after full disclosure; agreeing with the approach taken by Connecticut and Missouri; disagreeing

with Arizona, Kentucky, Nevada and New York opinions finding such a practice per se unethical); Illinois LEO 97-04 (1/23/98) ("A lawyer may not properly take a referral fee from an investment advisor for referring a client to the advisor unless the lawyer rebuts the presumption of undue influence that arises when a lawyer enters into a business transaction with the client; the presumption may be rebutted by showing the transaction was fair, the client had the opportunity for independent advice of counsel and consented to the transaction after full disclosure"); Virginia LEO 1581 (2/8/94) (a lawyer may accept a fee or commission for referring clients to a company which buys notes and other forms of commercial paper secured by real estate, as long as there is full disclosure and consent (since the commission is a non-legal fee) and the lawyer does not represent the client in connection with the company's purchase of the note.).

Other bars have rejected such arrangements as per se unethical.

- Ohio LEO 2000-1 (2/11/00) ("It is ethically improper for a lawyer to accept a fee from a financial services group for referring clients in need of financial services"); Arizona Opinion No. 98-09 (11/98) ("A lawyer ethically cannot accept a fee from an investment adviser for referring clients of the lawyer to the adviser. Such a referral arrangement would present a conflict of interest for the lawyer, in violation of ER 1.7(b)"); New York LEO 682 (6/7/96) (such an arrangement is per se unethical); Kentucky LEO B-390 (7/96) (such an arrangement is per se unethical).

The trend is clearly in favor of prohibiting such arrangements.

- **[E 1352]** North Carolina 2006-2 (4/21/06) (holding that a lawyer cannot accept a "finder's fee" from a financing company to which a lawyer refers a client).

- **[E 1133 B 5/10]** North Carolina LEO 2005-7 (10/21/05) ("[A]n attorney may recommend that a prospective client use a computer in the attorney's office and the services of an Internet-based company to complete a required bankruptcy certification form."; "[T]he attorney must determine that the use of the services of HCCE, or whatever third party company he recommends, is in the best interest of the client. To avoid conflicts of interest, the attorney may not earn a commission or a fee on the entrance requirement. See RPC 238. There must be full disclosure to the prospective client that the fee for the entrance requirement is being paid to the third party provider and that no portion of that fee goes to the attorney.").

- **[E 17 N 12/06]** Maine LEO 184 (3/30/04) (prohibiting a lawyer from receiving compensation from an investment advisor in exchange for the lawyer's referring clients to the advisor, although the lawyer would disclose to the client in writing that the lawyer would receive a portion of the advisor's management fee; holding that the arrangement would violate the prohibition on lawyers acquiring a pecuniary interest adverse to the client, and would amount to the collection of an excessive fee; listing other states' holdings on this issue, which take differing positions).

- **[E 1121 N 2/10]** North Carolina LEO 2001-9 (10/19/01) (holding that a lawyer may recommend the purchase of financial products from a client of the lawyer, but may not receive a commission for the sale of such products; "Rule 1.8(b), however, does not prevent an attorney from providing law-related services to a legal client, so long as the attorney fully discloses his self-interest in the referral and the referral is in the best interest of the client. 2000 Formal Ethics Opinion 9 was not intended and does not create an exception to Rule 1.8(b). That opinion allows an attorney to provide accounting services to his legal clients. Nothing in the opinion specifically permits an attorney/CPA, who holds an appropriate license, to sell securities or other products to a client and profit from the sale. An attorney may, however, provide accounting, financial planning, or other law-related services to a client and charge a fee for rendering those services. An attorney may also provide financial products to the client, but may not profit from the sale of those products by charging either an additional fee or a commission.").

- **[E 1546]** New York LEO 731 (7/27/00) ("[A] lawyer may not ethically refer to a client in a real estate transaction to a title company in which the lawyer holds an interest. It follows that a lawyer may not compensate the lawyer's employees for making such referrals.").

- **[E 1353]** North Carolina LEO 99-1 (4/23/99) (holding that a lawyer may not accept a referral fee or a solicitor's fee for referring a client to an investment advisor; "Although the law may permit such payments under certain circumstances, the Revised Rules of Professional Conduct impose a higher standard of conduct. A lawyer must exercise independent professional judgment on behalf of a client when referring a client to a third party for services related to the subject matter of the legal representation. . . . If a lawyer will receive a referral fee from the third party, the lawyer's professional judgment in making the referral is or may be impaired. Written disclosure to the client will not neutralize the potential for the lawyer's self-interest to impair his or her judgment. Other ethics opinions are consistent with this holding. CPR 241 rules that a lawyer who sells insurance should not sell insurance to clients for whom he has done estate planning. Similarly, RPC 238 permits a law firm to provide financial planning services provided no commission is earned by anyone affiliated with the firm.").

- **[E 18 N 12/06]** Vermont LEO 98-8 (1998) ("A lawyer may not accept a fee from an investment advisor for referring clients to the advisor even with prior disclosure and consent by the client. Clients view recommendations to other professionals as part of their representation by their lawyers and expect their lawyers to act independently of any underlying financial interest in such a referral.").

Only one bar seems to have taken a contrary view in recent years.

- See, e.g., **[E 422** N 9/08 (This was cited to Pennsylvania, but I couldn't find it there) B 1/09**]**-- **[CHECK THIS]** Philadelphia LEO 2008-7 (5/2008) (holding that a lawyer representing a lender in a commercial real estate development may refer the borrower to a title insurer and receive a referral fee from the title insurer, as long as the lawyer makes full disclosure to the lender, borrower and title company).

The reason for such a prohibition seems obvious at first blush. Lawyers should be guided in their recommendations by the client's best interest to find the appropriate service provider -- not by the percentage of fees that the service provider might share with the referring lawyer. In essence, the bars prohibiting such a practice do not trust lawyers to makes their decision on other than for selfish grounds, based on what monetary benefit they might derive from their referral.

On the other hand, it would seem paternalist to prohibit such arrangements per se, even if the client approved the arrangement after a full disclosure. In addition, no ethics rules totally prohibit informal and non-binding referral arrangements between lawyers and nonlawyers. It would be naive to think that a lawyer would not expect at least some service provider the lawyer recommends to a client not to keep that in mind when the service provider must refer his or her client to a lawyer. In other words, a lawyer who permissibly recommends a financial planner to the lawyer's clients almost

surely expects some return referrals from that financial consultant. Absent some improper binding arrangement of this sort, or evidence of a client's injury caused by some referral, no bar seems to have punished a lawyer for such an expectation or arrangement.

## Best Answer

The best answer to this hypothetical is **PROBABLY YES**.

# Third Party Paying a Lawyer's Fees and Expenses

## Hypothetical 31

You represented a husband and wife in preparing their fairly simple estate plan, which involved each leaving all of their assets to the other upon death. About two years after you finished working for this couple, you learn that they have divorced. You just received a call from the woman, who says that she will soon be marrying someone else, and wants you to represent her in redoing her estate plan.

May you represent the woman in handling her estate plan without her former husband's consent?

## YES (PROBABLY)

## Analysis

**[Analysis stolen from Basic II -- hypo 1 -- Bev -- update as needed]**

The basic conflicts rule governing adversity to former clients primarily rests on a duty of confidentiality, rather than on a duty of loyalty.

Unlike the analysis when a lawyer considers adversity to a current client, this assessment therefore must consider the nature of the earlier representation, and the substance of the information the lawyer learned or was likely to have learned in the earlier representation. The bottom-line rule is that lawyers may not (absent consent) be adverse to a former client if:

- the adversity is in the "same" or "substantially related" matter as the earlier representation; or
- the lawyer acquired material confidential information that could now be used to the former client's disadvantage.

ABA Model Rule 1.9(b).[1] Restatement (Third) of Law Governing Lawyers § 132 (2000).

[1] ABA Model Rule 1.9(a) ("A lawyer who has formerly represented a client in a matter shall not thereafter represent another person in the same or a substantially related matter in which that person's

These principles might apply to a lawyer who has prepared an estate plan for multiple clients who have now become adverse to one another. For instance, a lawyer who represented both a husband and wife in their estate planning normally can continue representing the wife in his estate planning if the husband and wife divorce -- as long as the lawyer is not misusing confidential information the lawyer obtained from the husband while representing the husband, and as long as the lawyer's work does not assist the wife in violating some contractual obligation to which she agreed during the marriage.

The lawyer's work for the wife normally would include directing her assets to someone other than her former husband (the lawyer's former client), but that financial adversity does not violate the ethics rules.

- See, e.g., **[E-1548 -- not cite checked]** Maryland LEO 86-62 (1986) (addressing the following situation: "You present the following factual situation. Your law firm previously represented both a husband and wife in an adoption matter and in preparing their Wills, the latter having occurred in 1981. Subsequently, the husband and wife obtained a divorce, each having separate representation by firms other than yours, at your insistence. The husband now requests you to redraft his Will, deleting his former wife as a legatee."; ultimately holding that "[t]he Committee does not believe that there is any inherent conflict in your situation such that you would have to automatically refuse representation of the husband.").

Although the ethics rules probably would allow a lawyer to redo an estate plan for one of two jointly represented clients after the clients' divorce, the ACTEC Commentaries explain that

> **[ACTEC - 19 -- ending section only** N 1/10**]** [s]ome experienced estate planners who represented both spouses in connection with estate planning matters prior to the commencement of a dissolution proceeding decline to

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interests are materially adverse to the interests of the former client unless the former client gives informed consent, confirmed in writing.").

> represent either of them in estate planning matters during and after the proceeding.

American College of Trust & Estate Counsel, Commentaries on the Model Rules of Professional Conduct, Commentary on MRPC 1.9, at 124 (4th ed. 2006), http://www.actec.org/Documents/misc/ACTEC_Commentaries_4th_02_14_06.pdf.

The ACTEC Commentaries' recommendation might be based as much on social considerations as ethics considerations.

The Restatement also deals with a somewhat unusual situation, an adverse party paying a lawyer's fees and expenses.

> Prevailing litigants in some types of litigation are entitled to recover attorney fees from an opposing party. On possible conflict-of-interest considerations in such cases, . . . . A litigant might be awarded a monetary sanction imposed on the opposing party . . . . Most fee statutes provide for recovery by a "prevailing party" rather than the party's lawyer. Under this Section, if a lawyer for the prevailing litigant does not foresee and contract for the possibility of a court-awarded fee consistently with §§ 18 and 34, the client rather than the lawyer is entitled to any such fee and can settle or waive the right to recover such a fee. The lawyer will recover from the client the fee otherwise contracted for or, in the absence of any contract, the fair value of services the client received as provided in § 39.

Restatement (Third) of Law Governing Lawyers § 38 cmt. f (2000). The Restatement also deals with whom should receive the fee award.

> However, the fee award would go to the lawyer rather than the client if the parties had reached an enforceable contract so providing or if law or the tribunal so directed. Such a contract must comply with §§ 18 and 34-37, but would not ordinarily constitute a client-lawyer business arrangement subject to § 126. Also, in a suit in which a fee

> award is available, if client and a lawyer have neither agreed to a basis or rate for a fee nor agreed that the lawyer will serve without payment, it is ordinarily appropriate to assume that the lawyer's fee is to be any attorney-fee award. A contract providing that a lawyer is to receive both a standard contractual fee and a fee award, without crediting the award against the contractual fee, is presumptively unreasonable under § 34

Restatement (Third) of Law Governing Lawyers § 38 cmt. f (2000).

Several illustrations provide some guidance about how this principle works.

> Lawyer agrees to represent Client in a lawsuit for an hourly fee. Because the opposing party defends the suit in bad faith, the court orders that party to pay reasonable attorney fees. The payment goes to Client, not Lawyer, unless they have otherwise agreed. A contract that Lawyer should receive the payment might sometimes be inferred from the circumstances, for example if the lawyer was to be paid a flat fee and the opposing party's bad faith had greatly extended the services required beyond what might have been expected.
>
> Lawyer agrees to represent Client in a lawsuit without discussing attorney fees or the possibility that the opposing party will be ordered to pay attorney fees. The suit is brought under a statute that has been construed to entitle virtually all prevailing plaintiffs to attorney fees. Client prevails, recovering $10,000 in damages and $5,000 in attorney fees. In the absence of special circumstances indicating agreement between Client and Lawyer to the contrary, Client is entitled to the $10,000 damage award and Lawyer to the $5,000 fee award.

Restatement (Third) of Law Governing Lawyers § 38 cmt. f, illus. 1, 2 (2000).

## Best Answer

The best answer to this hypothetical is **PROBABLY YES**.

# Champerty/Maintenance/Barratry

## Hypothetical 32

Your college classmate just called to ask whether you would help him in an arrangement that he sees as potentially very lucrative. One of your classmate's neighbors is pursuing a patent case against a nationally known company. However, that plaintiff is running out of money, and her lawyer has threatened to stop representing her and seeking to withdraw from the case. Your college classmate wants to know if you would help him pay his neighbor's lawyers' fees and expenses, in return for a percentage of whatever the neighbor recovers in the patent case.

Is such an arrangement permissible?

## MAYBE

## Analysis

Several traditional oddly-named and often-misunderstood doctrines generally prevent third parties from financial involvement in someone else's litigation. An article explained the differences among these odd doctrines.

- **[E 1601]** Douglas R. Richmond, Other People's Money: The Ethics of Litigation Funding, 56 Mercer L. Rev. 649 (2004-2005) (explaining the history of common law limitations on third parties' involvement in litigation; "The doctrines of 'champerty,' 'maintenance,' and 'barratry' originated in medieval England when claims and rights were not freely assignable. At common law, champerty refers to an agreement by which someone having no interest in the subject of an action 'undertakes to carry on the suit at his own expense, or to aid in so doing, in consideration of receiving, in the event of success, some part of the land, property, or money recovered or deriving some benefit therefrom. A person who engages in champerty is called a 'champertor,' and an agreement amounting to champerty is described as 'champertous.' Champerty is a form of maintenance, which is defined as 'officious intermeddling in a suit that in no way belongs to one, by maintaining or assisting either party with money or otherwise, to prosecute or defend it. Barratry is 'the crime or offense of frequently stirring up suits and quarrels between individuals. Simply summarized, 'maintenance is helping another prosecute a suit; champerty is maintaining a suit in return for a financial interest in the outcome; and barratry is a continuing practice of maintenance or champerty."; explaining that litigation funding in companies have recently begun to challenge the common law doctrine; "Litigation funding companies

may loan money to plaintiffs for living expenses or to attorney to fund case expenses. For example, a litigation funding company may agree to loan a plaintiff $10,000 in exchange for the first $25,000 of any settlement or judgment received within a specified time. Alternatively, a litigation funding company might advance money for expenses to an attorney. Upon recovery the attorney will repay the amount funded plus a fee equal to one dollar for every dollar of funding provided. Thus, a litigation funding company that advances $50,000 to a successful attorney will recoup its investment plus a $50,000 fee. All such loans or advances, whether to plaintiffs or attorneys, are nonrecourse. The litigation funding company's recovery is limited to any settlement or judgment obtained, and the company may not seek repayment from the plaintiff's or attorney's other assets.").

Some states' articulation of these principles sound almost laughably out of date.

- **[E 1611]** Illinois § 720 ILCS 5/32-11 (2010) ("If a person wickedly and willfully excites and stirs up actions or quarrels between the people of this State with a view to promote strife and contention, he or she is guilty of the petty offense of common barratry; and if he or she is an attorney at law, he or she shall be suspended from the practice of his or her profession, for any time not exceeding 6 months.").

- **[E 1610]** Illinois § 720 ILCS 5/32-12 (2010) ("If a person officiously intermeddles in an action that in no way belongs to or concerns that person, by maintaining or assisting either party, with money or otherwise, to prosecute or defend the action, with a view to promote litigation, he or she is guilty of maintenance and upon conviction shall be fined and punished as in cases of common barratry. It is not maintenance for a person to maintain the action of his or her relative or servant, or a poor person out of charity.").

States continue to take differing positions on the continued viability of these old doctrines. Some states continue to prohibit agreements that the court finds violate the doctrines.

- **[E 1618]** Del Webb Communities, Inc. v. Partington, 2009 U.S. Dist. LEXIS 85616 (D. Nev. Sept. 19, 2009) (granting summary judgment for plaintiff Del Webb in an action claiming that a lawyer had violated champerty principles in lining up plaintiffs to sue Del Webb; explaining that "[m]aintenance and champerty are closely related common law doctrines. Maintenance 'is officious intermeddling in a suit which in no way belongs to the intermeddler, by maintaining or assisting either party to the action, with money or otherwise, to prosecute or defend it.' 14 AM. JUR. 2d Champerty, Maintenance, and Barratry § 1 (2000). Champerty is a species of maintenance 'in which the intermeddler makes a bargain with one of the parties to the action to be

compensated out of the proceeds of the action.' Id. The United States Supreme Court has said, '[p]ut simply, maintenance is helping another prosecute a suit; champerty is maintaining a suit in return for a financial interest in the outcome; and barratry is continuing practice of maintenance or champerty.' In re Primus, 436 U.S. 412, 424 n. 15, 98 S. Ct. 1893, 1900 n. 15, 56 L.Ed.2d 417, 429 n. 15 (1978)."; "Some states have outrightly abolished these ancient doctrines. In Saladini v. Righellis, the Massachusetts Supreme Court held that champerty and maintenance would no longer be recognized in the state."; "Nevertheless, Nevada still recognizes maintenance and champerty. For purposes of these summary judgment motions, the Court limits its analysis the champerty. Champerty and maintenance are closely related, but there is a crucial distinction between the two: the offense of champerty differs from maintenance in that in the latter, the person assisting the suitor receives no benefit, while in the former, he receives some stake in the lawsuit. Here, Del Webb is basing its claim on the Mojave Defendants' efforts to promote the Chapter 40 complaints against Del Webb with the agreement that the Mojave Defendants would be reimbursed from the recovery. Therefore, although Del Webb characterizes its claim as one for champerty and maintenance, the claim is more appropriately limited to champerty."; "There are three basic elements of a champerty claim. First, the party involved must be one who has no legitimate interest in the suit. Second, the party must expend its own money in prosecuting the suit. Third, the party must be entitled by the bargain to share in the proceeds of the suit."; "The situation in this case is particularly problematic because the Mojave Defendants did not just offer a free home inspection, but they informed homeowners of how they could file complaints against Del Webb under Nevada law, the role of the home inspection in filing such complaints, and how they should go about hiring a law firm to assist with filing a complaint. As a result, the Mojave Defendants are liable for champerty in this case.").

- **[E 1613]** Rancman v. Interim Settlement Funding Corp., 99 Ohio St. 3d 121 (Ohio 2003) (addressing the following situation: "In April 1999, Rancman contacted appellant Interim Settlement Funding Corp. ('Interim'), seeking an advance of funds secured by her pending claim. In April 1999, after investigating Rancman's case, Interim's president, on behalf of a second company, appellant Future Settlement Funding Corporation ('FSF'), forwarded $ 6,000 to Rancman in exchange for the first $ 16,800 she would recover if the case was resolved within 12 months, $ 22,200 if resolved within 18 months, or $ 27,600 if resolved within 24 months. If the case was not resolved in Rancman's favor, she had no obligation under the contract."; explaining that "'[m]aintenance' is assistance to a litigant in pursuing or defending a lawsuit provided by someone who does not have a bona fide interest in the case. 'Champerty' is a form of maintenance in which a non-party undertakes to further another's interest in a suit in exchange for a part of the litigated matter if a favorable result ensues."; "The ancient practices of champerty and maintenance have been vilified in Ohio since the

early years of our statehood."; "In recent years, champerty and maintenance have lain dormant in Ohio courts."; "This can prolong litigation and reduce settlement incentives -- an evil that prohibitions against maintenance seek to eliminate."; "Except as otherwise permitted by legislative enactment or the Code of Professional Responsibility, a contract making the repayment of funds advanced to a party to a pending case contingent upon the outcome of that case is void as champerty and maintenance. Such an advance constitutes champerty and maintenance because it gives a nonparty an impermissible interest in a suit, impedes the settlement of the underlying case, and promotes speculation in lawsuits. The advances made to Rancman constituted champerty and maintenance. Consequently, the contracts requiring their repayment are void and shall not be enforced.").

In contrast, some states have simply abandoned the old doctrines.

- **[E 1626]** Steven Garber, Alternative Litigation Financing in the United States, Issues, Knowns, and Unknowns, Occasional Paper, Rand (2010) ("[T]here are three forms of ALF [Alternative Litigation Financing] that are currently fairly common in the United States. These are (1) consumer legal funding, which involves provision of non-recourse loans directly to consumer (i.e., individual) plaintiffs with pending lawsuits; (2) subprime lending to plaintiff's law firms (i.e., firms whose litigation work is largely concentrated in representing individuals with personal-injury claims); and (3) investments in commercial (i.e., business-against-business) lawsuits or their proceeds."; explaining the historical background: "[h]istorically, champerty and maintenance have been proscribed by common law, statues, rules of professional conduct for lawyers, or some combination of these. Stated simply, 'Maintenance is the provision of support for a lawsuit to which one is not a party[,] and champerty, a form of maintenance, involves acquiring an interest in the recovery from the lawsuit. . . . The current laws and rules vary across jurisdictions. More specifically, Sebok . . . writes, 'Twenty-eight of fifty-one United States jurisdictions (including the District of Columbia) explicitly permit champerty, albeit with varying limitations.' Sebok (2010, p.54) also writes, 'Of the twenty-eight states that permit maintenance in some form, sixteen explicitly permit maintenance for profit. The remaining states probably permit champerty -- it is just that they do not explicitly cite the investment by contract into a stranger's suit as permissible form of maintenance'. . . . Bond provides an overview of case law pertaining to champerty in the 50 states and the District of Columbia."; "Another concern that has been raised about ALF pertains to professional rules prohibiting lawyers from splitting fees with nonlawyers, as described by part of ABA's Model Rule 5.4, which is called 'Professional Independence of a Lawyer,' thus suggesting the broader concern that prohibitions of fee splitting are intended to address. Prohibitions on lawyers sharing fees with nonlawyers apply in all states, but not in the District of Columbia. . . ." (emphasis added)).

- See, e.g., **[E 1584]** Saladini v. Righellis, 426 Mass. 231 (Mass. December 8, 1997) (rejecting the application of the common law doctrines of champerty, barratry, and maintenance in Massachusetts; analyzing a situation in which plaintiff had advanced money to a third person to allow his pursuit of a lawsuit, but which the third person had refused to repay upon settling the lawsuit; noting that a trial court had dismissed the plaintiff's complaint because the agreement was champertous and therefore unenforceable as against public policy; explaining that "[c]hamperty has been described as the unlawful maintenance of a suit, where a person without an interest in it agrees to finance the suit, in whole or in part, in consideration for receiving a portion of the proceeds of the litigation."; "[U]nder our own development of the doctrine we have little doubt that the agreement between Saladini and Righellis would be champertous were we to continue to recognize the offense. We no longer are inclined to do so."; abandoning the common law doctrines; "We also no longer are persuaded that the champerty doctrine is needed to protect against the evils once feared: speculation in lawsuits, the bringing of frivolous lawsuits, or financing overreaching by a party of superior bargaining position."; ultimately concluding that "[w]e rule that the common law doctrines of champerty, barratry, and maintenance no longer shall be recognized in Massachusetts.").

Other states have either upheld or rejected arrangements, but without addressing the doctrines themselves.

- **[E 1615]** Echeverria v. The Estate of Marvin L. Lindner, 2005 NY Slip Op 50675U (N.Y.S. 2005) (finding that a loan arrangement did not violate the Champerty rules, but involved usurious interest and therefore was unenforceable; explaining that "[i]n order to constitute Champerty in New York law, the primary purpose of the purchase must be to bring suit or proceed with action upon the claim they received."; also explaining that "[i]n the case before this Court, the purpose and intent of purchasing the potential judgment in favor of Mr. Echeverria was not to bring an action based on LawCash's claim to a portion of the potential judgment, but simply to profit from its loan or investment. Any legal action that may be based upon receiving its payment would be a secondary purpose and not primary."; "If LawCash purchased Mr. Echeverria's recovery from this lawsuit with the intent of bringing a new lawsuit in order to collect that money from Mr. Echeverria, or the present defendants (whom we assume would be paying this judgment,) then we would have a champertous agreement, but this does not seem to be the intent of LawCash. LawCash has no primary intention of bringing legal action to collect the money Mr. Echeverria owes it."; noting that Ohio had different legal principles from New York; "[U]nder Ohio law, taking an assignment of a judgment for profit by itself is enough to constitute Champerty, while under New York law the primary purpose and intent of taking the assignment would

be to profit, and not to bring suit, which would prevent this action from being Champerty.").

- **[E 1614]** Kraft v. Mason, 668 So. 2d 679 (Fla. Ct. App. 1996) (finding that the Champerty doctrine did not prevent a sister from enforcing an arrangement in which she loaned money to her brother in connection with his lawsuit; "In the instant case, Mason [sister] clearly did not act in an officious manner. She was not intermeddling in a lawsuit. She did not instigate the litigation. Her assistance was sought out by Kraft [brother] when he needed money to continue his lawsuit. She did not bargain for the terms under which she made the loan -- they too were prepared by Kraft. Nor did she concern herself with the antitrust litigation or impose her views upon the attorneys or the litigants once she provided the loan.").

The Restatement takes the same basic approach.

> A lawyer may not acquire a proprietary interest in the cause of action or subject matter of litigation that the lawyer is conducting for a client, except that the lawyer may:
>
> > (a) acquire a lien . . . to secure the lawyer's fee or expenses; and
> >
> > (b) contract with a client for a contingent fee in a civil case except when prohibited . . . .

Restatement (Third) of Law Governing Lawyers § 36(1) (2000). A lengthy comment explains this principle, as well as its relation to the old champerty and maintenance doctrines.

> The rule in § 36(1) prohibiting acquisition of a proprietary interest in a claim the lawyer is litigating developed from restrictions on purchasing claims under the common law of champerty and maintenance. Such purchases were thought to breed needless litigation and to foster the prosecution of claims by powerful and unscrupulous persons. Contingent fees, however, permit lawyers to obtain a substantial economic share of a claim in return for their services . . . . The economic effect of the rule set forth in this Section is thus limited to prohibiting a lawyer from acquiring too large a

> share of a claim and from acquiring rights and powers of ownership through an otherwise proper contingent fee. It does not forbid a lawyer from taking an assignment of the whole claim and then pressing it in the lawyer's own behalf, so long as the lawyer has not represented the claim's original owner in asserting the claim. Such a purchase is subject to the requirements of §§ 18 and 126 when the buyer is the seller's lawyer. The arrangement must also be consistent with law concerning the assignment of claims and with champerty prohibitions that still exist in some states.
>
> The justification for the rule in its present form is that a lawyer's ownership gives the lawyer an economic basis for claiming to control the prosecution and settlement of the claim and provides an incentive to the lawyer to relegate the client to a subordinate position . . . . The risk in such an arrangement is greater than it would be with a contingent fee; a contingent fee -- in addition to being limited in most cases to well less than half of the recovery -- is clearly designated as payment for the lawyer's services rendered for the client. The rule also prevents a lawyer from disguising an unreasonably large fee, violative of § 34, by buying part of the claim for a low price.
>
> The Section applies to administrative as well as court litigation but does not reach nonlitigation services such as the incorporation of a business in return for payment in stock . . . . The Section does not bar a lawyer from owning stock or a similar ownership interest in an enterprise that retains a lawyer to conduct a litigation.
>
> The prohibition of the Section is limited to matters in litigation. Thus, subject to § 126 (business transactions with a client), a lawyer may acquire an ownership or other proprietary interest in a client's patent when retained to file a patent application, while under this Section the lawyer could not acquire such an interest if retained to bring a patent-infringement suit. The difference in treatment is largely historical.

Restatement (Third) of Law Governing Lawyers § 36 cmt. b (2000).

## Best Answer

The best answer to this hypothetical is **MAYBE**.

# Litigation Financing

## Hypothetical 33

You just received a call from a company that wants to hire you to seek your state bar's approval of a new way to finance litigation. In essence, the company provides loans to plaintiffs or defendants in large commercial cases, under an arrangement in which the company receives a return of its investment with a percentage "profit" if the person or entity borrowing the money succeeds in the lawsuit.

Does this arrangement violate the ethics rules?

## MAYBE

## Analysis

Litigation funding has become an increasingly common way for plaintiffs to assure that they can successfully assert claims. Interesting, litigation financing is becoming more popular among large companies rather than personal injury plaintiffs. A 2010 article generally describes these arrangements.

- **[E 1626]** Steven Garber, Alternative Litigation Financing in the United States, Issues, Knowns, and Unknowns, Occasional Paper, Rand (2010) ("[T]here are three forms of ALF [Alternative Litigation Financing] that are currently fairly common in the United States. These are (1) consumer legal funding, which involves provision of non-recourse loans directly to consumer (i.e., individual) plaintiffs with pending lawsuits; (2) subprime lending to plaintiff's law firms (i.e., firms whose litigation work is largely concentrated in representing individuals with personal-injury claims); and (3) investments in commercial (i.e., business-against-business) lawsuits or their proceeds."; explaining the historical background: "[h]istorically, champerty and maintenance have been proscribed by common law, statues, rules of professional conduct for lawyers, or some combination of these. Stated simply, 'Maintenance is the provision of support for a lawsuit to which one is not a party[,] and champerty, a form of maintenance, involves acquiring an interest in the recovery from the lawsuit. . . . The current laws and rules vary across jurisdictions. More specifically, Sebok . . . writes, 'Twenty-eight of fifty-one United States jurisdictions (including the District of Columbia) explicitly permit champerty, albeit with varying limitations.' Sebok (2010, p.54) also writes, 'Of the twenty-eight states that permit maintenance in some form, sixteen explicitly permit maintenance for profit. The remaining states

probably permit champerty -- it is just that they do not explicitly cite the investment by contract into a stranger's suit as permissible form of maintenance'. . . . Bond provides an overview of case law pertaining to champerty in the 50 states and the District of Columbia."; "Another concern that has been raised about ALF pertains to professional rules prohibiting lawyers from splitting fees with nonlawyers, as described by part of ABA's Model Rule 5.4, which is called 'Professional Independence of a Lawyer,' thus suggesting the broader concern that prohibitions of fee splitting are intended to address. Prohibitions on lawyers sharing fees with nonlawyers apply in all states, but not in the District of Columbia. . . .").

The trend is clearly in favor of permitting such litigation financing arrangements.

- **[E 1621]** Champerty is Still No Excuse in Texas: Why Texas Courts (And The Legislature) Should Uphold Litigation Funding Agreements, Houston Business and Tax Law Journal (2007) (explaining that "[a]t common law, maintenance was defined as 'officious intermeddling' by a completely unrelated third party using monetary or other assistance to enable either party to pursue the lawsuit. Champerty, a form of maintenance, referred under common law to an agreement between a plaintiff or potential plaintiff and a disinterested third party, under which the third party either contributed aid to plaintiff's case or pursued plaintiff's case at his own expense in exchange for some monetary, property, or other benefit upon successful suit."; "Although maintenance and champerty are often close companions, they maintain distinct legal identities. For example, all states specifically allow lawyers to choose to work on a contingent fee basis (champerty) but many frown upon 'officious intermeddling' (maintenance) through funding or litigation by lawyers and laypersons alike. Furthermore, laws relating to champerty and maintenance are designed and enforced at the state level, making jurisdiction a significant issue."; explaining the current treatment of champerty under various state laws; "Champerty is a state law doctrine. Approximately twenty-nine states currently prohibit a range of champertous agreements, including Texas. Examples of prohibited agreements include general speculation in litigation, assignment of legal malpractice claims, and assignment of personal injury tort claims. Many of the states that absolutely prohibit champertous agreements have followed the English common law prohibition for over a century, while other states have allowed the doctrine to erode slowly and now permit certain agreements to survive the ancient doctrine. Maine goes so far as to criminalize the practice, while Mississippi also makes champerty and maintenance unlawful and punishable by up to one year in state prison."; "In the opposite camp, several states have flatly denied the existence of champerty and maintenance within their borders for just as long. Others initially prohibited the doctrines but gradually concluded that certain aspects are no longer applicable in today's society. A few states such as Connecticut and Texas, gradually accomplished the reverse by initially embracing champerty but excluding certain previously-acceptable

champertous transactions on public policy grounds. In addition, several states that do not recognize tort claims in champerty and maintenance do generally permit invocation of the doctrines as contract defenses. Only Massachusetts, South Carolina, and New Jersey affirmatively uphold champertous devices.").

## Best Answer

The best answer to this hypothetical is **MAYBE**.

# Advancing Litigation Expenses

## Hypothetical 34

After law school you decided to spend a few years assisting in social causes that you think are worthwhile and handling some pro bono cases. You support yourself with an evening job as a waitress, and you find yourself spending even some of that salary to help your clients. In some situations, you have been tempted to pay the expert witness costs for clients in the politically-motivated cases you handle and the pro bono matters you handle for indigent clients.

**(a)** May you pay the expert fees incurred in your politically-motivated cases without insisting that your clients remain ultimately responsible for repaying you?

**YES**

**(b)** May you pay the expert fees for indigent clients you are representing in pro bono matters without insisting that your clients remain ultimately responsible for repaying you?

**YES**

## Analysis

**(a)** Although states take differing positions on this issue, the ABA Model Rules indicate that

> [a] lawyer shall not provide financial assistance to a client in connection with pending or contemplated litigation, except that: (1) a lawyer may advance court costs and expenses of litigation, the repayment of which may be contingent on the outcome of the matter; and (2) a lawyer representing an indigent client may pay court costs and expenses of litigation on behalf of the client.

ABA Model Rule 1.8(e). Thus, you may advance expert fees which are contingent on the case's outcome.

The Restatement takes the same basic approach.

> A lawyer may not make or guarantee a loan to a client in connection with pending or contemplated litigation that the

> lawyer is conducting for the client, except that the lawyer may make or guarantee a loan covering court costs and expenses of litigation, the repayment of which to the lawyer may be contingent on the outcome of the matter.

Restatement (Third) of Law Governing Lawyers § 36(2) (2000).

States generally take the same approach as well.

- **[E 1332]** District of Columbia LEO 354 (3/2010) ("Comment [9] to Rule 1.8 explains the rule's history and its intended scope: 'Historically, under the Code of Professional Responsibility, lawyers could only advance the costs of litigation. The client remained ultimately responsible, and was required to pay such costs even if the client lost the case. That rule was modified by this court in 1980 in an amendment to DR 5-103(B) that eliminated the requirement that the client remain ultimately liable for costs of litigation, even if the litigation was unsuccessful. The provisions of Rule 1.8(d) embrace the result of the 1980 modification, but go further by providing that a lawyer may also pay certain expenses of a client that are not litigation expenses. Thus, under Rule 1.8(d), a lawyer may pay medical or living expenses of a client to the extent necessary to permit the client to continue the litigation. The payment of these additional expenses is limited to those strictly necessary to sustain the client during the litigation, such as medical expenses and minimum living expenses. The purpose of permitting such payments is to avoid situations in which a client is compelled by exigent financial circumstances to settle a claim on unfavorable terms in order to receive the immediate proceeds of settlement. This provision does not permit lawyers to 'bid' for clients by offering financial payments beyond those minimum payments necessary to sustain the client until the litigation is completed. Regardless of the types of payments involved, assuming such payments are proper under Rule 1.8(d), client reimbursement of the lawyer is not required. However, no lawyer is required to pay litigation or other costs to a client. The rule merely permits such payments to be made without requiring reimbursement by the client.'").

**(b)** The ABA Model Rules allow a lawyer to pay court costs and expenses of litigation for an indigent client without making repayment contingent on winning the case.

> [A] lawyer representing an indigent client may pay court costs and expenses of litigation on behalf of the client.

ABA Model Rule 1.8(e)(2).

> Court costs and expenses of litigation, such as filing fees, expert-witness fees, and witness expenses, are normally payable by clients. In most states, a lawyer may not advance such expenses unless the client is obligated to repay them out of the client's recovery . . . . Under a contingent-fee contract, however, a client who does not prevail is not liable to the lawyer for court costs and litigation expenses, unless the client agreed to pay them or nonrefundable advances by the lawyer of such costs and expenses are unlawful in the jurisdiction.

Restatement (Third) of Law Governing Lawyers § 38 cmt. e (2000).

**Best Answer**

The best answer to **(a)** is **YES**; the best answer to **(b)** is **YES**.

**[FROM PREVIOUS DRAFT??]**

**(a)** May you enter into the arrangement the head of the detective agency has proposed?

**NO**

**(b)** If you cannot enter into the arrangement, what alternatives do you have?

**PROPOSE A DIFFERENT RATE STRUCTURE FOR DIFFERENT SIZE CASES**

## Analysis

**(a)** The ABA Model Rules explicitly indicate that except for certain situations (not applicable here),

> [a] lawyer or law firm shall not share legal fees with a nonlawyer.

ABA Model Rule 5.4(a). Therefore, the detective agency head's proposed arrangement would violate the Rules.[1]

The analysis would become more difficult if the agency head proposed that you pay the agency a yearly "bonus." A general bonus might be acceptable, but any extra amount tied to the results in particular cases would be questionable.

**(b)** One alternative to sharing fees with the detective agency is to propose a different rate structure for different size cases.

## Best Answer

The best answer to **(a)** is **NO**; the best answer to **(b)** is **PROPOSE A DIFFERENT RATE STRUCTURE FOR DIFFERENT SIZE CASES**.

[1] Accord ABA LEO 1519 (4/18/86) (a lawyer may not share a contingent fee with a non-lawyer research service).

# Loans for Living Expenses and Other Expenses

## Hypothetical 35

You have always enjoyed being a plaintiff's personal injury lawyer, because of the satisfaction it brings you to help people. Several recent clients have faced severe financial obstacles as well as injuries, and you wonder what you can do to assist them.

**(a)** Can you or your law firm loan money to a client for living expenses during the pendency of their case, as long as the client agrees to pay off the loan when the case settles or is tried?

**NO**

**(b)** Can you put a client in touch with a finance company which can loan the client living expenses during the pendency of their case?

**YES**

## Analysis

The ABA Model Rules will presumably prohibit such a loan.

> A lawyer shall not provide financial assistance to a client in connection with pending or contemplated litigation, except that: (1) a lawyer may advance court costs and expenses of litigation, the repayment of which may be contingent on the outcome of the matter; and (2) a lawyer representing an indigent client may pay court costs and expenses of litigation on behalf of the client.

ABA Model Rule 1.8(e). Such a loan would almost surely be seen as a provision of "financial assistance to a client," and not fall in one of the defined exceptions.

The Restatement provides a more extensive analysis of this issue.

> A lawyer may not make or guarantee a loan to a client in connection with pending or contemplated litigation that the lawyer is conducting for the client, except that the lawyer may make or guarantee a loan covering court costs and expenses of litigation, the repayment of which to the lawyer may be contingent on the outcome of the matter.

Restatement (Third) of Law Governing Lawyers § 36(2) (2000). A comment provides an explanation of this issue.

> A lawyer may provide financial assistance to a client as stated in Subsection (2). Lawyer loans to clients are regulated because a loan gives the lawyer the conflicting role of a creditor and could induce the lawyer to conduct the litigation so as to protect the lawyer's interests rather than the client's. This danger does not warrant a rule prohibiting a lawyer from lending a client court costs and litigation expenses such as ordinary- and expert-witness fees, court-reporter fees, and investigator fees, whether the duty to repay is absolute or conditioned on the client's success. Allowing lawyers to advance those expenses is indistinguishable in substance from allowing contingent fees and has similar justifications . . . , notably enabling poor clients to assert their rights. Requiring the client to refund such expenses regardless of success would have a particularly crippling effect on class actions, where the named plaintiffs often have financial stakes much smaller than the litigation expenses.
>
> With respect to a loan to a client under Subsection (2)(a), the requirements of § 126 do not apply to a client's undertaking to repay the loan out of the proceeds of a recovery. Any more extensive obligation of a client -- for example, to pay interest or to provide security beyond that provided under § 43 -- is subject to § 126.
>
> Loans for purposes other than financing litigation expenses are forbidden in most jurisdictions and under this Section. That prohibition precludes attempts to solicit clients by offering living-expenses loans or similar financial assistance. A few jurisdictions permit such payments, limiting them to basic living and similar expenses and sometimes with the restriction that they not be discussed prior to the lawyer's retention. Such permission is usually based on a policy of enabling clients to avoid being forced to abandon meritorious claims or to agree to inadequate settlements.

Restatement (Third) of Law Governing Lawyers § 36 cmt. c (2000).

States following the traditional ABA Model Rule and Restatement approach forbid lawyers from lending their clients such funds during litigation.

- **[E 331 B 1/09]** Maryland LEO 2008-06 (1/17/08) (explaining that Maryland lawyers may not lend clients money to pay their medical expenses).

- **[E 1526]** Mississippi Bar v. Shaw, 919 So. 2d 51, 2005 Miss. LEXIS 389 (Miss. 2005) (suspending for ninety days a lawyer who provided financial assistance to clients; noting that Mississippi ethics Rule 1.8(e) provides that "[a] lawyer representing a client may, in addition to the above, advance the following costs and expenses on behalf of the client, which shall be repaid upon successful conclusion of the matter."; "(a) Reasonable and necessary medical expenses associated with treatment for the injury giving rise to the litigation or administrative proceeding for which the client seeks legal representation; and (b) Reasonable and necessary living expenses incurred."; explaining that "[t]he nature of conduct involved included 555 advances made to sixty-seven clients over a three-year period totaling more than $160,000. Approximately $30,000 of the advances were made after a settlement had been agreed upon, but before the settlement documents were executed and funds were available for distribution. A majority of the advances were for basic necessities such as utilities, rent, food, travel, medical, and other living expenses."; "There is a need to deter similar conduct of making advancements without reporting them. The reporting requirements of Rule 1.8(e) seek to 'avoid improper use of what should be a humanitarian act.'. . . By allowing restricted ways of making client advances, the danger of bidding wars among attorneys is limited. . . . Furthermore, advancing large sums of money to clients may frustrate a party's willingness or ability to settle and/or cause a conflict of interest for the attorney. . . . Here, the Tribunal found that the failure to enforce Rule 1.8 would lead to 'wholesale violation and disregard of that rule,' and would, 'encourage the concept of buying clients.").

These jurisdictions taking a broader approach to a lawyer's freedom to provide such financial support sometimes find that the arrangement violates even those ethics rules.

- See, e.g., **[E 1331]** District of Columbia LEO 354 (3/2010) (explaining that immigration lawyers may not financially support their clients, despite D.C.'s uniquely broad rule allowing D.C. lawyers to financially assist clients in litigation and administrative proceedings; "Lawyers in immigration matters may not execute an Affidavit of Support (U.S. Citizenship and Immigration Services Form I-864) on the immigrant's behalf as a joint-sponsor while continuing to represent the immigrant in the matter. Typically, a person who signs an Affidavit of Support agrees to support the immigrant at an annual

income that is not less than 125% of the federal poverty level so that the Immigrant will not become a public charge. The ensuing contractual obligations continue for years after the immigrant is admitted on the basis of the Affidavit of Support. The Affidavit of Support is a guarantee of financial assistance to a client. Such guarantees are generally prohibited by Rule 1.8(d). Because the obligations continue long after the completion of the immigration proceeding, the undertaking does not fit within the narrow safe harbor of Rule 1.8(d)(2), which allows, but does not require, financial support strictly necessary to sustain the client during a proceeding. An Affidavit of Support undertaking by a lawyer to a client is also fraught with peril under Rule 1.7(b)(4) (conflicts of interest). Thus, a lawyer who wishes to serve as a joint sponsor for an immigration client by executing an Affidavit of Support on the immigrant's behalf must withdraw from the representation of that client before doing so."; quoting D.C.'s unique Rule 1.8(d): "Other financial assistance which is reasonably necessary to permit the client to institute or maintain the client to institute or maintain the litigation or administrative proceedings."; explaining that D.C. Rule 1.8 cmt. [9] explains the unique D.C. rule's history; "Historically, under the Code of Professional Responsibility, lawyers could only advance the costs of litigation. The client remained ultimately responsible, and was required to pay such costs even if the client lost the case. That rule was modified by this court in 1980 in an amendment to DR 5-103(B) that eliminated the requirement that the client remain ultimately liable for costs of litigation, even if the litigation was unsuccessful. The provisions of Rule 1.8(d) embrace the result of the 1980 modification, but go further by providing that a lawyer may also pay certain expenses of a client that are not litigation expenses. Thus, under Rule 1.8(d), a lawyer may pay medical or living expenses of a client to the extent necessary to permit the client to continue the litigation. The payment of these additional expenses is limited to those strictly necessary to sustain the client during the litigation, such as medical expenses and minimum living expenses. The purpose of permitting such payments is to avoid situations in which a client is compelled by exigent financial circumstances to settle a claim on unfavorable terms in order to receive the immediate proceeds of settlement. This provision does not permit lawyers to 'bid' for clients by offering financial payments beyond those minimum payments necessary to sustain the client until the litigation is completed. Regardless of the types of payments involved, assuming such payments are proper under Rule 1.8(d), client reimbursement of the lawyer is not required. However, no lawyer is required to pay litigation or other costs to a client. The rule merely permits such payments to be made without requiring reimbursement by the client."; explaining that "[t]he District of Columbia's approach is more permissive than that of some other jurisdictions because it allows, but does not require, minimum payments necessary to sustain the client during the litigation or administrative proceeding. Jurisdictions with more restrictive rules have disciplined lawyers for violations despite assertions that the payments were motivated by humanitarian concerns."; ultimately concluding that "[t]he exception at 1.8(d)(1) is not available

because the Affidavit of Support does not involve the expenses of litigation or administrative proceedings.").

**(b)** There seems to be no prohibition on lawyers working with their client to obtain a loan for living expenses from some third party.

- See, e.g., **[E 1612]** Illinois LEO 92-9 (1/22/93) ("Attorney may ethically assist clients in obtaining loans for payment of attorney fees, providing the attorney protects the client's confidences and meets his fiduciary obligation of complete disclosure."; "[T]he Committee is of the opinion that it is ethical for an attorney to suggest a loan agreement with a particular financial institution for the payment of his legal fees on the conditions that he complies with Rule 1.6 concerning the disclosure of confidences and also that he meets his further fiduciary obligations concerning full disclosure of all the terms of his involvement with the financial institution, the terms of the transactions are fair and reasonable, and also the client's right to obtain alternative financing.").

The Restatement also recognizes that "[t]he great majority of jurisdictions bar lawyers from making any loan for nonlitigation expenses, such as for living expenses." Restatement (Third) of Law Governing Lawyers § 36 cmt. c, reporter's note (2000).

The trend increasingly permitting litigation funding arrangements presumably would also affect the permissibility of arrangements with personal injury plaintiffs and others who might require living expenses during litigation.

## Best Answer

The best answer to **(a)** is **NO**; the best answer to **(b)** is **YES**.

# Billing for Expenses

## Hypothetical 36

As your law firm's new managing partner, you are trying to determine how to bill clients for all the many expenses you incur during your work for clients.

Without your client's consent, can you earn a profit on items such as copies, faxes, or long-distance services for which you bill clients?

**NO**

## Analysis

The ABA has explicitly prohibited lawyers from earning a profit on such disbursements, unless the client consents after full disclosure.

- ABA LEO _____.

A Restatement rule deals with expenses such as this.

> Unless a contract construed in the circumstances indicates otherwise:
>
> > (a) a lawyer may not charge separately for the lawyer's general office and overhead expenses;
> >
> > (b) payments that the law requires an opposing party or that party's lawyer to pay as attorney-fee awards or sanctions are credited to the client, not the client's lawyer, absent a contrary statute or court order; and
> >
> > (c) when a lawyer requests and receives a fee payment that is not for services already rendered, that payment is to be credited against whatever fee the lawyer is entitled to collect.

Restatement (Third) of Law Governing Lawyers § 38(3) (2000).

The Restatement takes the same approach.

> Under generally prevailing practice, the actual amount of disbursements to persons outside the office for hired consultants, printers' bills, out-of-town travel, long-distance

> telephone charges, and the like ordinarily are charges in addition to the lawyer's fee. Reimbursement is limited to the actual amount of disbursements the lawyer was authorized to make under the lawyer's general authority or a more specific delegation or contract . . . .
>
> . . . .
>
> Subsection (3)(a) provides that, unless the contract construed in its circumstances provides otherwise, a lawyer may not recover from a client payment in addition to the agreed fee for items of general office and overhead expense such as secretarial costs and word processing. A client lacking knowledge of the lawyer's usual practice cannot be expected to assume that the lawyer will charge extra for such expenses. The lawyer may, however, charge separately for such items if the client was told of the billing practice at the outset of the representation or was familiar with it from past experience with the lawyer or (in the case of a general billing custom in the area) from past experiences with other lawyers.

Restatement (Third) of Law Governing Lawyers § 38 cmt. e (2000).

Courts **[??]** take the same approach.

- **[E 1280 B 8/11]** Texas LEO 594 (2/2010) (holding that a lawyer must pass along any discounts to the client that the lawyer receives from a service provider; "[I]n the absence of disclosure and agreement to the contrary, a lawyer may recoup only the amount of expenses actually paid by the lawyer. In such circumstances, a client may reasonably be expected to understand that the amounts of third-party expenses incurred by a lawyer and recouped from the client, as reflected on a statement from the lawyer, are the amounts actually paid by the lawyer for the expenses shown. Absent an agreement to the contrary, a lawyer may not mark up or increase the amount of an expense being recouped from the client, and if a lawyer receives a discount on payment of the expense, the amount of the expense recouped from the client must take into account the discount.").

- **[E 1136 B 5/10]** North Carolina LEO 2005-11 (1/20/06) (holding that a law firm does not have to establish a trust account to hold money that belongs to the law firm; also holding that a lawyer may mark up overnight and courier

fees after making the following disclosure and obtaining a client's consent to the following statement; "I/we hereby acknowledge and agree that certain charges on my HUD-1 Settlement Statement, including but not limited to overnight/courier and recording fees, may not reflect the actual costs and in fact may be more than the actual costs to the settlement agent. The additional amount(s) may vary and are to help cover the administrative aspects of handling the particular item or service. I/we hereby consent to and accept the above-referenced up-charges.").

## Best Answer

The best answer to this hypothetical is **NO**.

# Calculating Charges for Expenses

## Hypothetical 37

You have been working with your firm's chief financial officer in trying to determine how to bill clients for various expenses.

**(a)** How do you determine an ethically proper expense for copy charges?

**??**

**(b)** How do you determine an ethically proper expense for cell phone charges?

**??**

**(c)** How do you determine an ethically proper expense for computerized research?

**??**

## Analysis

**(a)-(c)** It can be very difficult to properly analyze and calculate the expenses that a lawyer can pass along to a client without the client's consent to a markup.

The ABA LEO generally prohibiting markups acknowledges that

**[INSERT QUOTE ABOUT OVERHEAD COSTS]**

ABA LEO _____.

In the case of some disbursements, the analysis is fairly easy. If a lawyer receives a bill from a catering company for delivering breakfast food, the lawyer can only pass along that bill to the client -- without any markup (absent client consent after full disclosure). In contrast, consider how the lawyer must calculate the amount that the

lawyer can charge a client for full copying some of the client's documents. If the lawyer takes the document to a local copy service for copying, the lawyer can only pass only the bill that the lawyer receives from the copy service (absent client consent). If the lawyer has someone -- check the copies, put them into notebooks, etc., perhaps the lawyer can charge for that nonlawyer's time -- but that should not be characterized as "overhead" for the copying. However, what can the lawyer charge if he or she arranges for someone in the law firm to copy the client's documents? The lawyer incurs the expense of the paper, but also the expense of the copier (which the lawyer probably leases) and the law firm employee who copies the client's documents. It does not make sense to preclude the lawyer from adding at least some overhead into what the lawyer charges for each copy.

Some expenses can be even more complicated. For instance, charging a client for telephone calls to and from a lawyer's cell phone obviously involve the cell phone carrier's bill for that time. What does the lawyer do with a cell phone plan that allows a certain number of free minutes per month, after which the carrier charges a hefty bill for each additional minute. The lawyer should be entitled to charge the clients in some way for the free minutes, somehow calculated by figuring out the monthly charge for all of those minutes, and allocating that charge across the clients with whom the lawyer speaks on his or her cell phone. Clients being charged a bill for such additional minutes might ask the lawyer to deal with that client's matter early in the month.

Perhaps not surprisingly (given the expense), most of the analysis in this area has involved computerized research. Many law firms pay a set charge per month (or even year) for such research, and have to calculate how to spread that fixed cost over

the minutes used for a particular client. The Pennsylvania Bar dealt with this in a remarkably convoluted legal ethics opinion.

- **[E 42 N 12/06]** Pennsylvania LEO 2006-30 (6/13/06) (finding that a lawyer could charge clients for computer research that the law firm paid for on a fixed monthly charge using one of two methods: "'Method 1 – Direct Actual Costs Per Minute Charge. Under this method, I would calculate the average number of billable minutes per month during which the [CALR] service could be used based on an average day (21 work days per month x 7.5 hours per day = 158 average hours per month x 60 minutes per hour = 9,450 average minutes per month and arrive at a per minute charge of use of less than $.10. This uniform per minute charge would be available to charge each client for whom the Computer Research would be used during the month. Depending on the volume of client usage, this method may not permit me to recoup my actual monthly costs for the [CALR] service.'"; also allowing the law firm to use another method of charging clients for the computer research "so long as the clients gave informed consent to those charges after full disclosure of the method by which the charges would be calculated. Such disclosure would necessarily include an explanation of how per minute charges could vary dramatically from month to month, depending upon Inquirer's overall rate of CALR usage in a given month; also describing the other possible way of charging clients; "'Method 2 – Proportionate Allocation of Actual Costs Per Minute Charge. Under this method, I would calculate the total minutes used by all clients for whom the [CALR] services were used in a given month and obtain the percentage of the total minutes used by each client and then apply that percentage to the fixed monthly charge. The resulting figure for each client would be the charge for each client for that month. In sum, this method pro rates each client's monthly usage by the total usage of all clients in the given month and recoups the entire monthly charge by spreading the actual cost over all clients' usage during the month regardless of actual volume of usage. It should be noted that Method 2 can result in different per minute charge rates per month for the same client depending upon the client volume of monthly usage.'").

This issue has become so heated that one client even sued a well-known law firm for overbilling the client for computerized research. **[FIND LAWSUIT -- HE THINKS CROMWELL & SULLIVAN OR SOME OTHER LARGE NY LAW FIRM]**

## Best Answer

The best answer to **(a)** is **??**; the best answer to **(b)** is **??**; the best answer to **(c)** is **??**.

# Avoiding Commingling

## Hypothetical 38

Your law firm just hired a new finance director, who had previously worked in a corporate setting. After analyzing your firm's trust account procedures, she suggests that your law firm keep approximately $5,000 of its own money in the trust account -- as a "cushion" to assure that no checks drawn on the trust account will bounce.

May your law firm keep $5,000 of its own money in the trust account -- as a "cushion" to assure that no checks drawn on the trust account bounce?

**NO**

## Analysis

Very specific ethics rules govern lawyers' handling of any property (including any money) they obtain from clients or others.

As part of these stringent requirements, lawyers must very carefully segregate such property from their own property -- in a rule that seems counterintuitive at first but makes perfect sense upon some reflection.

### ABA Model Rules

The ABA Model Rules contain a somewhat surprisingly sparse provision dealing with safekeeping clients' and others' property.

> A lawyer shall hold property of clients or third persons that is in a lawyer's possession in connection with a representation separate from the lawyer's own property. Funds shall be kept in a separate account maintained in the state where the lawyer's office is situated, or elsewhere with the consent of the client or third person. Other property shall be identified as such and appropriately safeguarded. Complete records of such account funds and other property shall be kept by the lawyer and shall be preserved for a period of [five years] after termination of the representation.

ABA Model Rule 1.15(a) (emphasis added).

Not surprisingly, lawyers must provide notice when they receive such property.

> Upon receiving funds or other property in which a client or third person has an interest, a lawyer shall promptly notify the client or third person. Except as stated in this rule or otherwise permitted by law or by agreement with the client, a lawyer shall promptly deliver to the client or third person any funds or other property that the client or third person is entitled to receive and, upon request by the client or third person, shall promptly render a full accounting regarding such property.

ABA Model Rule 1.15(d).

If there is any dispute over the property's disposition, lawyers must continue the property's segregation until the dispute's resolution.

> When in the course of representation a lawyer is in possession of property in which two or more persons (one of whom may be the lawyer) claim interests, the property shall be kept separate by the lawyer until the dispute is resolved. The lawyer shall promptly distribute all portions of the property as to which the interests are not in dispute.

ABA Model Rule 1.15(e). A comment provides a further explanation.

> Paragraph (e) also recognizes that third parties may have lawful claims against specific funds or other property in a lawyer's custody, such as a client's creditor who has a lien on funds recovered in a personal injury action. A lawyer may have a duty under applicable law to protect such third-party claims against wrongful interference by the client. In such cases, when the third-party claim is not frivolous under applicable law, the lawyer must refuse to surrender the property to the client until the claims are resolved. A lawyer should not unilaterally assume to arbitrate a dispute between the client and the third party, but, when there are substantial grounds for dispute as to the person entitled to the funds, the lawyer may file an action to have a court resolve the dispute.

ABA Model Rule 1.15 cmt. [4].

A comment to the ABA Model Rules explains that a lawyer providing services other than legal services might be governed by other rules as well.

> The obligations of a lawyer under this Rule are independent of those arising from activity other than rendering legal services. For example, a lawyer who serves only as an escrow agent is governed by the applicable law relating to fiduciaries even though the lawyer does not render legal services in the transaction and is not governed by this Rule.

ABA Model Rule 1.15 cmt. [5].

The ABA Model Rules repeatedly warn against any "comingling" of the lawyer's property and anyone else's property. As explained above, lawyers must hold anyone else's property "separate from the lawyer's own property." ABA Model Rule 1.15(a). A comment reiterates this point.

> A lawyer should hold property of others with the care required of a professional fiduciary. Securities should be kept in a safe deposit box, except when some other form of safekeeping is warranted by special circumstances. <u>All property that is the property of clients or third persons, including prospective clients, must be kept separate from the lawyer's business and personal property and, if monies, in one or more trust accounts.</u> Separate trust accounts may be warranted when administering estate monies or acting in similar fiduciary capacities. A lawyer should maintain on a current basis books and records in accordance with generally accepted accounting practice and comply with any recordkeeping rules established by law or court order.

ABA Model Rule 1.15 cmt. [1] (emphasis added).

The ABA Model Rules explain the one very minor exception to the general rule prohibition comingling.

> A lawyer may deposit the lawyer's own funds in a client trust account for the <u>sole purpose of paying bank service charges on that account, but only in an amount necessary for that purpose.</u>

ABA Model 1.15(b) (emphasis added). A comment repeats the general rule before describing this minor exception.

> While normally it is impermissible to commingle the lawyer's own funds with client funds, paragraph (b) provides that it is permissible when necessary to pay bank service charges on that account. Accurate records must be kept regarding which part of the funds are the lawyer's.

ABA Model Rule 1.15 cmt. [2] (emphasis added).

**Restatement**

Like the ABA Model Rules, the Restatement prohibits lawyers from commingling their own funds and their clients' funds in a trust account.

> A lawyer holding funds or other property of a client in connection with a representation, or such funds or other property in which a client claims an interest, must take reasonable steps to safeguard the funds or property. A similar obligation may be imposed by law on funds or other property so held and owned or claimed by a third person. In particular, the lawyer must hold such property separate from the lawyer's property, keep records of it, deposit funds in an account separate from the lawyer's own funds, identify tangible objects, and comply with related requirements imposed by regulatory authorities.

Restatement (Third) of Law Governing Lawyers § 44(1) (2000) (emphasis added).

The Restatement provides a fairly lengthy explanation of the rationale for this approach.

> A lawyer often takes temporary possession of a client's property in the course of representing the client, for example as part of administering an estate, paying or collecting a judgment, or exchanging valuable documents at a closing. Precautions are required to assure safety of the property . . . . Requiring the property to be clearly identified and held separately reduces the danger of conversion, negligent misappropriation, or loss and protects the property from seizure by creditors of the lawyer or of other clients . . . . Notice to the client enables the client to obtain the property or to keep track of it while in the lawyer's possession . . . .

> Those precautions are also generally appropriate for property belonging to a third person that comes into a lawyer's possession in the course of a representation. Thus, a lawyer must safeguard a deed of a client's spouse, as well as property received in the lawyer's capacity as a trustee, executor, escrow agent, or the like, unless that capacity is unrelated to a representation. Receiving property in such a capacity may also give rise to additional duties under law governing that capacity. This Section does not apply to property received otherwise than in connection with a representation, such as office equipment rented by a lawyer under a commercial lease or property the lawyer stores for a friend.

Restatement (Third) of Law Governing Lawyers § 44 cmt. b (2000) (emphasis added).

Another Restatement comment explains the broad reach of this governing principle.

> This Section applies to all valuable objects including cash, jewelry, and the like, negotiable instruments, deeds, stock certificates, and other papers evidencing title. See also § 46, discussing documents in the lawyer's possession. This Section requires a lawyer to use reasonable measures for safekeeping such objects, for example by placing them in a safe-deposit box or office safe. The reasonableness of measures depends on the circumstances, including the market value of the property, its special value to the client or third person, and special difficulties that would be required to replace it if known to the lawyer, its transferability or convertibility, its susceptibility to loss or other damage, the reasonable customs of lawyers in the community, and the availability and cost of alternative methods of safekeeping.
>
> The terms of an agreement under which the lawyer receives property can modify the obligations imposed by this Section. For example, an escrow contract might require the lawyer serving as escrowee to pay out the escrow funds upon the occurrence of a stated event. A lawyer's obligation to safeguard property may be relaxed by a contract only if any client or third person whose interests are affected gives informed consent, on terms that serve some purpose other than the convenience or profit of the lawyer . . . . On business dealing with a client, see § 126.

Restatement (Third) of Law Governing Lawyers § 44 cmt. e (2000).

The Restatement also notes states' different and specific rules governing this issue.

> All jurisdictions have rules concerning a lawyer's responsibilities for client property, enforceable by disciplinary sanctions. Strong sanctions including disbarment have been imposed for converting or even commingling client funds. The rules often specify where the lawyer's bank account must be located, the records the lawyer must keep, and other matters. Many states provide for random audits of lawyer trust accounts, notification of bar authorities by banks when trust accounts are overdrawn, and client security funds to compensate clients injured by misappropriating lawyers.
>
> A lawyer who violates this Section can be subject to civil liability as well as disciplinary sanctions. A lawyer who converts the property of another is of course liable as is one who negligently fails to safeguard against the conversion or loss of property entrusted to the lawyer. Under agency principles, the lawyer is subject to liability for failure to segregate client property and keep proper records and must account for any profits resulting from the lawyer's misuse of the property . . . . Criminal conviction for embezzlement or similar offenses is also possible.

Restatement (Third) of Law Governing Lawyers § 44 cmt. c (2000).

Also like the ABA Model Rules, the Restatement also requires lawyers to provide notification when they receive such property.

> Upon receiving funds or other property in a professional capacity and in which a client or third person owns or claims an interest, a lawyer must promptly notify the client or third person. The lawyer must promptly render a full accounting regarding such property upon request by the client or third person.

Restatement (Third) of Law Governing Lawyers § 44(2) (2000). A comment provides some additional explanation.

> A lawyer who receives property claimed by a client or third person to whom the lawyer owes a duty of safekeeping must inform the owner or claimant so that the latter can protect his or her rights . . . . Likewise, the lawyer must render account of the property of others in the lawyer's possession when requested. . . .
>
> When the claimant is a third person whose interests conflict with those of the lawyer's client but to whom the lawyer owes a duty of safekeeping or notification, the lawyer must notify that person of the lawyer's receipt of the property. That situation could exist, for example, where the lawyer is an executor and the third person a legatee, where the law designates the lawyer a constructive trustee for the person because the property has been converted . . . , or where other law imposes a duty on the lawyer to turn over property or funds directly to the third person. The lawyer's duties of confidentiality to the client do not bar such notice because the lawyer may not assist the client to conceal the property from the third person to whom the lawyer owes the duty of safekeeping . . . . Moreover, the arrangement under which the lawyer receives property of a third person of adverse interest -- for example, an escrow arrangement -- can imply that the client and third person have agreed that the lawyer is to protect the third person's interests.

Restatement (Third) of Law Governing Lawyers § 44 cmt. h (2000).

Another comment repeats the general prohibition on commingling, and describes lawyers' options when handling trust account funds.

A comment provides an explanation.

> A lawyer must deposit funds of a client or a third person in an account, usually a trust or client account, separate from the lawyer's own funds, and including those of the lawyer's law practice. The trust account may contain funds of more than one person, but the records must adequately identify the share of each person. The lawyer may not receive interest on such funds. Most states now have arrangements under which certain client funds (usually small amounts) may or must be pooled in accounts, the interest from which is paid to a regulatory authority to fund legal services for the indigent and other similar activities. When trust accounts may bear interest for the benefit of an individual client and

> the amount and probable duration of the deposit justify the effort and expense involved, the lawyer should arrange for an interest-bearing account, with the interest to be transmitted to the clients. A lawyer holding client funds as a trustee or in other capacities may be required to invest them.

Restatement (Third) of Law Governing Lawyers § 44 cmt. d (2000) (emphasis added).

**Case Law and Bar Opinion**

The prohibition on comingling is so strong that lawyers can be punished for comingling funds even if no client suffers any harm.

- In re Osborne, 713 A.2d 312, 312 (D.C. 1998) (issuing a public censure of a lawyer whose bookkeeper had improperly commingled funds between the lawyer's trust account and operating account; noting that the lawyer took no action to correct the problem despite knowing about it for approximately one year; issuing the censure despite finding that "the bookkeeper kept careful records of all funds, and no clients ever lost funds due to [the lawyer's] actions").

In fact, lawyers can be punished for not keeping the required trust account records, even if no client loses money, and for failing to supervise unfaithful assistants.

- In re Robinson, 74 A.3d 688, 695, 695-96 (D.C. Cir. 2013) (suspending for seven months a lawyer who allowed his son-in-law (another lawyer at the firm) to handle the firm's trust account, and he did not follow-up upon receiving notices of two bounced checks; "Prior to the overdraft that triggered Bar Counsel's investigation, respondent relied on Kourtesis to manage the firm's trust account. Both the Hearing Committee and the Board concluded it was reasonable for respondent to do so."; "The time period following the initial overdraft is altogether another matter. We agree that respondent acted negligently following the first overdraft, and his negligence left the funds in the trust account depleted such that the misappropriation continued and a second overdraft occurred. Given the importance placed upon the scrupulous care of client funds, the overdraft was a serious wake-up signal to the sole individual with ultimate responsibility for the trust account and a situation that mandated his personal continuing attention. The Board found that respondent's failure to pursue the matter in a more diligent fashion resulted in the second overdraft, which extended the misappropriation." (footnote omitted); "Respondent asked Kourtesis to look into the problem and wrote a check to cover the deficit, but admitted that he never followed up with the matter and essentially washed his hands of the matter. The check barely covered the overdraft and left the trust account in a continuing depleted state. Nearly one

month later, the trust account was overdrawn a second time. Respondent again asked Kourtesis to investigate the matter, and wrote a check to cover the deficit. At the hearing, respondent did not recall following up with Kourtesis even on the second overdraft. And again, the check written to cover the overdraft was insufficient to make the trust account whole. In addition, respondent did not take control of the accounts away from Kourtesis after the second overdraft occurred." (footnote omitted); noting in its factual discussion that the overdrafts occurred because a trust check was mistakenly deposited in the firm's operations account).

- Mike Frisch, For The Absence Of Records, Law Profession Blog, Sept. 21, 2012 ("The Iowa Supreme Court imposed a 30-day suspension (rejecting the Grievance Commission panel's proposed reprimand) in a disciplinary case in which the complainant was the attorney's former paralegal assistant. The court found two instances in which the attorney had mishandled advanced retainers. The attorney also failed to maintain required records. The court noted that the found misconduct might warrant a non-suspensory sanction. However, because the attorney's records were so deficient '. . . we have no way of knowing whether the trust account violation outlined [in the opinion] was an isolated occurrence or a more frequent event.' Thus, the lack of records was treated as an aggravating factor.").

Every state seems to have different (and also very specific) rules governing trust accounts. In fact, this may be the reason why the ABA Model Rules are so general -- essentially conceding that every state will adopt its own detailed trust account provisions.

For instance, most states require lawyers to retain any disputed funds in a trust account until some court resolves the dispute (which is the approach adopted by the ABA Model Rules).

- Colorado LEO 118 (2/18/08) ("If a lawyer properly withdraws client funds from the lawyer's trust account to apply to the lawyer's fees, in accordance with Colo. RPC 1.5 and the lawyer's agreement with the client, and the client subsequently disputes the lawyer's fee, the lawyer is not required or permitted to return the disputed amount to the lawyer's trust account that holds funds of any clients. Although the lawyer is not required to, the lawyer may place the disputed amount in a separate trust account that holds only the disputed amount.").

Perhaps not surprisingly, California applies a different rule.

- California LEO 2006-171 (2006) ("Funds properly withdrawn from a CTA under rule 4-100(A)(2) and later disputed by the client neither retain nor regain their trust account status, and therefore do not need to be re-deposited into the attorney's CTA. Based on a plain reading of rule 4-100, such funds bear none of the indicia of trust account status at the moment of withdrawal, i.e., the withdrawn funds do not belong to the client, are not subject to a joint interest of attorney and client, are not subject to a joint interest of the client and any third party, and are not being held by the Attorney as part of the subject representation. The fact that Client later expresses remorse, regret or other dissatisfaction with the amount of Attorney's fee is a matter of contract to be resolved by an analysis of the engagement agreement and the respective performance of the parties.").

To make matters more complicated, states sometimes change their trust account rules in very basic ways.

For instance, as recently as 1996, the District of Columbia Bar specifically indicated that retainer checks (representing a deposit to cover future fees) could not be deposited in a trust account, but rather had to be placed in the lawyer's operating account. D.C. LEO 264 (2/14/96) (prohibiting a lawyer from depositing a retainer check in a trust account and requiring the lawyer to deposit the money in the law firm's operating account; acknowledging that "other jurisdictions may take the opposite approach and require that fee advances be placed in a trust account until earned"). The District of Columbia has now changed its rules to follow the national standard on this issue. D.C. Rule 1.15(d).

As might be expected, law firms having offices in different states must deal with choice of laws issues.

- Arizona LEO 09-03 (11/2009) ("An Arizona-licensed lawyer who maintains an office in Arizona but whose law firm also has an office in another jurisdiction may keep trust funds in a trust account held outside of Arizona provided that the client (or third person, where relevant) consents and the account is held at an approved financial institution. If the account is a pooled trust account on which interest and dividends are not paid to clients, the interest and dividends

on the funds from the Arizona-licensed lawyer must be paid to the Arizona Foundation for Legal Services and Education.").

- In re Disciplinary Action Against Overboe, 745 N.W. 2d 852 (Minn. 2008) (holding that the lawyer's abuse of trust account money would be governed by the ethics rules of the state where the bank is located, while the lawyer's state's ethics rules apply to the lawyer's alleged misrepresentation to the state bar).

## Conclusion

Although it may seem counter-intuitive, every state's ethics rules prohibit lawyers from keeping a "cushion" of their own money in their trust accounts.

The main "evil" that the bar hopes to prevent is lawyers' theft of client money from a trust fund. Even though such a "cushion" might actually prevent harm to other clients in the case of a "bounced" check, the ethics rules insist that law firms leave only enough non-client money in trust accounts to cover ordinary bank service charges (as well as any disputed amounts).

This assures that any erroneous check will bounce -- triggering the bank's notification to the bar, and guaranteeing a prompt investigation. In essence, the ethics rules require every trust account to be on a "razor's edge," so that lawyer misconduct will raise a red flag.

For this reason, lawyers must immediately withdraw any amount of a "retainer" deposit that the lawyer has earned -- keeping the lawyer's money in the trust account violates the ethics rules just as surely as wrongfully taking a client's money out.

Given the ultimate goal of assuring that lawyers "bounce" checks from their trust accounts if there is any impropriety, states generally prohibit lawyers to assure for "overdraft" protection.

However, at least one bar has permitted such an arrangement.

- California LEO 2005-169 (2005) ("1. An attorney does not commit an ethical violation merely by obtaining or using overdraft protection on a Client Trust Account, so long as the protection in question does not entail the commingling of the attorney's funds with the funds of a client. Overdraft protection that compensates exactly for the amount that the overdraft exceeds the funds on deposit (plus funds reasonably sufficient to cover bank charges) is permissible, whereas overdraft protection that automatically deposits an amount leaving a residue after the overdraft is satisfied is not. In all cases, banks must report to the State Bar any presentment of a check against a Client Trust Account without sufficient funds, whether or not the check is honored. Although overdraft protection will not avoid State Bar notification, nor exculpate any unethical conduct that caused the overdraft, it may avoid negative consequences to a client resulting from a dishonored check. 2. When a check is issued against a Client Trust Account with insufficient funds to cover the amount of the check, an attorney must deposit funds sufficient to clear the dishonored check or otherwise make payment, must take reasonably prompt action to ascertain the condition or event that caused the check to be dishonored, and must implement whatever measures are necessary to prevent its recurrence. In addition, if a client will experience negative consequences from the dishonoring of the check, the attorney may have to advise the client of the occurrence. 3. An attorney must withdraw earned fees from a Client Trust Account at the earliest reasonable time after they become fixed in order to comply with the attorney's ethical obligations, but need not do so immediately." (emphasis added)).

## Best Answer

The best answer to this hypothetical is **NO**.

B 11/14

# Trust Account Ramifications of Client Retainers

## Hypothetical 39

Your new finance director has asked for some guidance on whether client retainer payments should be deposited into your firm's trust account or whether they should be deposited into the firm's operating account.

Should the following client retainer payments be deposited into the firm's trust account?

**(a)** A "true" retainer payment?

**NO**

**(b)** A fixed-fee payment for a real estate transaction?

**YES**

## Analysis

Not surprisingly, a lawyer's trust account obligations upon receipt of a retainer payment depends on the exact nature of the payment.

**(a)-(b)** Apart from any state-specific nuances, the general rule requires that lawyers (1) deposit into their operating account (not their trust account) any "true" retainer payments or other payments that the pertinent state considers the lawyers to have earned upon receipt; (2) place into their trust accounts any client deposit against future fees that the lawyers will bill; (3) not withdraw any amounts placed in their trust account until they have earned the amounts; and (4) keep in their trust account any disputed amounts.

To the extent that client payments can be characterized as deposits against which the lawyer will charge a fee when earned, the ABA Model Rules indicate that such an amount belongs in lawyers' trust accounts.

> A lawyer shall deposit into a client trust account legal fees and expenses that have been paid in advance, to be withdrawn by the lawyer only as fees are earned or expenses incurred.

ABA Model Rule 1.15(c).

A comment provides a further explanation, and warns lawyers not to take advantage of their clients.

> Lawyers often receive funds from which the lawyer's fee will be paid. The lawyer is not required to remit to the client funds that the lawyer reasonably believes represent fees owed. However, a lawyer may not hold funds to coerce a client into accepting the lawyer's contention. The disputed portion of the funds must be kept in a trust account and the lawyer should suggest means for prompt resolution of the dispute, such as arbitration. The undisputed portion of the funds shall be promptly distributed.

ABA Model Rule 1.15 cmt. [3].

States' legal ethics opinions agree with this approach.

- D.C. LEO 355 (6/10) ("In its decision in In re Mance, 980 A.2d 1196 (D.C. 2009), the District of Columbia Court of Appeals held that, absent informed consent from the client to a different arrangement, a lawyer must deposit a flat or fixed fee paid in advance of legal services in the lawyer's trust account. Under Mance, such funds must remain in the lawyer's trust account until earned unless the client gives informed consent to a different arrangement." (emphasis added)).

- In re Mance, 980 A.2d 1196, 1203, 1204, 1206, 1207 (D.C. 2009) ("A corollary to the rule that a flat fee is an advance of unearned fees, is that the fee must be held as client funds in a client's trust or escrow account until they are earned by the lawyer's performance of legal services." (emphasis added); "Another important benefit to placing flat fees in a trust or escrow account is preservation of the client's right to choose his or her counsel, including the right to discharge an attorney."; "But we also note that, consistent with the general requirement that a lawyer must entrust flat fees in a trust or escrow account until earned, the client may consent otherwise . . ., and the fee agreement may specify how and when the attorney is deemed to earn the flat fee or specified portions of the fee."; "Although the default rule is that an attorney must hold flat fees in a client trust or escrow account until earned, we note that an attorney may obtain informed consent from the client to deposit

all of the money in the lawyer's operating account or to deposit some of the money in the lawyer's operating account as it is earned, per their agreement."; "Where there is no discussion regarding the fee arrangement besides merely stating the overall fee, and no mention of the escrow account option, a client cannot be said to have a sufficient basis to give informed consent to waive the requirements of a rule designed to protect the client's interests.").

- North Carolina LEO 2008-10 (10/24/08) (in a compendium opinion about fees, explain the four existing types of fees paid in advance, and creating a new type of permissible fee to be paid in advance -- called a "minimum fee"; identifying five types of fees that can be paid in advance, and providing additional details about all five: advance payment; general retainers, flat fee or prepaid flat fee; hybrid fees and minimum fees; providing additional information about "advance payment" fees, which the bar defines as: "a deposit by the client of money that will be billed against, usually on an hourly basis, as legal services are provided; not earned until legal services are rendered; deposited in the trust account; unearned portion refunded upon the termination of the client-lawyer relationship."; providing additional explanation of such an advance payment fee; "RPC 158 holds that an advance payment to a lawyer for services to be rendered in the future, in the absence of an agreement with the client that the payment is earned immediately, is a deposit securing the payment of a fee which is yet to be earned. As such, it remains the property of the client and must be deposited in the lawyer's trust account. See also 2005 FEO 13 (minimum fee that is collected at the beginning of a representation and will be billed against at a lawyer's regular hourly rate is neither a general retainer nor a flat fee; therefore, minimum fee remains the client's money until earned by the provision of legal services and must remain on deposit in the trust account until earned).").

In contrast, lawyers must deposit into their operating account any amounts that can be properly characterized as "true" retainers -- which lawyers earn at the moment that the client makes the payment.

- Arizona LEO 10-03 (6/2010) (explaining how non-refundable fees [which Arizona permits under certain circumstances] must be handled in connection with a lawyer's trust account: "A non-refundable fee becomes the property of the lawyer when paid. Such funds should not be placed in a trust account where they will commingle with client funds. ER 1.15(a). On the other hand, the client retains ownership of, or at least an equitable claim to, funds representing an advance payment of fees. Accordingly, those funds must be deposited in the lawyer's trust account. ER 1.15(c). The lawyer may withdraw the advanced fee from the trust account only when, and to the extent that, he or she earns the fee by the criteria specified in the fee

agreement. In the case of the type of 'hybrid' fee at issue here -- in part non-refundable, and in part earned on an hourly or other basis -- prepaid funds advanced to secure the hourly fee would go into the trust account, but funds earned on receipt would not." (emphasis added); ultimately finding that the non-refundable fee as not unethical; "The Committee believes that the fee arrangement at issue is not on its face unethical, if the total fee is reasonable. The Committee's concern centers around use of the term 'flat fee' for the proposed arrangement, because of the traditional understanding by clients of what the term 'flat fee' entails. The proposed arrangement would not pose this problem of confusion if the fee paid for the specified number of hours was termed a 'minimum fee.' In reality, the proposed fee arrangement is calling for the payment of a minimum fee, not what has been traditionally terms a 'flat fee.'"; "This minimum fee could be designated as 'earned on receipt' and 'non-refundable,' in which case the funds should be placed n the lawyer's operating account. If the minimum fee is not so designated, the funds should be placed in the trust account and transferred to the operating account when the funds have been earned." (footnote omitted)).

- North Carolina LEO 2008-10 (10/24/08) (in a compendium opinion about fees, explain the four existing types of fees paid in advance, and creating a new type of permissible fee to be paid in advance -- called a "minimum fee"; identifying five types of fees that can be paid in advance, and providing additional details about all five: advance payment; general retainers, flat fee or prepaid flat fee; hybrid fees and minimum fees; providing further explanation about a new fee that the bar calls a "minimum fee," which the bar defines as follows: "consideration paid at the beginning of a representation to reserve the exclusive services of a lawyer; lawyer provides legal services up to the value of the minimum fee; earned upon payment; paid to lawyer or deposited in firm operating account; some or all of the minimum fee is subject to refund if clearly excessive under the circumstances as determined upon the termination of the client-lawyer relationship." (emphasis added); explaining that "[i]f there is a seeming inconsistency in the ethics opinions it arises from the strict formulation of the general retainer. A lawyer is allowed to charge a general retainer as consideration for the reservation of the lawyer's services and to treat the money as earned immediately. But the client is not given a credit for future legal services up to the value of the retainer. This strikes many lawyers as detrimental to the client's interests and it has lead to the creation of hybrid fees. The strict formulation of the general retainer has been maintained by the Ethics Committee for three important reasons. It avoids the client confusion that is engendered if a client is told that a payment both reserves the lawyer's services and pays for future representation. In addition, requiring general retainers to be separate and distinct from advance fees means that, if an advance fee is charged for future legal services, there is no penalty to the client for deciding to change legal counsel before the advance fee is exhausted and, if a refund is owed to the client because expected services have not been performed, the money is

readily available in the trust account."; "Upon further reflection, the Ethics Committee has, nevertheless, determined that it is in the client's interest to receive legal services up to the value of a general retainer provided the client fully understands and agrees that the payment the client makes at the beginning of the representation is earned by the lawyer when paid, will not be deposited in a trust account, and is only subject to refund if the charge for reserving the lawyer's services (as opposed to the charge for the legal services performed) is clearly excessive under the circumstances. This newly acknowledged form of fee payment made by a client at the beginning of a representation will be referred to as a minimum fee. . . ."; offering the following proposed (but not mandatory) model fee provision dealing with such a fee: "As a condition of the employment of Lawyer, Client agrees to pay $___ ___ to Lawyer. This money is a minimum fee for the reservation of Lawyer's services; to insure that Lawyer will not represent anyone else relative to Client's legal matter without Client's consent; and for legal work to be performed for Client."; "Client understands and specifically agrees that: the minimum fee will be earned by Lawyer immediately upon payment and will be deposited in Lawyer's business account rather than a client trust account; Lawyer will provide legal services for Client on an hourly basis [or other appropriate basis] according to the schedule attached to this agreement until the value of those services is equivalent to the minimum fee; thereafter, Client will be billed for the legal work performed by Lawyer and his/her staff on an hourly basis [or other appropriate basis] according to the schedule attached to this agreement; and when Lawyer's representation ends, Client will not be entitled to a refund of any portion of the minimum fee, even if the representation ends before Lawyer has provided legal services equivalent in value to the minimum fee, unless it can be demonstrated that the minimum fee is clearly excessive fee under the circumstances." (emphasis added)).

- Dowling v. Chi. Options Assocs., Inc., 875 N.E.2d 1012, 1018, 1021, 1022 (Ill. 2007) (explaining that Illinois recognizes three different kinds of retainers, one of which is an "advance payment retainer" that must be placed in the lawyer's operating account even though the lawyer has not yet undertaken the work and might be obligated to pay the retainer back to the client; "Two types of retainers are generally recognized. The first is variously referred to as the 'true,' 'general,' or 'classic' retainer. Such a retainer is paid by a client to the lawyer to secure the lawyer's availability during a specified period of time or for a specified matter. This type of retainer is earned when paid and immediately becomes property of the lawyer, regardless of whether the lawyer ever actually performs any services for the client. . . . The second type of retainer is referred to as a 'security retainer.' Under this arrangement, the funds paid to the lawyer are not present payment for future services; rather, the retainer remains the property of the client until the lawyer applies it to charges for services that are actually rendered. Any unearned funds are refunded to the client. The purpose of a security retainer is to secure payment of fees for future services that the lawyer is expected to perform. . . .

Pursuant to Rule 1.15(a) of the Illinois Rules of Professional Conduct, a security retainer must be deposited in a trust account and kept separate from the lawyer's own property."; "There is yet a third type of retainer, called the 'advance payment retainer.' This type of retainer consists of a present payment to the lawyer in exchange for the commitment to provide legal services in the future. Ownership of this retainer passes to the lawyer immediately upon payment. . . . Accordingly, the lawyer deposits the retainer into his or her general account; in fact, an advance payment retainer may not be deposited into a trust account, since a lawyer may not commingle property of a client with the lawyer's own property." (emphasis added); explaining this type of retainer; "[W]e recognize advance payment retainers as one of three retainers available to lawyers and their clients in this state. The other retainers are the classic or general retainer and the security retainer."; "An appropriate use of advance payment retainers is illustrated by the circumstances of the instant case, where the client wishes to hire counsel to represent him or her against judgment creditors. Paying the lawyer a security retainer means the funds remain the property of the client and may therefore be subject to the claims of the client's creditors. This could make it difficult for the client to hire legal counsel. Similarly, a criminal defendant whose property may be subject to forfeiture may wish to use an advance payment retainer to ensure that he or she has sufficient funds to secure legal representation. We caution, however, that such fee arrangements, as well as those involving security retainers, are subject to a lawyer's duty to refund any unearned fees, pursuant to Rule 1.16(e) (134 Ill. 2d R. 1.16(e)). A client has an unqualified right to discharge a lawyer and, if discharged, the lawyer may retain only a sum that is reasonable in light of the services the lawyer performed prior to being discharged."; holding that an individual's payment to DLA Piper [plaintiff's lawyers] amounted to this kind of retainer, and therefore was properly placed in the law firm's operating account and unavailable to creditors of the individual).

- North Carolina LEO 2005-13 (1/20/06) (analyzing the following situation: "Partner C, who practiced family law litigation, typically used a fee contract referred to by the firm as a 'minimum fee' contract. The contract provides that the initial fee charged to the clients is the greater of (1) the flat fee established in the contract, or (2) an hourly rate applied to actual time that will be spent in representation of the client. A minimum fee paid by the client was deposited into the firm's general account. The contract, however, did not state that the fee was deemed earned and payable to the attorney upon receipt."; holding that lawyers remaining at the law firm (after Partner C left and took most of his clients with him) are required to refund unused funds to the clients; "In order for a payment made to an attorney to be earned immediately, the attorney must clearly inform the client that it is earned immediately, and the client must agree to this arrangement. See RPC 158. Even with the consent of the client, only true retainers and flat fees are deemed earned by the lawyer immediately and therefore can be deposited into the operating account

upon receipt. A minimum fee that will be billed against at the lawyer's hourly rate is client money and belongs in the trust account until earned. See Rule 1.15-2 (b). In the present case, at some point during the representation, Law Firm would calculate the number of hours C spent on the case and determine whether the client owed more money. The fee arrangement was therefore neither a true retainer nor a flat fee. Furthermore, Law Firm's fee contract did not make an allowance for the fee to be deposited into the firm's operating account. Therefore, those portions of the minimum fees that were not earned by C's labor while with Law Firm remain client funds and must be returned to the clients. See Rule 1.16(d). If Law Firm does not return the unearned portions of the funds to C's clients, they will have collected an excessive fee in violation of Rule 1.5(a).").

In some situations, a client's single payment may include both types of payments, and therefore must be split between the trust account and the lawyer's operating account.

- North Carolina LEO 2008-10 (10/24/08) (in a compendium opinion about fees, explain the four existing types of fees paid in advance, and creating a new type of permissible fee to be paid in advance -- called a "minimum fee"; identifying five types of fees that can be paid in advance, and providing additional details about all five: advance payment; general retainers, flat fee or prepaid flat fee; hybrid fees and minimum fees; providing additional explanation about a "hybrid fee," which the bar defines as follows: "fee paid at the beginning of a representation that is in part a general retainer or a flat fee and in part an advance payment to secure payment of fees yet to be earned; one portion of the fee is earned immediately and the other remains the client's property on deposit in the trust account; client must consent and agree to the portion that is a flat fee or a general retainer and earned immediately; unearned portion of the advance payment refunded upon termination of the client-lawyer relationship; flat fee/general retainer portion subject to refund if clearly excessive under the circumstances as determined upon the termination of the client-lawyer relationship." (emphasis added); explaining that "[t]he opinion recognizes that a lawyer may charge a client hybrid fees. Such hybrid fees include a payment that is part general retainer or flat fee and part advance to secure the payment of fees yet to be earned. With hybrid fees, one portion of the fee is earned immediately and the other portion remains the client's property and must be deposited in the trust account to be withdrawn as earned. 'There should be a clear agreement between the lawyer and the client as to which portion of the payment is a true general retainer, or a flat fee, and which portion of the payment is an advance. Absent such an agreement, the entire payment must be deposited into the trust account and will be considered client funds until earned.'" (emphasis added)).

With some types of client payments, the proper handling can be nearly impossible to assess.

For instance, in 2006 the North Carolina Bar explicitly indicated that "flat fees" must be deposited into an operating account.

- North Carolina LEO 2005-13 (1/20/06) (analyzing the following situation: "Partner C, who practiced family law litigation, typically used a fee contract referred to by the firm as a 'minimum fee' contract. The contract provides that the initial fee charged to the clients is the greater of (1) the flat fee established in the contract, or (2) an hourly rate applied to actual time that will be spent in representation of the client. A minimum fee paid by the client was deposited into the firm's general account. The contract, however, did not state that the fee was deemed earned and payable to the attorney upon receipt."; holding that lawyers remaining at the law firm (after Partner C left and took most of his clients with him) are required to refund unused funds to the clients; "In order for a payment made to an attorney to be earned immediately, the attorney must clearly inform the client that it is earned immediately, and the client must agree to this arrangement. See RPC 158. Even with the consent of the client, only true retainers and flat fees are deemed earned by the lawyer immediately and therefore can be deposited into the operating account upon receipt. A minimum fee that will be billed against at the lawyer's hourly rate is client money and belongs in the trust account until earned. See Rule 1.15-2 (b). In the present case, at some point during the representation, Law Firm would calculate the number of hours C spent on the case and determine whether the client owed more money. The fee arrangement was therefore neither a true retainer nor a flat fee. Furthermore, Law Firm's fee contract did not make an allowance for the fee to be deposited into the firm's operating account. Therefore, those portions of the minimum fees that were not earned by C's labor while with Law Firm remain client funds and must be returned to the clients. See Rule 1.16(d). If Law Firm does not return the unearned portions of the funds to C's clients, they will have collected an excessive fee in violation of Rule 1.5(a)." (emphasis added)).

Three years later, a District of Columbia court indicated exactly the opposite.

- In re Mance, 980 A.2d 1196, 1203, 1204, 1206, 1207 (D.C. 2009) ("A corollary to the rule that a flat fee is an advance of unearned fees, is that the fee must be held as client funds in a client's trust or escrow account until they are earned by the lawyer's performance of legal services." (emphasis added); "Another important benefit to placing flat fees in a trust or escrow account is preservation of the client's right to choose his or her counsel, including the right to discharge an attorney."; "But we also note that, consistent with the general requirement that a lawyer must entrust flat fees in a trust or escrow

account until earned, the client may consent otherwise . . . and the fee agreement may specify how and when the attorney is deemed to earn the flat fee or specified portions of the fee."; "Although the default rule is that an attorney must hold flat fees in a client trust or escrow account until earned, we note that an attorney may obtain informed consent from the client to deposit all of the money in the lawyer's operating account or to deposit some of the money in the lawyer's operating account as it is earned, per their agreement."; "Where there is no discussion regarding the fee arrangement besides merely stating the overall fee, and no mention of the escrow account option, a client cannot be said to have a sufficient basis to give informed consent to waive the requirements of a rule designed to protect the client's interests.").

Three years after that, an Alaska legal ethics opinion explained that determining the right place to deposit a "flat fee" is "not so obvious."

- Alaska LEO 2012-2 (4/30/12) (analyzing the trust account implications of a "security retainer"; "In the case of a security retainer, without question the funds must be deposited in the client trust account pursuant to ARPC 1.5(a). It is likewise clear that classic retainers, in which the client has agreed to pay to secure the lawyer's availability over a specific period of time, whether or not legal services are actually rendered, may not be deposited in the trust account because the funds are the property of the lawyer when paid and may not be commingled with the client's funds." (footnote omitted) (emphasis added); contrasting this with a flat fee; "The answer is not so obvious in the case of a flat fee. Whether the flat fee is treated as client funds or the property of the lawyer upon payment could have substantial consequences for the client. If the funds remain the client's property -- and are thus required by ARPC 1.14(a) to be segregated in a trust account -- they will be subject to claims of the client's creditors. A client facing determined creditors may need to ensure that she has the wherewithal to resist the creditors' claims by funding her legal defense in advance. Once the defense funds become the lawyer's property they are often beyond the reach of creditors and the lawyer is under an obligation to provide the legal services required to resist the creditor's claims." (emphasis added); "[I]n certain circumstances the client's interests would best be served by being able to prepay for legal services in a manner that allows the client to convey ownership of some or all of the funds to the lawyer at the time of the payment, most commonly when the client is funding legal resistance to creditors or government entities seeking forfeiture. In those circumstances a rule requiring prepaid fees to be placed in a client trust account would be contrary to the client's economic interest. Such a rule may also impinge on the client's ability to hire legal counsel and on the willingness of lawyers to undertake such representation. . . . For example, a lawyer taking on a client's case may be required to forego other representations because of potential conflicts or time constraints, so it may be

reasonable for a lawyer to require some or all of an advance payment to be denominated as earned (and thus the property of the lawyer on payment) to account for those eventualities.").

Unfortunately, despite this uncertainty lawyers can face severe punishment if they remove money from a trust account and move it into their operating account too early.

- Iowa Supreme Court Attorney Disciplinary Bd. v. Powell, 830 N.W.2d 355, 358, 359 (Iowa 2013) (suspending for three months a lawyer who had improperly removed money from a trust fund before he earned it; "We agree with the commission that Powell violated rule 32:1.15, and the Iowa Court Rules governing trust funds. However, the evidence failed to support a finding that Powell had no colorable claim to the funds he removed from his trust account or failed to place in his trust account. Instead, consistent with the charges brought by the Board, he repeatedly failed to comply with the rules and procedures governing trust accounts. The fighting question turns on the sanction that should result from the violations, largely in light of the temporary seven-month suspension served by Powell prior to and during the pendency of this proceeding."; "Broadly, this case involves conduct by a lawyer in improperly removing client funds from a trust account and failing to deposit advance fees into the trust account. Within this broad category of conduct, we recognize that a revocation normally results when the conduct of the offending lawyer constitutes conversion or theft."; "Yet, when the case involves client funds held as an advance fee and the conduct of the attorney involves the conversion of the funds before they were earned, we generally impose discipline in the form of a suspension.").

## Best Answer

The best answer to **(a)** is **NO**; the best answer to **(b)** is **YES**.

B 11/14

# Timing of Trust Account Disbursements from a Trust Account

## Hypothetical 40

Your firm's commercial real estate practice is finally picking up a bit, and you have several questions about the timing of disbursements from a trust account following a real estate transaction.

**(a)** If your best client gives you a check to deposit into your trust account, can you immediately disburse on that check?

**NO**

**(b)** If a client gives you a cashier's check to deposit into your trust account, can you immediately disburse on that check?

**MAYBE**

**(c)** If a client wire transfers money into your trust account, can you immediately disburse on that check?

**YES (PROBABLY)**

## Analysis

**(a)-(c)** Every state's ethics rules and every state's bar emphasize the prohibition on disbursing any funds until they are completely collected.

This obsession rests on the notion that disbursing any supposed funds that ultimately prove to be unavailable necessarily amounts to stealing another client's trust funds and using it for the benefit of a different client.

Every state follows this approach.

Given lawyers' fertile imaginations (especially in matters involving money), one would expect that lawyers would propose elaborate arrangements to avoid this strict technical requirement -- while assuring in good faith that their clients are not harmed.

States, courts and bars universally reject such proposed arrangements.

Courts and bars have explicitly indicated that lawyers may not:

- Post-date checks drawn on trust accounts, to assure that the funds are collected when the check is presented.[1]
- Arrange for a bank handling a trust account to immediately credit deposited funds without waiting for clearance, and honor all trust account checks.[2]
- Arrange for a line of credit -- under which the firm might ultimately become responsible for the loan -- that would enable the firm to immediately disburse funds from a trust account upon personal injury settlements.[3]
- Deposit a check endorsed by the client and the lawyer in the firm's trust account, and write the client a check from the operating account for the amount that the client is due -- intending to reimburse the operating account from the trust account once the check clears.[4]

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[1] New Jersey LEO 609 (12/10/87) (explaining that "it would be improper to draw upon these funds until the check is cleared . . . and this is true even where the instrument is certified or is a cashier's or bank check representing the settlement proceeds of a negligence case"; "[W]e hold that it is improper for an attorney to issue any checks drawn upon an attorney's trust account until the instrument representing the funds against which the check or checks are drawn has in fact cleared").

[2] Virginia LEO 1021 (1/7/88) (even if the bank handling a trust account has agreed to immediately credit deposited funds without waiting for clearance and honor all trust account check, a personal injury lawyer may not disburse funds from a trust account before the funds have cleared).

[3] Virginia LEO 1256 (7/25/89) (a law firm may not arrange for a line of credit (under which the firm might ultimately become responsible for the loan) that would enable the firm to immediately disburse funds from a trust account upon personal injury settlements, because: the firm would be acquiring an interest in the outcome of the litigation; the lawyer would be advancing money other than appropriate litigation expenses; and it would commingle the lawyer's funds and the client's funds).

[4] Virginia LEO 614 (10/30/84) (except as authorized by statute, a lawyer may not disburse funds from a trust account until the funds have cleared; a lawyer may not deposit a check endorsed by the client and the lawyer in the firm's trust account and write the client a check from the operating account for the amount the client is due (intending to reimburse the operating account from the trust account once the check clears)).

Of course, one key factor is how to determine when funds are actually present in the lawyer's trust account -- at which time the lawyer can safely disburse them without putting at risk any other clients' funds in the trust account.

Some states take a very strict approach.

- Virginia LEO 1835 (9/7/06) (explaining that although banking law defines when funds are "cleared" (meaning that they are "available for withdrawal and disbursement with no chance of revocation or recall by the financial institution"), Rule 1.15 prohibits lawyers from disbursing on funds until they are cleared; concluding that this per se rule applies even if the trust account holds only one client's funds, or has somehow been "securitized.").

Some states take a somewhat more liberal attitude toward the type of payments against which lawyers may immediately disburse.

- North Carolina LEO 2001-3 (4/27/01) ("[A] lawyer may settle a tort claim by making disbursements from a trust account in reliance upon the deposit of funds provisionally credited to the account if the deposited funds are in the form of a financial instrument that is specified in the Good Funds Settlement Act, G.S. Chap. 45A.").

The increasing frequency and sophistication of scam artists has magnified lawyers' exposure to sanctions and personal risks.

- Tam Harbert, Law Firm Flimflam Scam Continues, Law Tech. News, June 8, 2012 ("Despite repeated warnings from the Federal Bureau of Investigation (FBI), law firms continue to fall for an old internet scam."; "In the scam, the firm gets an e-mail requesting assistance with some form of debt collection, financial settlement, or real estate transaction. In some instances, the purported client negotiates with the law firm to take the matter to court. Before any lawsuits are filed, however, the law firm receives a large check from the alleged debtor, and the purported client instructs the firm to deposit the check, deduct its fee, and send the rest of the money to the client. The check turns out to be counterfeit and the firm is left holding the bag, usually for $100,000 or more."; "According to the 2011 Internet Crime Report, the Internet Crime Complaint Center (IC3) has received more than 600 attorney collection scam complaints totaling more than $16 million in losses. The complaints started in 2007, rose to an annual high of 250 in 2010 and subsided to 167 in 2011, according to FBI spokesperson Jennifer Shearer. The IC3 report notes that in August 2011 a Nigerian court granted extradition to the U.S. of Emmanuel Ekhator, who allegedly defrauded United States law

firms of more than $29 million. Ekhator will stand trial on the charges in the United States District Court for the Middle District of Pennsylvania."; "More recently, Milavetz, Gallop & Milavetz of Edina, Minn., is suing Wells Fargo Bank over a loss of nearly $400,000 in a scam. The suit claims that Wells Fargo assured the law firm that the check had cleared, and that bank employees knew or should have known the check was fraudulent.").

- Fischer & Mandell LLP v. Citibank, N.A., 632 F.3d 793, 795. 799, 800 (2d Cir. 2011) (granting summary judgment for Citibank in a lawsuit brought by a law firm which had lost money in a scam involving a counterfeit check; explaining that Citibank had not represented to the law firm that the funds were available for disbursement; "In January 2009, pro se plaintiff-appellant Fischer & Mandell LLP ('F&M'), a law firm, deposited a check for $225,351 into its account at defendant-appellee Citibank, N.A. ('Citibank'). The funds were made 'available' before the check cleared, and F&M wired most of the funds elsewhere. The check, however, turned out to be counterfeit and was dishonored. Citibank debited the account the amount of the check plus a $10 returned check fee."; "The district court correctly rejected F&M's interpretation and accepted Citibank's. The Agreements clearly show that while Citibank gave its customers the ability to make use of check proceeds provisionally, that is, before checks cleared, that right was subject to a charge back if a check was returned. We hold, in the circumstances here, that 'available' meant only that account balances were 'available' for use on a provisional basis, subject to a charge back if a check was returned, and not that the account balance represented collected funds." (footnote omitted); "The obvious flaw with this argument is that Citibank did not advise F&M that the funds were 'available for withdrawal *as* of right.' Rather, Citibank advised only that the funds were 'available,' without representing that the Check had cleared or that the funds had been collected or that settlement had become final. 'Available' is different from 'available as of right.'").

- Peter Vieth, Beware of Phony Checks at Closing, Va. Laws. Wkly., Feb. 10, 2011, at 2 ("Scammers continue to target lawyers in Virginia and elsewhere with schemes involving counterfeit checks."; "The latest warning comes from leaders of the real estate bar who warn of phony checks being offered for real estate closings."; "The attempts at real estate fraud are similar to previous reported scams. The bad check comes with instructions to deposit it into a lawyer's trust account, with an excess amount to be wired as soon as possible to a foreign entity. Lawyers have been burned when they thought the check had cleared, only to find out it was fake. By then, the wired funds were gone."; "Charlottesville lawyer Larry J. McElwain, current chair of the Virginia Bar Association real estate section, said two attempts were made to use phony checks for real estate purchases while he served as closing attorney. In the first instance, a cashier's check apparently issued by a major national bank turned out to be counterfeit. The bank caught an error in the check number sequence and notified the law firm in time to prevent a loss,

McElwain said."; "In the second incident, a foreign check was presented. McElwain said his office took it by hand to the bank. After several fruitless presentations for collection, the check proved to be worthless."; "Matt McDonald, a lawyer and president of a Tennessee real estate title firm, posted warnings about counterfeit check scams on his company's blog. According to his post, he received eight FDIC alerts about counterfeit checks in one day. His company has announced a policy of requiring wire transfers for any closing involving more than $10,000."; "McMullan [sic] agreed with the advice to use wire transfers instead of cashier's checks for real estate closings. He adds an extra caveat -- to make sure the wire transfer has not been recalled at the last minute. He said wire transfers can be cancelled within a day or two, and lawyers are wise to check with the bank to make sure there has not been a recall.").

- Deborah Elkins, Lawyer falls prey to Chinese "Check Scam," 25 VLW 891, Va. Laws. Wkly., Jan. 17, 2011, at 3 (describing how a well-known Richmond, Virginia lawyer was defrauded by what is called the Chinese "check scam"; "On May 7, 2009, Witmeyer was contacted by a person claiming to be Albert Chang, the CEO of Asia Pacific Microsystems. Through an e-mail, Chang asked Witmeyer to help his company collect a $840,700 debt owed by Viar Electric Company of Lynchburg. Several days later, Witmeyer sent an e-mail agreeing to the representation subject to a proposed retainer agreement and deposit. Chang signed and returned the agreement May 18, indicating Witmeyer would soon receive a large check from Viar as a partial payment of the debt."; "Two weeks later, Witmeyer received what appeared to be an 'official check' issued by Citibank Investment Services N.A. for $362,400.25, payable to 'Witmeyer & Allen PLC.' The check listed 'Viar Electric Company' as the remitter. Viar was purportedly located in Lynchburg, and a company with this name is listed in online directories of Lynchburg electricians. But the check came by overnight delivery from Ontario, Canada."; "As was his usual business practice, Witmeyer authorized his bookkeeper to endorse the check 'for deposit only' into his client trust account, which he had maintained at BB&T for some 20 years. The bookkeeper deposited the check at the drive-through window and got a receipt stating 'all items are to be credited subject to payment.'"; "Chang e-mailed Witmeyer instructions to complete a wire transfer of $223,200 of the proceeds to the account of another entity, BECALM Co. Ltd. of Japan. The bookkeeper confirmed with the bank that the funds were available."; "Witmeyer personally completed the wire transfer. A bank employee chatted with Witmeyer about his recent business activity. The lawyer told the bank employee he was getting new clients through the Internet even though he had no website. She commented that it all sounded 'like a scam.' This transfer was the largest international wire transfer the bank employee had ever handled, the opinion said."; "The counterfeit check bounced with Citibank and BB&T charged the lawyer's trust account, leading to a $160,114.95 overdraft. BB&T sued to collect the overdraft and Witmeyer

counterclaimed for the value of the 'charge-back' of the amount transferred to BECALM.").

## Best Answer

The best answer to **(a)** is **NO**; the best answer to **(b)** is **MAYBE**; the best answer to **(c)** is **PROBABLY YES**.

B 11/14

# Client's Use of Credit Cards

## Hypothetical 41

Some new partners in your law firm have finally convinced you to start accepting credit card payments from clients. However, you wonder how clients' use of credit cards implicates various trust account rules.

**(a)** Can you accept a client's credit card payment for an outstanding legal bill?

**YES**

**(b)** Can you accept a client's credit card payment for a retainer?

**YES (PROBABLY)**

**(c)** Can you accept a client's credit card payment that includes both payment of an outstanding bill and a retainer amount?

**YES**

**(d)** If the bank with which you are dealing will only deposit such a combine payment into one account, should the payment go into your firm's trust account?

**YES**

**(e)** What should you do if the bank issues a "charge back" (triggered by a client's complaint about your firm) that automatically draws money out of the trust account into which you directed the client's credit card payment?

**IMMEDIATELY REPLACE THAT AMOUNT WITH THE LAW FIRM'S OWN MONEY (PROBABLY)**

## Analysis

### Introduction

Somewhat surprisingly, states take differing approaches to the trust account implications of clients using credit cards to pay their bills and retainers.

Just a few decades ago, many bars (including the ABA) prohibited or at least discouraged the use of credit cards for clients' payment of their bills. The bars' longstanding reluctance to allow clients' use of credit cards for paying their bills may have resulted from the very complicated issues that necessarily arise when clients use credit cards.

First, some banks insist on making just one payment to the lawyer when a client uses a credit card. This practice does not create a problem if the client is either paying an existing bill (the payment for which should go into the lawyer's operating account) or paying an unearned retainer (the payment of which should go into the lawyer's trust account). However, such a bank practice creates a difficult situation if the client uses a credit card to pay both an old bill and a retainer -- because those separate amounts must go into separate accounts.

Second, bars have had to wrestle with the service fees that banks charge vendors. To the extent that a bank moves into the lawyer's trust or operating account an amount less than the client has charged (retaining the difference as a service fee), there obviously will be a shortfall in either of the lawyer's accounts. In the case of a trust account, this could be an obvious problem.

Third, all banks insist that vendors allow what are called "chargebacks" -- pulling money back from the vendor after the bank pays the money, if the credit card user asks the bank to do so (because the credit card user is not satisfied with the service or product, disputes whether the bill is the appropriate amount, etc.). Such "chargebacks" create obvious problems if the lawyer has properly arranged for the bank's payment into a trust account, or moved such deposited money into an operating account as required

by the ethics rules. In either case, a bank pulling money back as a "chargeback" would be taking money directly out of the lawyer's trust account.

**(a)** Despite these troublesome issues, bars eventually moved in the direction of allowing clients to use credit cards to pay their outstanding bills. In 2000, the ABA switched its position. ABA LEO 419 (7/7/00) (withdrawing the following ABA LEOs dealing with advertising and the use of credit cards to pay a lawyer's bill: ABA LEOs 320, 338 and ABA Informal Ops. 1120, 1176).

One recurring issue triggered by clients' use of credit cards involves the service charges credit card companies assess. If the lawyer will pay the service charges, they should be treated like bank service charges -- which means that a lawyer may leave enough money in the trust account to pay the expected credit card service charges.

The Oregon Bar has acknowledged that some jurisdictions (including Colorado, Maryland and South Carolina) allow lawyers to pass the credit card transaction fees to the client, if there has been full disclosure and consent. Oregon LEO 2005-172 (8/2005). But the Oregon Bar warned that such a practice might implicate Regulation Z of the Truth in Lending Act (12 CFR § 226), thus "requiring that the lawyer make certain specific disclosures to the client and offer cash discounts to all clients." Oregon LEO 2005-172.

Most states follow this approach -- allowing lawyers to pass merchant fees along to their clients after full disclosure.

- Washington LEO 2214 (2012) (posing the following question: "A lawyer accepts payments from a client by credit card. The client pays the lawyer with a credit card and the credit card company then charges the lawyer a fee for the transaction. May the lawyer charge the client an additional amount to cover the fee charged the lawyer for the credit card transaction?"; providing the following answer: "It is not prohibited under the Rules of Professional

Conduct, PROVIDED that the lawyer notifies the client in advance of such charges and does not charge the client any more than a fee that reasonably reflects the actual cost incurred by the lawyer for the credit card transaction. HOWEVER, the attorney should consult the merchant services agreement from their credit card processor, as it is typically prohibited to charge these fees back to the customer.").

- Louisiana LEO 12-RPCC-019 (10/24/12) ("If the lawyer treats the transaction fee as an overhead expense, the lawyer must make arrangements to treat the remittance received from the credit card company as a remittance in satisfaction of the entire amount owed. If the lawyer intends that the client still must pay the difference between the original charge amount and the remittance received (i.e., the 'transaction fee'), then the lawyer must be certain to comply with Rule 1.8(e)(3) and obtain the informed consent of the client for such a charge.").

- Virginia LEO 348 (4/14/09) (having received an opinion from Virginia's Attorney General, approving Virginia lawyers passing along to their client the transactional costs/merchant fees charged by a credit card company when the client uses a credit card -- as long as the lawyer explains the process to the client before the client uses the credit card; explaining that such transactional/service fees may be deducted from the lawyers' trust account, but lawyers using best practices should arrange for the fees to be deducted from the lawyers' operating account; warning that lawyers must "monitor and personally replace any escrow funds that are subject to a chargeback" by a credit card company -- and lawyers using best practices should arrange for any chargebacks to come from the lawyers' operating account rather than trust account).

- D.C. LEO 348 (3/09) (generally allowing lawyers to arrange for their clients' payment of bills by using a credit card; explaining the lawyer's duty of confidentiality; "A credit card company may require a lawyer to provide information about the nature of services, "A credit card may require a lawyer to provide information about the nature of services, with the amount of detail required determined by the particular credit card company. Therefore, a lawyer should make every effort to enter into an agreement with a credit card company that will allow her to provide generic descriptions of services rendered."; "A more troubling confidentiality problem is the requirement by some credit card companies that the lawyer cooperate with them in the event there is a dispute between the client and the company. The lawyer should first seek to enter into an agreement with a credit card company that relieves her of any obligation to cooperate with the company in the event of a dispute between the credit card company and the client. If that is not possible, the lawyer is obligated to inform the client of the ramifications of the lawyer cooperating with the credit card company in any dispute between the company and the cardholder, and to obtain the client's informed consent that he still wants to pay by using a credit card. In the event a dispute develops and the credit card company seeks the lawyer's cooperation, the lawyer must

comply with Rule 1.6."; also allowing lawyers to pass along any credit card fees to their clients; "[A] lawyer who incurs an additional cost for accepting credit cards may pass those costs on to the client who charged the legal services." (emphasis added); "Before passing on such fees, however, the lawyer must comply with Rule 1.5(b) by explaining to the client that the fee charged by the credit card company will be charged to the client as an expense. To guard against later misunderstanding, the Committee suggests that the lawyer go further and obtain the client's 'informed consent' to being charged an additional amount to recapture the fees that the lawyer must pay the credit card company."; "We conclude that there is no ethical bar to lawyers passing on the credit card processing fees to their clients, however, we note that as a matter of good business practice, lawyers may wish to follow the practice of other merchants and absorb the costs."; warning lawyers that they must understand the arrangement with a credit card company before accepting any retainer for future payments by a credit card; "Before accepting credit cards for an advance fee, the lawyer must have a complete and detailed understanding of the agreement imposed on her by credit card companies. In many cases it may prove impossible for the lawyer to deposit advance fees paid by credit card into trust accounts and adhere to the terms of the agreement. Funds in trust accounts belong to the clients, not to the lawyer. As such, they cannot be attached by the lawyer's creditors. But because many credit card agreements permit the credit card company to invade the merchant's bank account and charge back monies already paid the merchant if the customer disputes a bill, there is a danger that funds deposited in a lawyer's trust account might be 'clawed back.' Under some circumstances this could result in a situation where there are insufficient funds in the account."; specifically prohibiting an arrangement under which a credit card 'charge back' might be drawn from the lawyer's trust account; "[T]he lawyers must ensure that under no circumstances can the credit card company invade her trust account. If that possibility exists, a credit card may not be used. Moreover, the lawyer must understand all the provisions of her agreement with the credit card company to ensure that entrusted client funds are safe and secure. Absent that assurance, a credit card may not be used to advance entrusted funds."; explaining that D.C. allows the deposit of what the bar calls "advance fees" into the lawyer's operating rather than trust account; "Rule 1.15(d) permits the deposit of advance fees into a lawyer's operating account provided that the client provides informed consent. Such fees are treated as the lawyer's property, although she has the obligation to and must have the wherewithal to repay them promptly if she does not earn them. To ensure that the consent provided by a client is 'informed consent,' the lawyer must explain that, unlike fees deposited in a trust account, these fees can be attached by the lawyer's creditors because legally they are the lawyer's property. Moreover, the provisions of the agreement with the credit card company may raise other issues if credit cards are used to pay advance fees into an operating account, which the lawyer must not only understand, but explain to her client."; advising clients to wait until the time has expired for a

client's dispute of a charge before moving funds into the lawyer's operating account; "A lawyer may substantially eliminate the likelihood of a charge of misusing a client's funds if she follows a strict practice of billing clients only after the services have been rendered and withdrawing funds only after the dispute period (most cardholders typically have 120 days from the date of a transaction within which to dispute a charge)."; finally, warning lawyers to advise their clients if a credit card company would require any repayment to be made by a credit card (as opposed to a repayment by cash or check); "Accepting credit cards for the payment of unearned fees imposes on a lawyer the obligation to know whether her merchant contract with the credit card company requires her to refund any unearned funds to the client directly, or whether she may leave the charge on the credit card and return the fees to the client by cash or check. If the credit card company requires crediting the refund to the account, the lawyer must explain this in writing before accepting the credit card for payment.").

Not surprisingly, IRS regulations can complicate all of this.

- Joe Forward, Lawyers Taking Credit Card Payments Should Take Action to Avoid Internal Revenue Service Penalty, State Bar of Wis., Dec. 12, 2012 ("Are you a lawyer or law firm allowing clients to pay by credit card? If so, read on for instructions on avoiding an Internal Revenue Service (IRS) penalty with potential ethical implications."; "Starting January 1, 2013, the IRS will impose a 28 percent withholding penalty on all credit card transactions if the lawyer or law firm's tax ID number and entity name on file with the credit card processing company do not match, exactly, the tax ID number and entity name on file with the IRS."; "This means lawyers and law firms should contact their credit card processing company to ensure that tax ID numbers and entity names match IRS records. However, if LawPay is your credit card processing company, don't worry about contacting LawPay about this issue."; "LawPay, which partners with the State Bar of Wisconsin to provide reduced-fee credit card processing services while complying with American Bar Association and state requirements for managing client funds, is taking proactive steps to ensure their clients' tax IDs and entity names match."; "'If you are a LawPay client, you don't need to call us,' said Amy Porter, LawPay's chief executive officer. Porter says LawPay does quarterly validation checks with the IRS's tax database to ensure tax ID numbers and entity names match LawPay accounts."; "If the IRS reports a mismatch, LawPay deactivates the account until the problem is resolved, Porter says. This avoids the 28 percent penalty and potential ethical issues that could arise if a 28 percent withholding penalty is assessed on a transaction (see ethics discussion below)."; "Lawyers and law firms not using LawPay are advised to call the processing company for confirmation that tax IDs and entity names match IRS records. If you're unsure, Porter advises lawyers and law firms to stop accepting credit cards until the match is verified.").

**(b)** Most states allow clients to pay unearned retainers by credit card, as long as that amount stays in the lawyer's trust account.

However, not all states have taken this approach. For instance, in 2008 the Arizona Bar has indicated that "[u]se of credit cards for payment of advance fees or expected costs is not ethically permissible in Arizona for several reasons."

- Arizona LEO 08-01 (9/2008) ("A lawyer may accept credit-card payments only for earned fees, earned-upon-receipt retainers, or reimbursement for advanced costs. Such credit-card payments may not be deposited into the lawyer's trust account. A lawyer may not accept payment in advance by credit card for unearned fees or costs not yet advanced. A lawyer may receive a single, non-cash payment from a client consisting of funds belonging partly to the client and partly to the lawyer. Such a payment must occur by check, money order, or electronic-fund transfer, and must be deposited into the lawyer's trust account. After the transaction has cleared the issuing bank, the lawyer's portion must be removed promptly from the trust account."; "We recognize that some other ethics committees that have considered the ethical implications of credit-card transactions have concluded that advance payments of fees by credit card can ethically be deposited into the lawyer's trust account under certain conditions."; "In our opinion, a lawyer's fiduciary duty to safeguard client property in the trust account requires stricter controls than the Oregon and North Carolina solutions. We conclude that the credit-card company's right of access creates a degree of risk, when associated with a lawyer trust account, that cannot be overcome by relying on the lawyer to remain vigilant about the possibility of access and then acting promptly to deposit the lawyer's own funds into the trust account to replace funds withdrawn by the credit-card company. Nor do we believe it is within our jurisdiction to opine that Arizona lawyers may negotiate contractual arrangements with credit-card companies on a case-by-case basis that involve a credit-card company's right to access the lawyer's trust account under any circumstances."; "We recognize the potential advantage to both lawyers and clients to reach an agreement that involves the client's advance grant of authority to the lawyer to charge the client's credit card. In our opinion, Arizona lawyers and clients have three options to consider."; "The first option is to designate advance fees paid by credit card as 'earned-upon-receipt' or 'non-refundable.' Fees of this kind belong to the lawyer when received and, therefore, must not be deposited into the lawyer's trust account. Lawyers electing to use this option, however, must take three precautions. First, the fee must be reasonable. Second, the fee agreement must state explicitly that the fee is 'earned-upon-receipt' or 'non-refundable' and also must contain language, required by ER 1.5(d)(3), that the client 'may nevertheless discharge the lawyer at any time and in that event may be

entitled to a refund of all or part of the fee based upon the value of the representation pursuant to [ER 1.5(a)].' Third, the lawyer must not bill against or credit work performed on an incremental basis against the 'earned-upon receipt' or 'non-refundable' fee, as such a practice would be consistent with an advance fee (or retainer) and not with an 'earned-upon receipt' fee."; "The second option is for the lawyer and client to enter into an agreement whereby the client allows the lawyer to keep credit-card information on file and charge earned fees and advanced costs against the card on a periodic basis, provided the lawyer has sent an invoice to the client detailing the fees and charges and has allowed the client a reasonable period of time to review and, if possible , communicate any disputes to the lawyer. We believe a period of 10 calendar days after sending the invoice is presumptively reasonable, recognizing the special circumstances or needs may shorten or extend that period. Absent any communication from the client disputing all or part of the invoice, the lawyer may (in accordance with the prior agreement with the client) charge the client's credit card either for the full amount of the invoice or for any undisputed charges contained on the invoice. The lawyer's trust account, however, may not be designated as the merchant account for such credit-card transactions."; "If a lawyer elects to use an advanced authorization agreement as described above, it must be stated in a writing communicated to and agreed to by the client, either in the original fee agreement or, if such an arrangement constitutes a change to the lawyer's current billing practice, in a separate agreement. The lawyer must also take precautions to safeguard the confidentiality of the client's credit-card information. See ER 1.6 (establishing the lawyer's duty to safeguard client confidences). In accordance with Ariz. Ethics Op. 89-10, the agreement must also state whether the client or lawyer is responsible for paying any additional charges imposed by the credit-card provider."; "The third option is for the client to take a cash advance on the client's credit card and pay the lawyer in cash. Lawyers should be cognizant, however, that credit-card companies often charge higher interest rates for cash-advance transactions and should discuss that fact with clients before requiring or recommending that the client take a cash advance on a credit card.").

A year earlier, the California Bar explained that "the attorney may not ethically accept any payment or deposit from a client by credit card, whether for earned fees or fees not yet earned, if the payment or deposit includes advances for costs and expenses."

- California LEO 2007-172 (2007) (explaining that lawyers may take credit card payments for earned fees and may pay the service charge debited by the issuer; also explaining that lawyers may accept retainer fee payments by credit card; noting that under California ethics rules "an attorney is ethically

> permitted, but not required, to deposit fees not yet earned into a client trust account"; "If an attorney were required to deposit fees not yet earned into a client trust account, the attorney would not be permitted to accept such a deposit from a client by credit card to the extent that the credit card issuer deposits funds into a merchant account that is subject to invasion. That is because to that extent: (1) the credit card issuer deposits the funds into a merchant account; (2) the attorney, however, must deposit the funds into a client trust account; (3) the attorney must take reasonable care to protect the funds deposited into a client trust account; and (4) before the attorney can assert control over the funds, the merchant bank may invade the funds in the merchant account, thereby putting the funds at risk beyond the attorney's protection. As a consequence, the attorney could not immediately deposit such fees into a client trust account or take care to protect them, but would have to cede control to the merchant bank, at least initially. . . . But because an attorney need not deposit fees not yet earned into a client trust account, the attorney may accept such a deposit by credit card, resulting in a deposit into a merchant account."; noting that in contrast California ethics rules require lawyers to deposit any "advances for costs and expenses from a client into a client trust account"; "Because an attorney must deposit advances for costs and expenses from a client into a client trust account, he or she may not ethically accept such a deposit by credit card, as explained above, to the extent that the credit card issuer deposits funds into a merchant account that is subject to invasion. It follows that the attorney may not ethically accept any payment or deposit from a client by credit card, whether for earned fees or fees not yet earned, if the payment or deposit includes advances for costs and expenses. The attorney, however may accept reimbursement by credit card for costs and expenses already paid. By definition, reimbursement of costs and expenses already paid does not constitute an 'advance' of such costs and expenses, and consequently it need not -- and indeed may not -- be deposited into a client trust account." (footnote omitted)).

**(c)-(d)** Those states allowing clients to pay retainers by credit card face another issue -- whether lawyers should deposit such payments into their "merchant account" (the account into which the credit card company pays the necessary amounts, and from which it withdraws the service fees) or a trust account?

In Oregon LEO 2005-172 (8/2005), for instance, the Oregon Bar explained that other states "require[] that credit card transactions be treated like cash payments, with earned fees going into the business account and retainers into a trust account." Id. at n.3. Oregon joined Kansas, Missouri and North Carolina in explaining that the

> . . . better practice may be to have separate merchant accounts for credit card retainers and earned fees. However, if a lawyer's bank insists on a single merchant account, it should be a trust account. Credit card payments representing earned fees are funds belonging "presently or potentially" to the lawyer. It is not a violation of DR 9-101(A) to deposit all credit card transactions into a trust account, if the portion representing earned fees is promptly transferred to the lawyer's business account.

Oregon LEO 2005-172 (8/2005),

Since Oregon took this approach, other states have followed suit.

- North Carolina LEO 2009-4 (4/24/09) ("[A] law firm may establish a credit card account that avoids commingling by depositing unearned fees into the law firm's trust account and earned fees into the law firm's operating account provided the problem of chargebacks is addressed."; "To avoid the commingling of client funds with a lawyer's own funds, Rule 1.15-2 of the Rules of Professional Conduct requires payments of mixed funds, unearned fees, and money advanced for costs to be deposited into a lawyer's trust account, and payments for earned fees and reimbursements for expenses advanced by a lawyer to be deposited into a lawyer's operating account. Although a lawyer may accept payment of legal fees by credit card, if there is no way to distinguish a credit card payment for earned fees or costs advanced from a payment for unearned fees or anticipated expenses, all credit cards must be initially deposited into the lawyer's trust account. Earned fees and expense reimbursement are then withdrawn promptly from the trust account for deposit into the operating account or payment to the lawyer."; "As noted in 97 FEO 9, '[u]nder all circumstances, a lawyer is ethically compelled to arrange for a payment (from his or her own funds or from some other source) to the trust account sufficient to cover the chargeback in the event that a chargeback jeopardizes the funds of other clients on deposit in the account.' Therefore, provided the lawyer can comply with the requirements set forth in 97 FEO 9, the lawyer may establish a credit card account that deposits funds into separate accounts.").

- Michigan LEO RI-344 (4/25/08) (explaining various issues raised by lawyers' acceptance of fees and deposits (against future fees) by credit card; explaining that "[t]here are two alternative methods by which a lawyer may enter into credit card arrangements for payment of advance legal fees. The first and less problematic practice would involve the use of two bank accounts. The credit card company would make deposits for advance legal fees and expenses into the lawyer's trust account and takes [sic] merchant fees and chargebacks from the lawyer's business account. . . . <u>If the credit card company insists on using one account, all credit card payments for</u>

advance legal fees and expenses must be deposited into the lawyer's trust account and the lawyer must transfer legal fees and expenses to the business account as they are earned." (emphasis added); also explaining that "[t]o insure that credit card chargebacks do not impact the trust account, where chargebacks and credit card company fees are deducted from the trust account, legal fees and expenses paid by the credit card company into the trust account should not be considered fully earned until the credit card dispute period has expired.").

- Ohio LEO 2007-3 (4/13/07) ("A lawyer may accept credit card payments from clients for earned legal fees, reimbursement of legal expenses, advances on unearned legal fees, and advances on future expenses. Credit card payments for earned fees and reimbursement of legal expenses belong in a business account, whereas, credit card payments for advances on unearned legal fees and advances on future legal expenses must go into a client trust account. Preferably, a lawyer would maintain two credit card merchant accounts, one used for credit card payments to a business account and one for credit card payments to a client trust account. But, because two merchant accounts may not be feasible or practical, it is acceptable for a lawyer to maintain one merchant account with the credit card payments all going into a client trust account, provided that the credit card payments for earned legal fees and reimbursements of expenses are promptly transferred from the trust account to a business account. A lawyer may place his or her own funds into a client trust account to pay brokerage and credit card service charges. Credit card service charges are the responsibility of the lawyer and may not be deducted from the interest earned on a client trust account." (emphasis added)).

**(e)** Another recurring issue involves what are called "chargebacks" -- under which the credit card company debits the account into which the credit card company has made the payment, if a client disputes the payment.

States have taken different positions on this issue -- reflecting how difficult it can be to properly characterized payments, and comply with the ironclad prohibition on comingling funds, improperly transferring funds from a trust account into an operating account, and improperly leaving in a trust account money that should be moved to an operating account.

First, some bars have warned lawyers not to allow clients to use credit cards if credit card companies might improperly remove trust account funds.

- District of Columbia LEO 348 (3/2009) (analyzing an ethics issue involving clients' use of credit cards; ultimately concluding that "[c]redit cards are an acceptable method of paying legal fees provided that the client understands and consents to whatever disclosures to the credit card company are required by the merchant agreement. The client must also be informed of the actual cost of using the credit card if the lawyer intends to recapture from her client the fees she must pay to the credit card company. While credit cards may also be used to pay advance fees or retainers, this may be done only if it does not endanger entrusted client funds and only if the lawyer thoroughly understands the merchant agreement and arranges her affairs so that she has the ability to meet her obligation to refund unearned fees."; warning lawyers that they must preserve their clients' confidences, which requires the lawyers to " make every effort to enter into an agreement with a credit card company that will allow her to provide generic descriptions of services rendered. . . . If this level of generality cannot be accomplished, the lawyer must inform the client and obtain his informed consent to whatever disclosures the credit card company requires the lawyer to make."; also noting that lawyers fulfilling their obligation of preserving client confidences "should first seek to enter into an agreement with a credit card company that relieves her of any obligation to cooperate with the company in the event of a dispute between the credit card company and the client. If that is not possible, the lawyer is obligated to inform the client of the ramifications of the lawyer cooperating with the credit card company in any dispute between the company and the cardholder, and to obtain the client's informed consent that he still wants to pay by using a credit card."; also dealing with the issue of merchant fees; explaining that "[b]efore passing on such fees, however, the lawyer must comply with Rule 1.5(b) by explaining to the client that the fee charged by the credit card company will be charged to the client as an expense. To guard against later misunderstanding, the Committee suggests that the lawyer go further and obtain the client's 'informed consent' to being charged an additional amount to recapture the fees that the lawyer must pay the credit card company."; "We conclude that there is no ethical bar to lawyers passing on the credit card processing fees to their clients, however, we note that as a matter of good business practice, lawyers may wish to follow the practice of other merchants and absorb the costs." (footnote omitted); noting that lawyers must also deal with charge backs; "Because the Committee does not and cannot know the details of all contractual arrangements between lawyers and credit card companies, we cannot conclude that credit cards can never be used to pay advance fees into trust accounts. But if a credit card is used in this fashion, the lawyers must ensure that under no circumstances can the credit card company invade her trust account. If that possibility exists, a credit card may not be used." (emphasis

added); noting that D.C. ethics rules allow lawyers to place advance fees into the lawyer's operating account with the client's consent; explaining that lawyers engaging in that practice must also deal with chargebacks).

Second, some bars have required lawyers to arrange for banks to pull back "chargeback" amounts from the lawyer's operating account, or immediately replace any money a bank removes from the lawyer's trust account.

- Louisiana LEO 12-RPCC-019 (10/24/12) ("[T]he transactions should not be linked to bank accounts in a manner that exposes the lawyer's trust account to 'charge backs' or credit card costs arising from client disputes and/or transaction costs."; "The 'merchant agreement' or contract between the vendor/credit card company and lawyer should also provide that any 'charge back,' other disputed transaction, or costs associated with using the credit card will be charged solely to the lawyer's operating account.").

- Virginia LEO 1848 (4/14/09) (having received an opinion from Virginia's Attorney General, approving Virginia lawyers passing along to their client the transactional costs/merchant fees charged by a credit card company when the client uses a credit card -- as long as the lawyer explains the process to the client before the client uses the credit card; explaining that such transactional/service fees may be deducted from the lawyers' trust account, but lawyers using best practices should arrange for the fees to be deducted from the lawyers' operating account; warning that lawyers must "monitor and personally replace any escrow funds that are subject to a chargeback" by a credit card company -- and lawyers using best practices should arrange for any chargebacks to come from the lawyers' operating account rather than trust account).

- Oregon LEO 2005-172 (8/2005) (explaining that the chargeback process "can put the funds of other clients at risk if the credit card payment has already been earned and withdrawn before the lawyer learns of the chargeback"; "[o]ne solution is to have the bank deduct all chargebacks from the lawyer's business account. If the bank is unwilling or unable to debit a separate account, the lawyer should try to arrange for an interaccount transfer process by which funds from the lawyer's business account will be transferred immediately to cover any chargeback to the trust account. However it is ultimately handled, the lawyer is ethically bound to ensure that any chargebacks that jeopardize other client funds in trust are promptly covered with the lawyer's own funds.").

- North Carolina LEO 97-9 (1/16/98) ("To avoid the potential jeopardy to the funds of other clients on deposit in a trust account, the lawyer must first attempt to negotiate an agreement with the bank that requires the bank to

debit an account other than the trust account in the event of a chargeback. Some banks will route chargeback debits (and the discount fee for credit card charges) against a firm's operating account. Some banks may require a merchant to maintain a separate demand deposit account in an amount sufficient to cover chargebacks. If a bank cannot or is unwilling to debit a separate account, (i.e., the bank requires all chargebacks to be debited from the account into which credit card payments are deposited), the lawyer must request that the bank arrange an inter-account transfer such that the lawyer's operating account, or other non-trust account, will be immediately debited in the event of a chargeback against the trust account and the money promptly deposited into the trust account to cover the chargeback. If the bank will not agree to debit another account or arrange for inter-account transfers, the lawyer must establish a trust account for the sole purpose of receiving advance payments by credit card. The lawyer must withdraw all payments to this trust account immediately and deposit them in the lawyer's 'primary' trust account. In this way, the risk that a chargeback will impact the funds of other clients will be minimized."; "Under all circumstances, a lawyer is ethically compelled to arrange for payment (from his or her own funds or from some other source) to the trust account sufficient to cover the chargeback in the event that a chargeback jeopardizes the funds of other clients on deposit in the account.").

Third, one bar encouraged lawyers to set up a separate trust account to receive credit card companies' advance payments, from which the bank could remove any chargeback amounts.

- North Carolina LEO 97-9 (1/16/98) ("[P]rovided steps are taken to safeguard the client funds on deposit in a trust account, a lawyer may accept fees paid by credit card although the bank's agreement to process such charges authorizes the bank to debit the lawyer's trust account in the event a credit card charge is disputed by a client."; "To avoid the potential jeopardy to the funds of other clients on deposit in a trust account, the lawyer must first attempt to negotiate an agreement with the bank that requires the bank to debit an account other than the trust account in the event of a chargeback. Some banks will route chargeback debits (and the discount fee for credit card charges) against a firm's operating account. Some banks may require a merchant to maintain a separate demand deposit account in an amount sufficient to cover chargeback. If a bank cannot or is unwilling to debit a separate account, (i.e., the bank requires all chargebacks to be debited from the account into which credit card payments are deposited), the lawyer must request that the bank arrange an inter-account transfer such that the lawyer's operating account, or other non-trust account, will be immediately debited in the event of a chargeback against the trust account and the money promptly deposited into the trust account to cover the chargeback. If the bank will not

agree to debit another account or arrange for inter-account transfers, the lawyer must establish a trust account for the sole purpose of receiving advance payments by credit card. The lawyer must withdraw all payments to this trust account immediately and deposit them in the lawyer's 'primary' trust account. In this way, the risk that a chargeback will impact the funds of other clients will be minimized." (emphasis added)).

Fourth, some bars have indicated that lawyers should retain any amounts in their trust account until the time has lapsed for any clients to challenge the lawyer's entitlement to payment.

- Michigan LEO RI-344 (4/25/08) (explaining various issues raised by lawyers' acceptance of fees and deposits (against future fees) by credit card; explaining that "[t]here are two alternative methods by which a lawyer may enter into credit card arrangements for payment of advance legal fees. The first and less problematic practice would involve the use of two bank accounts. The credit card company would make deposits for advance legal fees and expenses into the lawyer's trust account and takes [sic] merchant fees and chargebacks from the lawyer's business account. . . . If the credit card company insists on using one account, all credit card payments for advance legal fees and expenses must be deposited into the lawyer's trust account and the lawyer must transfer legal fees and expenses to the business account as they are earned." (emphasis added); also explaining that "[t]o insure that credit card chargebacks do not impact the trust account, where chargebacks and credit card company fees are deducted from the trust account, legal fees and expenses paid by the credit card company into the trust account should not be considered fully earned until the credit card dispute period has expired." (emphasis added)).

## Best Answer

The best answer to **(a)** is **YES**; the best answer to **(b)** is **PROBABLY YES**; the best answer to **(c) YES**; the best answer to **(d)** is **YES**; the best answer to **(e)** is **IMMEDIATELY REPLACE THAT AMOUNT WITH THE LAW FIRM'S OWN MONEY (PROBABLY)**.

B 11/14

# IOLTA Programs

## Hypothetical 42

You just left a large firm at which you had very little interaction with trust accounts, but as a sole practitioner you have had to educate yourself very quickly. You have several questions about so-called "IOLTA" accounts.

**(a)** Is it possible to determine the interest paid on the trust account deposits of each client whose money is in your trust account?

**YES**

**(b)** May you pay all interest earned on your trust account deposits to your state bar's IOLTA program, to be used for funding legal aid services to indigent people in your state?

**YES**

**(c)** Must you pay all interest earned on your trust account to your state bar's IOLTA program, to be used for funding legal aid services to indigent people in your state?

**MAYBE**

## Analysis

Nearly every jurisdiction requires lawyers to pay interest earned on their trust accounts to some charitable or public service funds, usually those providing legal services to the indigent. These are usually known by the acronym IOLTA -- which stands for "Interest on Lawyers' Trust Accounts."

In a sense, this obligation stems from what might have been a logistical problem before the advent of computers, but continues as a public service policy with which clients sometimes disagree. Trust accounts nearly always contain numerous clients' property (and sometimes small amounts of lawyer property, to cover bank service

charges, etc.) for various amounts of time. Before computers, it may have been difficult to allocate interest earned on trust accounts to a particular client or to the lawyer. Perhaps that is the reason that bars began to insist that lawyers take the full amount of the interest and handle it in just one way -- rather than try to give each client the amount of interest that its trust account deposit generated each month.

Any justification of this sort disappeared with the advent of computers and software that undoubtedly would allow lawyers to determine to the exact penny what client earned what interest on what amount.

**(a)-(c)** Despite the development of this technology, nearly every state continues to insist that lawyers hand over their clients' interest for these admittedly worthwhile goals. The Restatement explains this majority approach.

> A lawyer must deposit funds of a client or a third person in an account, usually a trust or client account, separate from the lawyer's own funds, and including those of the lawyer's law practice. The trust account may contain funds of more than one person, but the records must adequately identify the share of each person. The lawyer may not receive interest on such funds. Most states now have arrangements under which certain client funds (usually small amounts) may or must be pooled in accounts, the interest from which is paid to a regulatory authority to fund legal services for the indigent and other similar activities. When trust accounts may bear interest for the benefit of an individual client and the amount and probable duration of the deposit justify the effort and expense involved, the lawyer should arrange for an interest-bearing account, with the interest to be transmitted to the clients. A lawyer holding client funds as a trustee or in other capacities may be required to invest them.

Restatement (Third) of Law Governing Lawyers § 44 cmt. d (2000) (emphasis added).

Most states follow this approach.

- Zoe Tillman, New Rule Approved to Verify District of Columbia Lawyers' Interest on Lawyers' Trust Account Participation, Nat'l L.J., Mar. 14, 2013 ("In

a move that would bring the District of Columbia Bar in line with other states with mandatory bars, the District of Columbia Court of Appeals recently approved a new rule giving the District of Columbia Bar Foundation authority to periodically check that local attorneys are participating in the Interest on Lawyers' Trust Accounts, or IOLTA, program."; "The mandatory program, which collects interest earned on lawyers' trust accounts, helps fund annual grants to local civil legal services organizations through the District of Columbia Bar Foundation. Katia Garrett, the foundation's executive director, said that having a way to verify participation is considered a best practice in managing IOLTA programs."; "'It's really to provide an added level of certainty,' she said. Garrett added that by checking, the foundation could make sure that the accounts reported by lawyers matched bank records."; "The IOLTA program has suffered in recent years because of low interest rates. Garrett said it's possible that new verification procedures would prompt attorneys not currently participating to do so, but that it was unlikely to make a dent in the program's declining revenues."; "Washington and 45 other jurisdictions have mandatory IOLTA programs. Of those, Garrett said that at least 40 have some form of reporting requirement for IOLTA programs. 'What all the stakeholders want is to have a system that makes it easy for lawyers to carry out their obligations,' she said."; "The foundation will have to develop a plan for how it intends to verify participation and submit it for approval by the District of Columbia Bar Board of Governors and the District of Columbia Court of Appeals. Once it starts checking, the foundation will also have to submit an annual report on its activities to the board of governors and the appeals court.").

One bar has even indicated that lawyers licensed in the state but holding some of their trust account amounts elsewhere must pay interest back to that state's chosen charity.

- Arizona LEO 09-03 (11/2009) ("An Arizona-licensed lawyer who maintains an office in Arizona but whose law firm also has an office in another jurisdiction may keep trust funds in a trust account held outside of Arizona provided that the client (or third person, where relevant) consents and the account is held at an approved financial institution. If the account is a pooled trust account on which interest and dividends are not paid to clients, the interest and dividends on the funds from the Arizona-licensed lawyer must be paid to the Arizona Foundation for Legal Services and Education.").

However, several states have balked at such mandatory programs.

- Kathleen Baydala Joyner, Bar Again Delays IOLTA Rule Change, Daily Report, Jan. 14, 2014 ("For the second time in three months, the State Bar of Georgia's Board of Governors delayed a vote on a professional rules change that would require lawyers to establish client trust funds exclusively with banks that offer competitive interest rates."; "The proposal now is slated to

come up for a vote during the Board of Governors' spring meeting in March at Lake Oconee. It is part of a package of fund-raising measures recommended by a bar task force to fill a $1.8 million gap in the budgets of Georgia Legal Services and the Atlanta Legal Aid Society."; "'I am disappointed that we did not get to a vote today,' said Rita Sheffey, the vice chairwoman of the task force and secretary of the bar. 'I am confident we had the support.'"; "The bar's Civil Legal Services Task Force, a 14-member panel of judges and lawyers appointed last year by bar President Charles 'Buck' Ruffin, was poised to ask the Board of Governors for a vote on Saturday. The task force met in Atlanta Thursday afternoon to go over the proposal, which had been tabled during the bar's fall meeting in November at Jekyll Island. At that time, members of the Board of Governors said they had not had enough time to review the proposal."; "This time the delay came from the Georgia Bar Foundation, which collects and disburses funds gleaned from interest on lawyer trust accounts, also known as IOLTA.").

- Alan Cooper, Virginia's Mandatory IOLTA Effort Stalls, Va. Laws. Wkly., Feb. 22, 2011 ("Proponents of reinstating mandatory IOLTA as a tool to raise money for legal aid appear to have stumbled at the first step. The Supreme Court of Virginia approved mandatory IOLTA, the acronym for Interest on Lawyers' Trust Accounts, on a 4-3 vote in 1993, much to the consternation of state bankers. Two years later, the bankers prevailed in a lobbying battle by winning the adoption of Virginia Code § 54.1-3915.1, which banned the program. Since then, lawyers with trust accounts have been required to affirmatively opt out of participating in a voluntary IOLTA program. With the ban in place, the first task was to get the legislature to remove it. Delegates William H. Cleaveland, R-Botetourt, and A. Donald McEachin, D-Richmond, sponsored repeal legislation, House Bill 1571 and Senate Bill 817. Cleaveland's bill died in the House Courts of Justice Committee on a 10-12 vote, but the Senate version squeaked by Senate 22-18. That sent the concept to the House, but the Courts committee there failed to report it to the full House yesterday on an 11-11 vote. As we reported last month, just how much money the proposal would generate, at least in the near term, is very much in question. The amount collected through the program dropped from $4.6 million to $700,000 as the economy tanked and interest rates on the accounts dropped to near zero. Moreover, no one knows how much of the money that might be generated by a mandatory program is already being collected by the opt-out program. About 5,100 trust accounts participate in the program, compared with roughly 23,000 attorneys with active practices in the state. But some of the accounts cover entire law firms, and many lawyers don't have practices with a need for a trust account that would generate revenue for legal aid. And, as the 1993 vote suggests, getting the endorsement of the Virginia State Bar and the approval of the Supreme Court for the program was by no means a certainty.").

## Best Answer

The best answer to **(a)** is **YES**; the best answer to **(b) YES**; the best answer to **(c) MAYBE**.

B 11/14

# Creditors' Claims Against Trust Account Funds

## Hypothetical 43

With many of your clients facing severe financial hardships, you have had to address several incidents in which your clients' creditors asserted claims against client funds held in your trust account.

**(a)** Can one of your clients' creditors assert a lien on client funds in your account?

**YES**

**(b)** If you receive a letter from one of your clients' creditors claiming that the client has specifically pledged the amount held in your trust account for the benefit of that creditor, must you hold that money even if the client asks you to return it?

**MAYBE**

**(c)** If you know that one of your clients is facing financial problems and owes many creditors fairly substantial amounts, must you hold all of the client's trust account amount even if the client asks them to be returned?

**NO (PROBABLY)**

## Analysis

**(a)-(c)** To the extent that clients and their lawyers disagree about the ownership of money being held in the trust account, the lawyer must keep the money in the trust account until the dispute has been resolved.

> When in the course of representation a lawyer is in possession of property in which two or more persons (one of whom may be the lawyer) claim interests, the property shall be kept separate by the lawyer until the dispute is resolved. The lawyer shall promptly distribute all portions of the property as to which the interests are not in dispute.

ABA Model Rule 1.15(e) (emphasis added).

The Restatement takes the same basic approach.

> This Section does not apply to property indisputably owned by a lawyer. Thus, when a client does not dispute a lawyer's good-faith claim to a certain amount as a fee then owing, the lawyer may transfer that amount into the lawyer's personal account. See also § 21 . . . , discussing when a lawyer may validly endorse a check on which the client is payee. Similarly, if a payment to a lawyer is a flat fee paid in advance rather than a deposit out of which fees will be paid as they become due, the payment belongs to the lawyer . . . . A lawyer holding client funds as an advance fee payment may withdraw them for fees as earned, so long as there is no existing dispute about the lawyer's right to do so. In such instances, the lawyer acts rightly in retaining the money even though, for example, the client might later claim that the fee was unreasonable . . . or the advance payment becomes unreasonable in light of later developments . . . .
>
> When a lawyer asserts a lien on the client's property . . . , the lawyer must hold the client's property separate from the lawyer's personal or office funds and property . . . . Similarly, in most jurisdictions a lawyer must keep separate the disputed portion of any fund claimed both by the lawyer and a client or third person.

Restatement (Third) of Law Governing Lawyers § 44 cmt. f (2000) (emphasis added).

States unanimously agree that lawyers must keep any disputed amount in their trust accounts until some resolution.

- North Carolina LEO 2005-12 (1/20/06) (analyzing several hypotheticals dealing with flat fees; (1) "Adult Client and her mother come to Lawyer's office together. Mother agrees to pay a $5,000 advance fee for representation of Client in her domestic case. Pursuant to Rule 1.8, Lawyer makes sure Mother understands that Lawyer represents only Client's interests, not Mother's, and that information received from Client during the course of the representation remains confidential. Client consents to the payment of her fees by Mother, and Mother agrees to pay under these terms. Lawyer deposits the $5,000 in his trust account and begins billing against it."; "Shortly thereafter, Mother and Client having a falling out, and Mother demands the unused portion of the $5,000 back. Client wants Lawyer to keep the funds and continue with the representation."; "Must Lawyer return the unearned portion of the fees to Mother?"; answering as follows: "Yes. Under these facts, Lawyer understands that the legal fees were paid by a third party for the purpose of Client's representation. See Rule 1.8(f). The unearned funds held in trust belong to the third party, not the client. In the event the payor wants

the funds returned, Lawyer is obliged to do so. Lawyer should explain to both Client and the third-party payor, at the outset, that the funds belong to the third party, that the funds will remain in trust until earned, and that if the third-party payor demands return of the unearned funds, Lawyer must return the funds to the payor. In addition, Lawyer may continue representation and seek payment from Client. If Client is unable to pay, Lawyer must decide whether withdrawal from representation is appropriate under Rule 1.16(b)(6)."; (2) "Assume the same facts as in Inquiry #4 [above], except that Lawyer received a $5,000 flat fee from Mother to represent Client in her domestic matter. Lawyer explained to Client and Mother that the fee is earned immediately and will be placed in Lawyer's operating account. Lawyer also explained that the flat fee would not vary based upon the amount of time expended and assured them that this was the only legal fee owed to him. After Lawyer has begun work on the case, Mother demands the fee back. Client does not consent." (emphasis added); "What should Lawyer do?"; answering as follows: "If the flat fee is earned immediately and it is not "clearly excessive" under the circumstances, then the fee will ordinarily belong to the lawyer. See Rule 1.5(a). Lawyer need not return any portion of the fee to Mother. If, upon conclusion of the representation, however, Mother disputes the amount of fee charged, Lawyer must notify Mother of the State Bar's program of fee dispute resolution. Lawyer should place the disputed portion of the funds back in his trust account and must participate in good faith in the fee dispute process if Mother submits a proper request to the State Bar. See Rule 1.5(f)." (emphases added)).

In fact, lawyers can be punished if they remove disputed amounts, or amounts the client later proves that the lawyer had not yet earned.

- Iowa Supreme Court Attorney Disciplinary Bd. v. Powell, 830 N.W.2d 355, 358, 359 (Iowa 2013) (suspending for three months a lawyer who had improperly removed money from a trust fund before he earned it; "We agree with the commission that Powell violated rule 32:1.15, and the Iowa Court Rules governing trust funds. However, the evidence failed to support a finding that Powell had no colorable claim to the funds he removed from his trust account or failed to place in his trust account. Instead, consistent with the charges brought by the Board, he repeatedly failed to comply with the rules and procedures governing trust accounts. The fighting question turns on the sanction that should result from the violations, largely in light of the temporary seven-month suspension served by Powell prior to and during the pendency of this proceeding." (emphasis added); "Broadly, this case involves conduct by a lawyer in improperly removing client funds from a trust account and failing to deposit advance fees into the trust account. Within this broad category of conduct, we recognize that a revocation normally results when the conduct of the offending lawyer constitutes conversion or theft."; "Yet, when the case involves client funds held as an advance fee and the conduct of the

attorney involves the conversion of the funds before they were earned, we generally impose discipline in the form of a suspension.").

- North Carolina LEO 2011-13 (10/21/11) (explaining that a lawyer may not pay legal fees for money held in a trust account without the client's consent; "Rule 1.15-2(g) permits a lawyer to withhold only funds to which the lawyer has a claim to entitlement such as funds deposited as a client's advance payment of a legal fee or funds from a settlement negotiated by the lawyer that, by prior agreement, include a contingent fee. However, client funds or the funds of a third party that are placed in the lawyer's control for the purpose of being safeguarded, managed, or disbursed in connection with a transaction, but which were not otherwise designated or identified as funds for the payment of legal fees, may not be retained in the trust account as disputed funds pursuant to Rule 1.15-2(g). As explained in Comment [14] to Rule 1.15, '[a] lawyer is not required to remit to the client funds that the lawyer reasonably believes represent fees owed. However, a lawyer may not hold funds to coerce a client into accepting the lawyer's contention.'"; "Regardless of whether the funds are identified as funds of the Estate of E or funds of the PLLC, the funds in this inquiry are the property of the Estate of E and were delivered to Attorney for the purpose of being managed by Attorney as a part of his legal services to the estate. The funds are subject to legal requirements to pay the claims of the creditors of the PLLC and of the estate. Moreover, payment of administrative expenses of an estate from estate assets, including attorney's fees, is only permitted on the issuance of an order of the clerk of superior court and requires the clerk to exercise judicial discretion in such matters. A personal representative must file a petition seeking an order from the clerk enabling the payment of attorney's fees by an estate. These legal restrictions on the assets of an estate demonstrate that Attorney had no claim of entitlement to the funds. Therefore, when the representation ended, Attorney was obligated to deliver all of the funds as directed by Administrator. Rule 1.15-2(m) (a lawyer shall promptly pay or deliver to the client, or to third persons as directed by the client, any entrusted property belonging to the client and to which the client is currently entitled)." (footnotes omitted); "Rather than deposit the funds of an estate in a general trust account, estate funds should, in most instances, be deposited in a fiduciary account maintained solely for the deposit of fiduciary funds or other entrusted property of a particular person or entity. Rule 1.15-1(e) (defining 'fiduciary account'). In a fiduciary account, the funds can be invested as usually required for prudent management of fiduciary funds.").

Things can become far more complicated if some third party asserts a claim to amounts lawyers have deposited in their trust accounts.

The ABA Model Rules recognize this in their black letter provision.

> When in the course of representation a lawyer is in possession of property in which two or more persons (one of whom may be the lawyer) claim interests, the property shall be kept separate by the lawyer until the dispute is resolved. The lawyer shall promptly distribute all portions of the property as to which the interests are not in dispute.

ABA Model Rule 1.15(e). A comment provides an explanation of this issue.

> Paragraph (e) also recognizes that third parties may have lawful claims against specific funds or other property in a lawyer's custody, such as a client's creditor who has a lien on funds recovered in a personal injury action. A lawyer may have a duty under applicable law to protect such third-party claims against wrongful interference by the client. In such cases, when the third-party claim is not frivolous under applicable law, the lawyer must refuse to surrender the property to the client until the claims are resolved. A lawyer should not unilaterally assume to arbitrate a dispute between the client and the third party, but, when there are substantial grounds for dispute as to the person entitled to the funds, the lawyer may file an action to have a court resolve the dispute.

ABA Model Rule 1.15 cmt. [4].

The Restatement deals with this scenario in more detail than the ABA Model Rules.

> A lawyer might be in possession of property claimed both by the lawyer's client and by a third person, for example a creditor claiming an interest in the client's property, a previous lawyer of the client claiming a lien on the client's recovery . . . , or a person claiming that property deposited with the lawyer by the client was taken or withheld unlawfully from that person. In such circumstances, this Section requires the lawyer to safeguard the contested property until the dispute has been resolved . . . , but does not prescribe the rules for resolving it. Those rules are to be found in other law. Thus, if a third person claims that property stolen from that person has been used by the client to pay the lawyer's fee, the lawyer's right to keep the payment depends on the law generally applicable to transfers of stolen property. The result might turn on whether the lawyer was a bona fide purchaser for value without notice of the theft, on whether the property was negotiable, or on other

> circumstances. It might also be affected by statutes providing for the forfeiture of property to the government, to the extent that such statutes validly apply to property used to pay lawyer's fees.

Restatement (Third) of Law Governing Lawyers § 44 cmt. g (2000) (emphasis added).

> A lawyer who receives property claimed by a client or third person to whom the lawyer owes a duty of safekeeping must inform the owner or claimant so that the latter can protect his or her rights . . . . Likewise, the lawyer must render account of the property of others in the lawyer's possession when requested. . . .
>
> When the claimant is a third person whose interests conflict with those of the lawyer's client but to whom the lawyer owes a duty of safekeeping or notification, the lawyer must notify that person of the lawyer's receipt of the property. That situation could exist, for example, where the lawyer is an executor and the third person a legatee, where the law designates the lawyer a constructive trustee for the person because the property has been converted . . . , or where other law imposes a duty on the lawyer to turn over property or funds directly to the third person. The lawyer's duties of confidentiality to the client do not bar such notice because the lawyer may not assist the client to conceal the property from the third person to whom the lawyer owes the duty of safekeeping . . . . Moreover, the arrangement under which the lawyer receives property of a third person of adverse interest -- for example, an escrow arrangement -- can imply that the client and third person have agreed that the lawyer is to protect the third person's interests.

Restatement (Third) of Law Governing Lawyers § 44 cmt. h (2000).

State legal ethics opinions have also dealt with this issue, requiring lawyers to gauge the legitimacy of such third-parties' claim against amounts in their trust accounts.

- Washington LEO 2220 (2012) ("Under the facts of the inquiry, a lawyer receives an advance fee deposit from client and places the funds in his or her client trust account. While work is underway for the client, a third party creditor of the client serves a writ of garnishment on the lawyer based on an unrelated judgment the creditor obtained against the client. The lawyer has requested an advisory opinion on his/her ethical obligations in these circumstances."; "On the facts presented, after receipt of a properly served

writ of garnishment, the lawyer must determine whether a dispute exists between the creditor and the client regarding the funds subject to the writ. If a dispute exists with respect to entitlement to the subject funds, the lawyer must hold the funds in trust until the issuing court determines the rights of the judgment creditor and debtor with respect to the client funds, or the client and creditor otherwise resolve their dispute. If the client does not dispute the creditor's assertion of rights to the funds, the lawyer must disburse the funds in accordance with garnishment procedures." (emphasis added); "A dispute between the client and the creditor with respect to a writ of garnishment triggers a lawyer's safekeeping duties because the writ of garnishment is specific to funds in the lawyer's possession, and has a valid legal basis; namely, the underlying judgment, which is presumptively well-founded and represents a legal obligation from client to creditor. In the event of a dispute, the lawyer is required to maintain the client funds in trust until the issuing court determines the rights of the judgment creditor and debtor with respect to the client funds, or the client and creditor otherwise resolve their dispute. Retaining the funds in trust over a client's objection does not constitute a violation of RPC 1.15A(f) because a client may not be 'entitled' to funds subject to a writ of garnishment. RPC 1.15A(g). In addition, if the lawyer has begun work on a matter to the extent that he or she is entitled to fees from the client, then the lawyer's own interest in the advance deposit may also be part of the dispute to be resolved before the funds are disbursed.").

- Virginia LEO 1865 (11/16/12) (explaining that Virginia's unique Comment 4 to Rule 1.15 describes a lawyers' duties in dealing with trust account funds to which a third party might claim some entitlement; indicating that in the case of such formal indicia of entitlement as "a statutory lien, a judgment lien and a court order or judgment," lawyers have the same duty to such third parties as they do to clients -- even though the lawyer is not a party to such agreement and has not signed any document; noting that lawyers need not determine if the client or such a third party is entitled to the trust account funds, but instead "should hold the disputed funds in trust for a reasonable period of time or interplead the funds into court."; also noting that lawyers should indicate in retainer letters that "medical liens will be protected and paid out of the settlement proceeds or recovery."; warning that although in most situations lawyers' duties arise only if they have "actual knowledge" of a third party's lawful claim to trust account funds, "in some situations under federal or state law, the lawyer need only be aware that the client received medical treatment from a particular provider or pursuant to a health care Plan."; noting that if a third party "has not taken the steps necessary in order to perfect its lien or claim" to trust account funds, and cannot point to a "contract, order or statute establishing entitlement to the funds," lawyers may safely distribute the trust account funds to the client -- but should warn the client of the risks the client faces in disregarding a third party's claim; addressing three hypotheticals, concluding that: (1) a lawyer who knows that a client had medical bills paid by a health plan, but who has insufficient information to

know whether a valid lien for that claim even exists, may not investigate the plan's claim against the settlement amount without the client's informed consent -- because the lawyer's inquiries might "remind or encourage the plan to perfect a lien."; the lawyer may thus disburse the settlement funds to the client without violating the ethics rules, but should warn the client in writing of the risk of the client then disbursing the funds; the lawyer and the client may also "suffer civil liability under federal law."; (2) a lawyer who receives a letter from a health plan asserting subrogation rights, and who has twice requested documentation from the plan supporting its claims without receiving a response, may safely disburse the trust account funds to the client, because the lawyers has "exercised reasonable diligence" to determine the plan's subrogation claims or a lien; (3) a lawyer representing a client who has settled a claim against a hospital, and who has received a health plan's response asserting subrogation rights and citing federal regulations, but who has not heard back from the plan after three emails and a voice mail message seeking more information about the plan's subrogation rights, may safely disburse funds to the client without violating any ethics rules; explaining that a third party's "mere assertion" of a claim to trust account funds does not entitle the third party to the funds; indicating that lawyers must exercise "competence and reasonable diligence" to determine whether a "substantial basis exists for a claim asserted by a third party," but in the absence of such a basis and the absence of the third party's steps perfecting its entitlement to funds, a lawyer may disburse funds to the client after warning the client about "the consequences of disregarding the third party's claim."; concluding that if a lawyer "reasonably believes" that a third party has an interest in trust account funds (or the client "has a non-frivolous dispute" over a third party's entitlement to funds), the lawyer cannot disburse the funds -- but must hold them in trust until the dispute is resolved, or interplead the funds into court.

- Arizona LEO 11-03 (12/2011) ("A lawyer holding property in which both the client and a third person have an 'interest' must account for the property, pay undisputed sums to the proper party, and abide resolution of any disputes. Arizona Rules of Professional Conduct ('ERs') 1.15(d), (e). ER 1.15(d) requires a lawyer with knowledge of claims against the client to protect those with an 'interest' in funds in the lawyer's control. An 'interest' is a matured legal or equitable claim. The ethical claim. The ethical rules do not require a claimant's lawyer to search public records or other sources for medical liens or claims in order to acquire knowledge of an 'interest.'" (emphasis added); "[N]othing in the applicable ethics rules or previous opinions suggests that a lawyer has an obligation to discover or inquire about claims, contracts, liens or other encumbrances that would constitute an interest within the meaning of ER 1.15(d). Nor would recording a medical lien without actual notice to the lawyer give the lawyer knowledge of the lien. Further, the Committee has made it clear that contractual or other obligations of the client that do not rise to the level of an 'interest' are outside the scope of ER 1.15(d).").

- Arnold, Matheny & Eagan, P.A. v. First Am. Holdings, Inc., 982 So. 2d 628, 641 (Fla. 2008) (holding that a lawyer had a duty to stop payment on a check when that lawyer receives a writ of garnishment on the funds immediately after writing a check on the proceeds; "We conclude that Florida law imposes on both bank and non-bank garnishees the duty to retain funds held by the garnishee, even after a check on those funds has been drawn by the garnishee and delivered to the payee. We hold that the funds remain in the possession or control of an attorney garnishee if service of the writ of garnishment occurs after a check drawn on an attorney's trust account has been written and delivered to a client but before presentment to the attorney's bank. Accordingly, pursuant to the provisions of the garnishment statute, the attorney in those circumstances has an obligation to inquire of the bank as to the status of the funds in its account and to issue a stop payment order if he or she has the ability to do so. This decision is consistent with the garnishment statute and prior case law interpreting the statute, as well as the Rules Regulating the Florida Bar." (footnote omitted)).

Lawyers risk being whipsawed by clients' directions that contradict some third parties' claim against the trust account amounts. Lawyers must generally follow their clients' instructions about disbursing money from trust accounts.

- New York LEO 946 (11/7/12) ("Upon receiving clear instruction from a client to distribute settlement proceeds to the client or a named third person, a lawyer may follow the request of the client to distribute the funds in a certain manner.").

Somewhat ironically, lawyers generally must follow client instructions even if they suspect some impropriety.

- Texas LEO 606 (5/2011) (holding that a Texas lawyer may not withhold fees in a trust account based on the lawyer's suspicions about the origins of the fees; explaining that "since there has been no claim made by the federal prosecutor's office or any other person regarding the funds held in the lawyer's trust account relating to the client's matter, the lawyer is required to return the portion of the funds to the client as required under the fee agreement."; ultimately concluding that "[u]nder the Texas Disciplinary Rules of Professional Conduct, a lawyer is not permitted to continue to hold in the lawyer's trust account unearned fees that are otherwise repayable to a client under the fee agreement between the lawyer and client if continuing to hold the unearned fees is based only on the lawyer's belief, in the absence of a claim asserted, that the client may have improperly or illegally obtained the funds paid by the client. The lawyer is not permitted to communicate with

possible claimants to determine the existence of unasserted claims to funds to which the client is otherwise entitled.").

## Best Answer

The best answer to **(a)** is **YES**; the best answer to **(b)** is **MAYBE**; the best answer to **(c)** is **PROBABLY NO**.

B 11/14

# Handling Left-Over Client Trust Account Funds

## Hypothetical 44

Your firm just merged with another firm, and you took the opportunity to carefully review the status of your newly combined trust account. You have discovered that a number of clients sent in retainer checks and then disappeared -- leaving the deposit in your trust account. You have also found that some checks your lawyers wrote in connection with real estate transactions were never cashed by the payee surveyors, couriers, title companies, etc.

**(a)** Must you try to find the clients who left the money in the trust account?

**YES**

**(b)** If your effort to find the missing clients will require some expense, may you withdraw some of their money from the trust account to pay the search expenses?

**YES**

**(c)** What should you do with leftover funds for which you cannot locate the client, the payee, etc.?

**FOLLOW YOUR STATE'S ESCHEAT LAWS (PROBABLY)**

## Analysis

Not surprisingly, lawyers occasionally find that their trust accounts have left-over money -- because some vendor or transactional party neglected to cash a trust account check, etc. As in other areas, some counterintuitive principles apply to such remaining funds.

**(a)** Most (if not all) ethics rules require lawyers to take reasonable steps to find clients entitled to receive leftover trust account funds.

- District of Columbia LEO 359 (6/2011) ("Applying Rule 1.15 and the Unclaimed Property Act to the present inquiry, this Committee concludes that a lawyer must make reasonable efforts to locate a missing client whose last

known address is in the District or where the lawyer's principal place of business is in the District to return that client's trust account monies. Reasonable efforts to locate a missing client might include using available internet technologies and on-line directories, sending a certified letter with return receipt requested to the client's last known address, contacting friends or relatives, or posting a notice in a newspaper of general circulation in the vicinity of the last known address of the property owner." (emphasis added); "A lawyer who is in possession of funds (or other intangible personal property) belonging to a client who cannot be located, and whose last known address in in the District of Columbia (or where the lawyer is domiciled in the District), must exhaust reasonable efforts to locate the client as described more particularly above. Therefore, it is not a violation of the D.C. Rules of Professional Conduct for a lawyer in such circumstances to report to the Mayor and transfer client funds that are deemed to be abandoned as required by the D.C. Unclaimed Property Act.").

- Virginia LEO 1644 (6/9/95) (provideing guidance to a real estate lawyer whose checks are not cashed: (1) the lawyer should follow the Uniform Disposition of Unclaimed Property Act (Va. Code § 55-210.1 et seq.); (2) a lawyer must "use whatever means are reasonable" to find people entitled to receive trust funds (this would "in almost all instances" include first class mail and -- "if the amount of money involved justifie[s] the cost" -- include checking with telephone information or postal records); (3) a lawyer may deduct from the funds held in trust reasonable costs incurred in attempting to locate the party, but may not deduct an attorney's fee; (4) the lawyer may not agree with the client in advance that the lawyer may keep unclaimed funds.).

In a later legal ethics opinion, the Virginia Bar indicated that the lawyer does not need to hire an investigator to find the clients, because "[d]ue diligence is all that is required of an attorney trying to locate a client." Virginia LEO 1673 (5/16/96).

**(b)** If the search for a client results from the client's actions, bars generally allow lawyers to expend trust fund monies in an effort to find the clients. As might be expected, bars generally do not allow lawyers to pay themselves a fee (out of the trust account money) for the search.

**(c)** Bars have issued some guidelines (often evolving over time) for the handling of leftover trust account money.

For instance, the Virginia Bar issued a number of early legal ethics opinions inviting lawyers[1] or their estates[2] to keep any leftover money.

More recently, North Carolina took this approach.

- North Carolina RPC 226 (4/12/96) (holding that a law firm may take ownership of trust account funds if the law firm has failed to identify to whom the trust account funds are owed; inexplicably not pointing to the escheat statute).

However, more recent opinions indicate that leftover money goes to the states under escheat laws.

- District of Columbia LEO 359 (6/2011) ("Applying Rule 1.15 and the Unclaimed Property Act to the present inquiry, this Committee concludes that a lawyer must make reasonable efforts to locate a missing client whose last known address is in the District or where the lawyer's principal place of business is in the District to return that client's trust account monies. Reasonable efforts to locate a missing client might include using available internet technologies and on-line directories, sending a certified letter with return receipt requested to the client's last known address, contacting friends or relatives, or posting a notice in a newspaper of general circulation in the vicinity of the last known address of the property owner."; "A lawyer who is in possession of funds (or other intangible personal property) belonging to a client who cannot be located, and whose last known address in in the District of Columbia (or where the lawyer is domiciled in the District), must exhaust reasonable efforts to locate the client as described more particularly above. Therefore, it is not a violation of the D.C. Rules of Professional Conduct for a lawyer in such circumstances to report to the Mayor and transfer client funds that are deemed to be abandoned as required by the D.C. Unclaimed Property Act." (emphasis added)).

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[1] Virginia LEO 548 (3/1/84) (a lawyer who cannot determine to whom leftover trust account money should be paid may transfer the money to the lawyer's own account after diligently trying to determine to whom the money is owed and waiting until it is reasonable to conclude that no one will claim the money).

See also Virginia LEO 415 (5/20/81) (a lawyer whose real estate escrow account check was never cashed may withdraw funds from the trust account and place them in a separate interest-bearing account pending resolution of the lost check).

[2] Virginia LEO 697 (5/10/85) (a deceased lawyer's trust account may be paid to the lawyer's estate if a diligent effort has not uncovered the clients to whom the money is owed and the money is kept in an interest-bearing account until it is unlikely that any client would claim it; [the lawyer should also check any escheat laws]).

- Ohio LEO 2008-3 (8/15/08) ("[P]roper disposition of client funds in a lawyer's IOLTA or individual client trust account, when either the identity or the whereabouts of the client who is the owner of the funds is unknown, is for a lawyer to follow the statutory procedure for the disposition of unclaimed funds to the state set forth in Chapter 169 of the Ohio Revised Code. A lawyer's reporting of unclaimed funds of a client whose identity or whereabouts are unknown does not violate either the ethical duty of safekeeping a client's funds under Rule 1.15 or the ethical duty to protect a client's confidentiality under Rule 1.6." (emphasis added)).

## Best Answer

The best answer to **(a)** is **YES**; the best answer to **(b)** is **YES**; the best answer to **(c)** is **FOLLOW YOUR STATE'S ESCHEAT LAWS (PROBABLY)**.

B 11/14

# Provisions Allowing Withdrawal and Recovery of Collection Costs

## Hypothetical 45

You are trying to standardize your law firm's form files, and have several questions about the types of revisions you may ethically include in fee agreements.

**(a)** Can you include a provision allowing your law firm to withdraw from representing any client that does not pay a bill within 30 days?

**MAYBE**

**(b)** Can you include a provision requiring clients to pay the cost (including reasonable attorney's fees) you incur in seeking the payment of any unpaid bills?

**NO (PROBABLY)**

## Analysis

**(a)-(b)** As fiduciaries, lawyers must be very wary of any contractual arrangements with their clients that seem to overreach. Lawyers might confront this standard if they ask or require their clients to agree in advance to what bars or courts might find to be onerous provisions triggered by the client's failure to pay the lawyer.

To be sure, the ABA Model Rules allow lawyers to limit their services up to a certain value or fee amount.

> An agreement may not be made whose terms might induce the lawyer improperly to curtail services for the client or perform them in a way contrary to the client's interest. For example, a lawyer should not enter into an agreement whereby services are to be provided only up to a stated amount when it is foreseeable that more extensive services probably will be required, unless the situation is adequately explained to the client. Otherwise, the client might have to bargain for further assistance in the midst of a proceeding or transaction. However, it is proper to define the extent of services in light of the client's ability to pay. A lawyer should

> not exploit a fee arrangement based primarily on hourly charges by using wasteful procedures.

ABA Model Rules 1.5 cmt. [5] (emphases added).

If clients do not comply with such arrangements, lawyers presumably may rely on ABA Model Rule 1.16 to withdraw from representing the client.

> Except as stated in paragraph (c), a lawyer may withdraw from representing a client if . . . the client fails substantially to fulfill an obligation to the lawyer regarding the lawyer's services and has been given reasonable warning that the lawyer will withdraw unless the obligation is fulfilled.

ABA Model Rule 1.16(b)(5). A comment provides a bit more guidance.

> A lawyer may withdraw if the client refuses to abide by the terms of an agreement relating to the representation, such as an agreement concerning fees or court costs or an agreement limiting the objectives of the representation.

ABA Model Rule 1.16 cmt. [8].

However, some courts and bars have condemned unconditional provisions allowing such withdrawals.

- New York LEO 805 (1/10/07) (holding that a lawyer may not include in a retainer agreement a provision "that would secure a client's advance assent to a lawyer's withdrawal from employment if the client fails to pay agreed legal fees and expenses in a timely manner"; explaining that a provision could refer to the ethics rules standard for withdrawing, but that the provision in question would allow withdrawal even from "an inadvertent failure to pay or a failure to pay a de minimus amount").

Courts have taken different positions on the ethical acceptability of retainer agreements requiring delinquent clients to pay their lawyers' attorney fees if those lawyers must litigate against the clients to seek payment.

Some courts and bars have found such retainer provisions acceptable.

- Timothy Whelan Law Assocs., Ltd. v. Kruppe, 947 N.E.2d 366, 370 (Ill. App. Ct. Mar. 31, 2011) (finding that a lawyer could arrange for a retainer provision

allowing the lawyer to recover attorney's fees if the lawyer had to sue a former client to recover fees; explaining that the clients signed a retainer agreement with the following provision: "'In the even [*sic*] it becomes necessary to bring a collection proceeding against you for nonpayment of fees and costs, I may include reasonable attorney fees and cost [*sic*] in those proceedings.'"; finding the provision ethically permissible and not against public policy).

- Delaware LEO 2009-2 (3/25/09) (analyzing the following question: "Would it be ethically permissible to include a provision in a client engagement letter or retainer agreement which would say something to the effect that 'in the event of default in payment, Client will pay reasonable attorney's fees and costs incurred in collecting said amount which may be due?'"; offering the following conclusion: "It is the Committee's opinion that inclusion of language and conditions in a client engagement or retainer letter providing for the Attorney's ability to recover actual costs and reasonable outside counsel attorney's fees, if a collection action is instituted against the client, is ethically permissible under the Delaware Lawyers' Rules of Professional Conduct, specifically Rule 1.15"; explaining that the lawyer must include in any retainer letter "[a] clear statement that, should the client default on payments to Attorney, that [sic] Attorney has the ability to seek payment of the owed amounts, and, in addition, seeks costs and outside counsel attorney's fees for the recovery efforts"; "A clear statement that the right to recover costs and outside counsel fees is reciprocal or mutual in nature, in that the client, in the event a fee dispute arises, also has the ability to seek the same costs and reasonable attorneys' fees in defending the action by Attorney"; "A clear statement that the costs would be limited to actual costs incurred by the Attorney or client in bringing or defending against the action"; "A clear statement that the client may seek the advice of an independent attorney prior to the execution of the engagement or retainer letter, and that the engagement or retainer letter does not in any way prevent the client from seeking or retaining other counsel at any time, including a situation where a fee dispute arises.").

- Virginia LEO 1783 (12/22/03) (explaining that a lawyer representing a lender in collecting on a defaulted note that included a provision requiring the borrower to pay attorney's fees equal to 25% of the principal balance due may give the client/lender any portion of the 25% that exceeds the actual cost of the legal services; noting that the 25% attorney's fee provision is "an agreed upon contract term" which provides "commercial certainty for all parties"; concluding that allowing the nonlawyer client/lender to receive a portion of the 25% does not threaten the "independent judgment of an attorney from improper nonlawyer interference," and therefore does not amount to an unethical sharing of legal fees with a nonlawyer).

Other courts and bars have criticized retainer agreements that tend to shift collection costs to clients.

- Ween v. Dow, 822 N.Y.S.2d 257 (N.Y. App. Div. 2006) (a lawyer's retainer agreement may not hold the client liable for expenses the lawyer incurs in collecting unpaid fees).

- Virginia LEO 1667 (7/8/96) (holding that a fee agreement under which a client must pay an additional $500 if the lawyer must institute collection proceedings to recover an unpaid fee would be unethical, because such an automatic collection fee could exceed the unpaid balance; explaining that a fee agreement is not like a normal contract, and even an agreed-upon term can violate the Code; also explaining that a fee's reasonableness is not judged solely at the time of the agreement, because "[t]he occurrence of events not contemplated by the parties at the outset of the representation may also be relevant to the reasonableness of the fee."; noting that it would not be improper to include in the fee agreement a provision for the recovery of reasonable attorneys' fees if the lawyer must sue to collect an unpaid fee.).

- Lee v. Daniels & Daniels, No. 04-07-00096-CV, 2008 Tex. App. LEXIS 1023 (Tex. App. Feb. 13, 2008) (finding that a lawyer's retainer agreement may not require the client to pay the lawyer's hourly fee for time spent in connection with the lawyer's withdrawal), opinion withdrawn & vacated on other grounds, opinion substituted at Lee v. Daniels & Daniels, 264 S.W.3d 273 (Tex. App. 2008).

## Best Answer

The best answer to **(a)** is **MAYBE**; the best answer to **(b)** is **PROBABLY NO**.

B 11/14

# Attorney Liens

## Hypothetical 46

Your managing partner wants to take a more aggressive approach to clients who do not pay their bills. You are considering ways that you can deal with such delinquent clients.

**(a)** Can you assert a lien over any money in your firm's trust account over which the client might have some claim?

**YES**

**(b)** Can you assert a lien over the file you generated while representing the client?

**MAYBE**

## Analysis

Attorney liens can involve the attorney's claim of some right: (1) to a priority position in a claim for an amount the client recovers, the non-monetary value of a recovery, an amount held in the lawyer's trust account, etc.; or (2) to retain the client's property or the file the lawyer created while representing the client, as security for the lawyer's recovery of fees or expenses from a client that has not paid them.

### Attorney Lien Owed Money or Property

The ABA Model Rules . . .

The Restatement contains several provisions dealing with a lawyer's lien over client property (or property whose ownership is disputed).

> (1) Except as provided in Subsection (2) or by statute or rule, a lawyer does not acquire a lien entitling the lawyer to retain the client's property in the lawyer's possession in order to secure payment of the lawyer's fees and disbursements. A lawyer may decline to deliver to a client or former client an original or copy of any document prepared by the lawyer or

> at the lawyer's expense if the client or former client has not paid all fees and disbursements due for the lawyer's work in preparing the document and nondelivery would not unreasonably harm the client or former client.
>
> (2) Unless otherwise provided by statute or rule, client and lawyer may agree that the lawyer shall have a security interest in property of the client recovered for the client through the lawyer's efforts, as follows:
>
> > (a) the lawyer may contract in writing with the client for a lien on the proceeds of the representation to secure payment for the lawyer's services and disbursements in that matter;
> >
> > (b) the lien becomes binding on a third party when the party has notice of the lien;
> >
> > (c) the lien applies only to the amount of fees and disbursements claimed reasonably and in good faith for the lawyer's services performed in the representation; and
> >
> > (d) the lawyer may not unreasonably impede the speedy and inexpensive resolution of any dispute concerning those fees and disbursements or the lien.

Restatement (Third) of Law Governing Lawyers § 43(1), (2) (2000). A comment provides an explanation.

> Under this Section a lawyer generally does not acquire a nonconsensual lien on property in the lawyer's possession or recovered by the client through the lawyer's efforts. The Section thus does not recognize retaining liens on the client's documents except as provided by statute or rule . . . , although a lawyer may retain possession of a document when the client has not paid the lawyer's fee for preparing the document . . . .
>
> Security interests in property of nonclients, for example a mortgage on the house of a client's relative, are not as such subject to this Section. However, the nonclient might have a close relationship with the client, such as that of parent or spouse, and thus might be subject to similar pressures. Such security arrangements must meet the requirements of general law, which might treat such

> transactions as subject to obligations similar to those stated in this Section.

Restatement (Third) of Law Governing Lawyers § 43 cmt. a (2000).

A Restatement comment explains the basis for a lawyer seeking a lien over proceeds of a representation.

> Legislation in many states and judicial decisions in others allow a lawyer who has represented a successful claimant to retain out of the proceeds of the suit an amount sufficient to pay the lawyer's claimed fee and disbursements . . . . With appropriate safeguards, such charging liens can secure proper payment for lawyers without the coercive effects of a retaining lien. If the client were given the disputed sum, the money might be dissipated before the lawyer could secure a remedy. Especially when the client has no other assets and the lawyer is receiving a contingent fee, the charging lien gives the lawyer important assurance that the fee and disbursements will actually be paid. It thus makes it easier for people to secure competent representation when they have small means and meritorious claims.
>
> The provisions of this Section apply in the absence of a statute or rule providing otherwise. Not all safeguards required by the Section are required in all jurisdictions, many of which, for example, recognize a charging lien without a contract. Such charging liens apply in representations involving formal adjudication or in other representations such as those involving negotiation or arbitration. The charging lien is limited to the amount of the lawyer's good-faith claim for fees and disbursements; the lawyer must promptly pay the client the rest of the proceeds of the matter . . . . The disputed amount may not be mingled with the lawyer's own funds until the dispute is resolved . . . .

Restatement (Third) of Law Governing Lawyers § 43 cmt. d (2000).

The Restatement describes the steps that a lawyer must take before asserting such a lien.

> Lien statutes and decisions differ in their requirements for making the lien effective against a third party. Two such

> general requirements apply in the absence of a contrary statutory arrangement.
>
> First, the client and lawyer must contract in writing for the lien. That requirement ensures that the client has notice that the lawyer may detain part of any recovery and an opportunity to bargain for a different result . . . . The requirement of a writing also permits third parties to verify the lien's existence and provisions. The lien contract need not specify the amount of the fee, which is often unknown in advance, and need not use the word 'lien.' However, it must make clear that the lawyer will be entitled to part of the proceeds of the action to pay the lawyer's fee.
>
> Second, to be enforceable against a third party that person must have been afforded notice of the lien as required by law. Otherwise, that party could not fairly be held liable to the lawyer after making payment directly to the plaintiff . . . . If there are several third parties, the lien is binding only on those with notice. Absent waiver or estoppel or other law to the contrary, effective notice can be given at any time before the third party makes payment to the client.
>
> If a consensual charging lien satisfies the two requirements described above, a nonclient who pays the sum in dispute to the client is nevertheless obliged to pay the lawyer the underlying fee claim (up to the amount of the lien). The nonclient thereupon may seek reimbursement from the client. The lawyer, however, may not prevent the client from settling the case or sue to enforce a judgment that the client leaves uncollected . . . . The lien can be used only to collect a valid and enforceable fee claim. If, for example, the lawyer's fee claim has been forfeited . . . , the lien becomes unenforceable.

Restatement (Third) of Law Governing Lawyers § 43 cmt. e (2000). The next provision explains how a third party can protect itself in this circumstance.

> The third party can protect itself against double payment by applying to the court for a protective order, by an interpleader proceeding, or by satisfying the judgment or other obligation (as under a settlement contract) with an instrument requiring endorsement by both the claimant and the claimant's lawyer.

Restatement (Third) of Law Governing Lawyers § 43 cmt. e (2000).

The Restatement explains the priority of a lawyer's lien in these circumstances.

> A lawyer's charging lien ordinarily takes priority over security interests that the client grants to other persons after the lawyer's lien has been perfected. According priority to a lawyer's charging lien might raise at least three issues, on which there is mixed authority. One issue is what if any steps, such as filing a financing statement, a lawyer must take to perfect the lawyer's rights against other creditors of the client. A second issue is whether the lawyer's lien takes priority over security interests previously granted by the client. A third issue is whether the lawyer's lien takes priority over security interests such as tax liens that are not granted by the client. This Restatement takes no position on those issues.

Restatement (Third) of Law Governing Lawyers § 43 cmt. f (2000).

Not surprisingly, a separate Restatement provision explains a tribunal's right to rule on ownership of such property.

> A tribunal where an action is pending may in its discretion adjudicate any fee or other dispute concerning a lien asserted by a lawyer on property of a party to the action, provide for custody of the property, release all or part of the property to the client or lawyer, and grant such other relief as justice may require.

Restatement (Third) of Law Governing Lawyers § 43(3) (2000). A comment provides an additional explanation of the tribunal's power.

> Pursuant to Subsection (3), if there is dispute as to what fee is due, and thus as to the appropriate scope of the lawyer's charging lien, the court may resolve it under ancillary jurisdiction . . . . It can protect the funds in dispute while the controversy is adjudicated in another forum, for example by requiring their deposit in an interest-bearing account. The court can also refuse to enforce the lien because of compelling circumstances; some courts, for example, have concluded that no lien should attach to child-support payments.

Restatement (Third) of Law Governing Lawyers § 43 cmt. g (2000).

The Restatement addresses a lawyer's lien over property that is not in the client's or the lawyer's possession.

> With respect to property neither in the lawyer's possession nor recovered by the client through the lawyer's efforts, the lawyer may obtain a security interest on property of a client only as provided by other law and consistent with §§ 18 and 126. Acquisition of such a security interest is a business or financial transaction with a client within the meaning of § 126.

Restatement (Third) of Law Governing Lawyers § 43(4) (2000). A lengthy comment provides an explanation.

> Under Subsection (4), a lawyer may obtain a consensual security interest in a client's property not otherwise involved in the representation, such as a mortgage on the client's land, a pledge of the client's stocks, or an escrow arrangement. This Section does not prohibit such security arrangements. They are typically created by a writing that informs the client of the obligations secured. Typically they are used when the client's ability or willingness to pay is questionable, and they thus aid such a client (for example, a criminal defendant with nonliquid assets but no money) to obtain counsel.
>
> Subsection (4) recognizes, however, that consensual security interests on a client's property raise problems of fairness to the client. The client might not adequately understand the transaction and might as a result be treated unfairly. Enforcement of the security interest might involve harsh consequences, such as the client's dispossession, and places client and lawyer in a continuing financial relationship that involves differing interests for the lawyer.
>
> Accordingly, a security interest for a lawyer is subject to the rules governing other business transactions between client and lawyer . . . . Notice and consent must be in writing when required under lawyer disciplinary rules or the general law governing mortgage and security interests. When a lawyer obtains the security interest after commencing the

> representation, the arrangement is subject to close scrutiny under § 18.

Restatement (Third) of Law Governing Lawyers § 43 cmt. i (2000). The next provision explains situations where the lawyer has not obtained a security interest.

> Advance payment of fees . . . , payment of an engagement retainer . . . , contracts for payment of interest on unpaid bills . . . , and contracts requiring regular billing and payment do not create security interests or liens within the meaning of this Section and are not subject to the restrictions of § 126. For example, a lawyer who has required an advance payment may retain in the lawyer's trust account a sum sufficient to cover a disputed fee . . . . Such arrangements are not subject to close scrutiny under § 18 if agreed upon before the lawyer begins to perform legal services. However, such contracts must be reasonable in the circumstances . . . and are construed as they would be by a reasonable client . . . .

Restatement (Third) of Law Governing Lawyers § 43 cmt. i (2000).

Separate Restatement provisions deal with the lawyer's obligation to return the client's or a non-client's property.

> (1) Except as provided in Subsection (2), a lawyer must promptly deliver, to the client or nonclient so entitled, funds or other property in the lawyer's possession belonging to a client or nonclient.
>
> (2) A lawyer may retain possession of funds or other property of a client or nonclient if:
>
> > (a) the client or nonclient consents;
> >
> > (b) the lawyer's client is entitled to the property, the lawyer appropriately possesses the property for purposes of the representation, and the client has not asked for delivery of the property;

> (c) the lawyer has a valid lien on the property (see § 43);
>
> (d) there are substantial grounds for dispute as to the person entitled to the property; or
>
> (e) delivering the property to the client or nonclient would violate a court order or other legal obligation of the lawyer.

Restatement (Third) of Law Governing Lawyers § 45 (2000). A comment explains the timing of this requirement.

> A lawyer's basic obligation under this Section is to deliver property of a client or nonclient promptly to that client or person unless an exception stated in Subsection (2) applies. The obligation covers all kinds of property. For example, a lawyer who has received a deposit against future fee bills must return the unearned portion of the deposit when the representation ends . . . .
>
> How soon the delivery must occur depends on the circumstances . . . . When the owner asks for delivery of the property, the lawyer must comply with the request. If the lawyer knows that the owner has need to possess the property by a given time, the lawyer should if reasonably possible deliver it by that time. The lawyer ordinarily should not delay longer than necessary to record and transmit the funds . . . . A client entitled to proceeds of a judgment normally should not have to wait more than a few days to receive the property from the client's lawyer. When the representation ends, moreover, any delay in delivering the client's property can hamper the client's affairs . . . . On the other hand, during the representation a lawyer is not required, in the absence of client request, to deliver items that might turn out to be needed for the representation . . . .

Restatement (Third) of Law Governing Lawyers § 45 cmt. b (2000).

The next Restatement provision deals with the client's consent to the lawyer's continued possession of the property.

> Clients and others often ask a lawyer to retain possession of property. No formal contract is required. Most clients would

> expect that during a representation the lawyer would keep property needed for further steps in the representation, unless the client indicates to the contrary. Thus, during the representation a lawyer need not return documents or court exhibits unless the client so requests. For treatment of documents after the representation ends, see § 46. In some circumstances, for example, when the client agrees that the lawyer will invest client funds, the arrangement constitutes a business transaction with the client subject to the requirements of § 126.

Restatement (Third) of Law Governing Lawyers § 45 cmt. c (2000).

The Restatement deals with the lawyer's obligation if there is a dispute about the property.

> When it is unclear who is entitled to property in the lawyer's possession, the lawyer is not required to deliver the disputed property to either claimant; indeed, if the lawyer delivers the property to one claimant, the lawyer can later be held liable to the other. The lawyer should therefore safeguard the property until the disputants resolve it by contract or an appropriate procedure . . . . If a lawyer holds property belonging to one person and a second person has a contractual or similar claim against that person but does not claim to own the property or have a security interest on it, the lawyer is free to deliver the property to the person to whom it belongs. If a lawyer holds funds as an advance fee payment, the lawyer is not obliged to deliver those funds to the client when the client disputes the lawyer's good-faith claim that the sum withheld is due to the lawyer, but the lawyer may not transfer the disputed funds to the lawyer's personal account . . . .

Restatement (Third) of Law Governing Lawyers § 45 cmt. d (2000). Not surprisingly, lawyers must comply with any court order dealing with the property.

> A court may order a lawyer to deposit property in court or in an interest-bearing account pending further court orders. A court might also require a lawyer to surrender an object to another party or allow its inspection at the lawyer's office, regardless of the wishes of the lawyer's client. Such a court order ordinarily binds a client's lawyer even if only the client is named in the order. A lawyer might also be constrained

> by a legal obligation not arising from a court order, for example a lien asserted by a third party. A lawyer is not required by any supposed duty to a client to deliver property to a claimant when doing so would cause the lawyer to violate a court order or other legal obligation.

Restatement (Third) of Law Governing Lawyers § 45 cmt. e (2000).

Finally, the Restatement addresses the interesting situation in which a lawyer receives stolen property.

> The lawyer's duties of confidentiality do not prevent a lawyer from complying with the requirement of this Section to return promptly to its owner property that a client has stolen and placed in the lawyer's possession. The client's transfer of the property as such is ordinarily not a communication subject to the attorney-client privilege . . . . Although the lawyer's knowledge that the goods are stolen from a given person will usually derive from confidential client information . . . , a lawyer who knowingly retains stolen goods is helping the thief conceal them from their proper owner, which is a crime. The same would be true were the lawyer, once having taken possession of the goods, to return them to the thief. By asking the lawyer to possess stolen goods, moreover, the client has lost the protection of the attorney-client privilege for any accompanying communications . . . .
>
> Although the lawyer must return the goods, there is no requirement that the lawyer explain their provenance or name the thief. To do so voluntarily might well violate the lawyer's duties of confidentiality . . . , even though a tribunal might be able to require disclosure . . . . In representing the client in defending against a charge of crime, the lawyer may retain the goods long enough to test or inspect them in preparation for the client's defense, though this does not authorize keeping them secret until the trial. . . .
>
> Finally, if a genuine dispute exists as to ownership of the property, the lawyer need not deliver it . . . , but must then notify each person having a substantial claim of the lawyer's possession . . . so that the lawyer's possession does not conceal the property from its owner.

Restatement (Third) of Law Governing Lawyers § 45 cmt. f (2000).

## Attorney Lien Over File

The ethics rules, ethics opinions and the case law take differing positions on a lawyer's right to retain the file, depending on whether the lawyer has been paid or not.

The Restatement addresses the lawyer's obligation to safeguard property that the client has given the lawyer, or which the lawyer has created during the representation.

> (1) A lawyer must take reasonable steps to safeguard documents in the lawyer's possession relating to the representation of a client or former client.
>
> (2) On request, a lawyer must allow a client or former client to inspect and copy any document possessed by the lawyer relating to the representation, unless substantial grounds exist to refuse.
>
> (3) Unless a client or former consents to non-delivery or substantial grounds exist for refusing to make delivery, a lawyer must deliver to the client or former client, at an appropriate time and in any event promptly after the representation ends, such originals and copies of other documents possessed by the lawyer relating to the representation as the client or former client reasonably needs.

Restatement (Third) of Law Governing Lawyers § 46(1), (2), (3) (2000). A comment provides a further explanation of this duty.

> A lawyer's duty to safeguard client documents does not end with the representation . . . . It continues while there is a reasonable likelihood that the client will need the documents, unless the client has adequate copies and originals, declines to receive such copies and originals from the lawyer, or consents to disposal of the documents.
>
> The lawyer need take only reasonable steps to preserve the documents. For example, a law firm is not required to preserve client documents indefinitely and may destroy documents that are outdated or no longer of consequence. Similarly, a lawyer who leaves a firm may

> leave with that firm the documents of clients the lawyer represented while with the firm, provided that the lawyer reasonably believes that the firm has appropriate safeguarding arrangements. So long as a lawyer has custody of documents, the lawyer must take reasonable steps in arrangements for storing, using, destroying, or transferring them. If the jurisdiction allows a lawyer's practice to be sold to another lawyer, the lawyer must comply with the rules governing the sale. If a firm dissolves, its members must take reasonable steps to safeguard documents continuing to require confidentiality, for example by entrusting them to a person or depository bound by appropriate restrictions.

Restatement (Third) of Law Governing Lawyers § 46(1), (2), (3) (2000).

The next Restatement provision discusses the client's right to the documents.

> As stated in Subsection (3), a client is entitled to retrieve documents in possession of a lawyer relating to representation of the client. That right extends to documents placed in the lawyer's possession as well as to documents produced by the lawyer, subject to the right to retain property under a valid lien . . . and to other justifiable grounds as discussed hereafter.
>
> A client is ordinarily entitled to inspect and copy at reasonable times any document relating to the representation in the possession of the client's lawyer . . . . A client's failure to assert the right to inspect and copy files during the representation does not bar later enforcement of that right, so long as the lawyer has properly not disposed of the documents . . . .

Restatement (Third) of Law Governing Lawyers § 46 cmt. c (2000).

The general Restatement requirement that the lawyer provides documents in the lawyer's possession is subject to the lawyer's right to

> decline to deliver to a client or former client an original or copy of any document under circumstance permitted by § 43(1) [which deals with the lawyer's ability to retain document until the lawyer is paid].

Restatement (Third) of Law Governing Lawyers § 46(4) (2000).

The Restatement explains several situations in which the lawyer can refuse the client's request to such access.

> A lawyer may deny a client's request to retrieve, inspect, or copy documents when compliance would violate the lawyer's duty to another . . . . That would occur, for example, if a court's protective order had forbidden copying of a document obtained during discovery from another party, or if the lawyer reasonably believed that the client would use the document to commit a crime . . . . Justification would also exist if the document contained confidences of another client that the lawyer was required to protect.
>
> Under conditions of extreme necessity, a lawyer may properly refuse for a client's own benefit to disclose documents to the client unless a tribunal has required disclosure. Thus, a lawyer who reasonably concludes that showing a psychiatric report to a mentally ill client is likely to cause serious harm may deny the client access to the report . . . . Ordinarily, however, what will be useful to the client is for the client to decide.
>
> A lawyer may refuse to disclose to the client certain law-firm documents reasonably intended only for internal review, such as a memorandum discussing which lawyers in the firm should be assigned to a case, whether a lawyer must withdraw because of the client's misconduct, or the firm's possible malpractice liability to the client. The need for lawyers to be able to set down their thoughts privately in order to assure effective and appropriate representation warrants keeping such documents secret from the client involved. Even in such circumstances, however, a tribunal may properly order discovery of the document when discovery rules so provide. The lawyer's duty to inform the client . . . can require the lawyer to disclose matters discussed in a document even when the document itself need not be disclosed.

Restatement (Third) of Law Governing Lawyers § 46 cmt. c (2000).

The Restatement describes documents that the lawyers must furnish even without the clients requesting such documents.

> Even without a client's request or the discovery order of a tribunal, a lawyer must voluntarily furnish originals or copies of such documents as a client reasonably needs in the circumstances. In complying with that standard, the lawyer should consider such matters as the client's expressed concerns, the client's possible needs, customary practice, the number of documents, the client's storage facilities, and whether the documents originally came from the client. The client should have an original of documents such as contracts, while a copy will suffice for such documents as legal memoranda and court opinions. Except under extraordinary circumstances -- for example, when a client retained a lawyer to recover and destroy a confidential letter -- a lawyer may keep copies of documents when furnished to a client.
>
> If not made before, delivery must be made promptly after the representation ends. The lawyer may withhold documents to induce the client to pay a bill only as stated in § 43. During the representation, the lawyer should deliver documents when the client needs or requests them. The lawyer need not deliver documents when the client agrees that the lawyer may keep them or where there is a genuine dispute about who is entitled to receive them . . . .

Restatement (Third) of Law Governing Lawyers § 46 cmt. d (2000).

The Restatement also addresses the lawyer's right to be paid for this effort.

> Because a lawyer's normal duties include collection and delivery of documents that came from the client or that the client should have, a lawyer paid by the hour should be compensated for time devoted to that task. Copying expenses may be separately billed when allowed under the principles stated in § 38(3)(a) and Comment e thereto. When the client seeks copies that the lawyer was not obliged to furnish in the absence of such a request, the lawyer may require the client to pay the copying costs.

Restatement (Third) of Law Governing Lawyers § 46 cmt. e (2000).

Another Restatement provision deals with a lawyer's right to retain the file until the client pays the lawyer.

> While a broad retaining lien might protect the lawyer's legitimate interest in receiving compensation, drawbacks outweigh that advantage. The lawyer obtains payment by keeping from the client papers and property that the client entrusted to the lawyer in order to gain help. The use of the client's papers against the client is in tension with the fiduciary responsibilities of lawyers. A broad retaining lien could impose pressure on a client disproportionate to the size or validity of the lawyer's fee claim. The lawyer also can arrange other ways of securing the fee, such as payment in advance or a specific contract with the client providing security for the fee under Subsection (4). Because it is normally unpredictable at the start of a representation what client property will be in the lawyer's hands if a fee dispute arises, a retaining lien would give little advance assurance of payment. Thus, recognizing such a lien would not significantly help financially unreliable clients secure counsel. Moreover, the leverage of such a lien exacerbates the difficulties that clients often have in suing over fee charges . . . . Efforts in some jurisdictions to prevent abuse of retaining liens demonstrate their undesirability. Some authorities prohibit a lien on papers needed to defend against a criminal prosecution, for example. However the very point of a retaining lien, if accepted at all, is to coerce payment by withholding papers the client needs.
>
> Retaining liens are therefore not recognized under this Section except as authorized by statute or rule and to the extent provided under Subsection (4). Under this Section, lawyers may secure fee payment through a consensual charging lien on the proceeds of a representation . . . and through contractual security interests in other assets of the client . . . and other contractual arrangements such as a prepaid deposit. The lawyer may also withhold from the client documents prepared by the lawyer or at the lawyer's expense that have not been paid for . . . .

Restatement (Third) of Law Governing Lawyers § 43 cmt. b (2000). The next provision also addresses this basic principle.

> A client who fails to pay for the lawyer's work in preparing particular documents (or in having them prepared at the lawyer's expense, for example by a retained expert) ordinarily is not entitled to receive those documents. Whether a payment was due and whether it was for such a document depend on the contract between the client and the lawyer, as construed from the standpoint of a reasonable client . . . .

Restatement (Third) of Law Governing Lawyers § 43 cmt. c (2000). Several illustrations provide additional guidance.

> Client retains Lawyer to prepare a series of memoranda for an agreed compensation of $ 100 per hour. Lawyer is to send bills every month. Client pays the first two bills and then stops paying. After five months, Client requests copies of all the memoranda. Lawyer must deliver all memoranda prepared during the first two months, but need not deliver those thereafter prepared until Client makes the payments.
>
> 2. The same facts as in Illustration 1, except that Client and Lawyer have agreed that Lawyer is to send bills every six months. After five months, Client requests copies of all the memoranda. Lawyer must deliver them all, because Client has not failed to pay any due bill. Had Client stated in advance that it would not pay the bill, the doctrine of anticipatory breach might allow Lawyer not to deliver.

Restatement (Third) of Law Governing Lawyers § 43 cmt. c, illus. 1, 2 (2000).

The Restatement explains that lawyers may not enforce this right if it would "unreasonably harm the client."

> A lawyer may not retain unpaid-for documents when doing so will unreasonably harm the client. During a representation, nonpayment of a fee might justify the lawyer in withdrawing . . . , but a lawyer who does not withdraw must continue to represent the client diligently . . . . A lawyer who has not been paid a fee due may normally retain those documents embodying the lawyer's work . . . . Even then, a

> tribunal is empowered to order production when the client has urgent need. A lawyer must record or deliver to a client for recording an executed operative document, such as a decree or deed, even though the client has not paid for it, when the operative effect of the document would be seriously compromised by the lawyer's retention of it.

Restatement (Third) of Law Governing Lawyers § 43 cmt. c (2000).

> Although most jurisdictions recognize charging liens only when a statute authorizes them, some allow contractual liens without a statute. Cetenko v. United California Bank, 638 P.2d 1299 (Cal.1982).

Restatement (Third) of Law Governing Lawyers § 43 cmt. d, reporter's note (2000).

## Best Answer

The best answer to **(a)** is **YES**; the best answer to **(b)** is **MAYBE**.

# Arbitration Provisions

## Hypothetical 47

Over the past several years, a number of your firm's former clients have threatened to sue your firm for malpractice -- usually to deter an anticipated suit for unpaid fees. One of your partners has proposed adding an arbitration provision to your standard retainer letter. The arbitration provision would cover disputes over fees and any complaints about the quality of your work.

**(a)** May your standard retainer letter include an arbitration provision covering disputes over your fees?

**YES**

**(b)** May your standard retainer letter include an arbitration provision covering disputes over the quality of your legal work?

**YES**

## Analysis

**[Steal from Conflicts between Clients and Their Lawyers, Parts I and II when completed]**

**(a)-(b)** The ABA Model Rules contain the standard ethics principle prohibiting a lawyer from limiting the lawyer's own liability to a client in advance. ABA Model Rule 1.8(h).

Most state courts[1] and bars[2] have taken the more liberal view toward arbitration provisions in retainer agreements, presumably because they affect merely the

[1] Hearn v. Gonzalez, 18 S.W.3d 684 (Tex. App. 2000) (compelling arbitration; finding that determination of the attorney-client relationship did not invalidate the arbitration agreement); Powers v. Dickson, Carlson & Campillo, 54 Cal. App. 4th 1102, 63 Cal. Rptr. 2d 261 (1997), modified, 97 Cal. Daily Op. Serv. 4007 (May 23, 1997) (compelling arbitration of malpractice claim). But see Lawrence v. Walzer & Gabrielson, 207 Cal. App. 3d 1501, 256 Cal. Rptr. 6 (1989) (finding that an arbitration clause requiring arbitration of "any other aspect of our attorney-client relationship" applied only to fee disputes and not to malpractice and breach of fiduciary duty claims).

procedure and not the substance of the client's claim against the lawyer. Some require the client be separately represented.[3]

## Best Answer

The best answer to **(a)** is **YES**; the best answer to **(b)** is **YES**.

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[2] Connecticut LEO 97-5 (3/4/97) ("We therefore conclude that an engagement letter providing for mandatory arbitration of fee disputes is ethically permissible. In light of the significance of this provision, it may be better that the lawyer inform the client in writing and the client consents in writing to the mandatory arbitration."); Virginia LEO 1586 (4/11/94) (a retainer letter requiring arbitration of fee disputes does not amount to a per se violation of the Code as long as: there is "full and adequate disclosure as to all possible consequences" of the agreement; the client consents; and the arrangement is not "unconscionable, unfair, or inequitable when made."); DC LEO 218 (6/18/91) ("We therefore conclude that a fee agreement providing for mandatory arbitration of fee disputes before the ACAB is ethically permissible provided the agreement informs the client in writing that counselling and a copy of the ACAB's rules are available through the ACAB staff and further that the lawyer encourage the client to contact the ACAB for counselling and information prior to deciding whether to sign the agreement. Moreover, the client must consent in writing to the mandatory arbitration.").

[3] DC LEO 211 (5/15/90) ("A lawyer may not insist that a client enter into a fee agreement containing a clause mandating arbitration of fee and malpractice disputes unless the client is represented by other counsel. . . . In summary, this Committee has come to the conclusion that it is unrealistic to expect lawyers to provide enough information about arbitration to a prospective client, particularly on a first visit, so that the client can make an informed consent to a mandatory arbitration provision. It is equally unrealistic to conclude that limited disclosure coupled with the advice to seek independent legal counsel will cure the problem. How many clients either will see or can afford to see a second lawyer as a condition of entering into an agreement with the first? Therefore, we now conclude that Opinion 190 was incorrect in supposing that adequate disclosures concerning mandatory arbitration could be made to lay clients. Accordingly, mandatory arbitration agreements covering all disputes between lawyer and client are not permitted under either our prior Opinions or Rule 1.8(a) unless the client is in fact counselled by another attorney."); see also DC LEO 218 (6/18/91) ("A retainer agreement providing for mandatory arbitration of fee disputes before the DC Bar Attorney-Client Fee Arbitration Board is not unethical provided the client is advised in writing of the availability of counselling by the staff of the ACAB and provided the client consents in writing to the mandatory arbitration.").

# Non-Privileged Nature of Fee Agreements and Amounts

## Hypothetical 48

You represent a company which has received a third-party subpoena in a commercial litigation matter between two other large corporations. Among other things, the subpoena calls for you to produce documents sufficient to show the amount of attorneys' fees that your client paid your law firm over the past two years. The court has already ruled that such evidence is relevant, and entered a strict protective order preventing dissemination of the information beyond the litigants. However, you still want to resist providing the information by citing the attorney-client privilege.

Does the attorney-client privilege protect the amount of fees that your client paid you over the last two years?

**NO**

## Analysis

Basic information such as the retainer arrangement and the total amount of a lawyer's fees usually do not deserve protection by the attorney-client privilege.[1]

Even large firms can mistakenly claim the attorney-client privilege protection in the face of this general rule. In LNC Investments, Inc. v. First Fidelity Bank, No. 92 Civ. 7584 (CSH), 2000 U.S. Dist. LEXIS 11926, at *7-8 (S.D.N.Y. Aug. 18, 2000), for instance, the New York City law firm of Weil Gotshal objected to producing information about the fees paid by one of its clients. The court rejected the law firm's contention, noting that "[a] bare bones schedule of fee amounts also does away with any basis for

[1] United States v. Ellis, 90 F.3d 447, 450-51 (11th Cir. 1996) (holding that the identity of a client and the lawyer's receipt of fees "normally are not privileged matters" unless their disclosure "would lead to uncovering privileged information"); United States v. Blackman, 72 F.3d 1418, 1424 (9th Cir. 1995) ("As a general rule, client identity and the nature of the fee arrangement between attorney and client are not protected from disclosure by the attorney-client privilege."); In re Grand Jury Subpoena, 55 F.3d 368, 369 (8th Cir. 1995) (finding that the attorney-client privilege did not apply to "client identity and fee information"); United States v. Under Seal (In re Grand Jury Proceedings), 33 F.3d 342, 354 (4th Cir. 1994) ("The attorney-client privilege normally does not extend to the payment of attorney's fees and expenses").

assertion of the attorney-client privilege. Weil Gotshal's objection reveals the common misapprehension that any communication passing between a client and his attorney, in either direction, is covered by the privilege." Id. As the court explained it, "[a] schedule of fees, stated in stark dollar amounts, does nothing to reveal what the clients in question said in confidence to Weil Gotshal attorneys. Accordingly the attorney-client privilege does not apply." Id. at *8.

On the other hand, the attorney-client privilege can protect specific billing information whose disclosure would reveal some privileged communication or details about the lawyer's work for the client.[2]

Because bills are normally prepared in the ordinary course of business, they generally do not deserve work product protection even if they are created during or in anticipation of litigation.[3]

## Best Answer

The best answer to this hypothetical is **NO**.

---

[2] Fidelity & Deposit Co. v. McCulloch, 168 F.R.D. 516, 523 (E.D. Pa. 1996) ("billing records clearly are subject to the attorney-client privilege 'to the extent that they reveal litigation strategy and/or the nature of services performed'" (quoting United States v. Keystone Sanitation Co., 885 F. Supp. 672, 675 (M.D. Pa. 1994)); Garvey v. National Grange Mut. Ins. Co., 167 F.R.D. 391, 396 (E.D. Pa. 1996) ("billing statements and time records are generally protected by the attorney-client privilege, but only to the extent that they reveal litigation strategy and/or the nature of the services provided"; finding that the time records did not meet that standard); Leach v. Quality Health Servs., 162 F.R.D. 499, 501-02 (E.D. Pa. 1995) (holding that a lawyer's billing statements and time records were protected by the attorney-client privilege only if they revealed "litigation strategy and/or the nature of services performed" (citing Keystone, 885 F. Supp. at 675); explaining that billing records were not likely to be protected by the work product doctrine because they are "commonly created in the regular course of business, which removes them from this doctrine's coverage"); Gonzalez Crespo v. Wella Corp., 774 F. Supp. 688 (D.P.R. 1991) (holding that a lawyer's bill would be privileged if it revealed the nature of the work performed).

[3] Leach, 162 F.R.D. at 501-02 (holding that a lawyer's billing statements and time records were protected by the attorney-client privilege only if they revealed "litigation strategy and/or the nature of services performed" (citing Keystone, 885 F. Supp. at 675); explaining that billing records were not likely to be protected by the work product doctrine because they are "commonly created in the regular course of business, which removes them from this doctrine's coverage").

# Request for Attorneys' Fees as Waiving the Attorney-Client Privilege and Work Product Protections

## Hypothetical 49

You represent a company that licenses software to dental offices. You are near the end of hard-fought litigation with one dental office that refused to pay for the software, and alleged that your client fraudulently misrepresented the software's capabilities. The software agreement entitles the winning party in any litigation to recover reasonable attorneys' fees, and you had sought the award of such fees in your initial responsive pleading. Now that it looks as if you might win the lawsuit, you have begun to review your litigation team's billing records and their work product to determine the amount you might be able to recover under that provision. Among other things, you are troubled by some entries in a young associate's time records which imply that your client might have violated some regulations. You begin to wonder about the effect of seeking attorneys' fees under the software agreement.

**(a)** If you decide to seek attorneys' fees under the software agreement, would it amount to a waiver of whatever attorney-client privilege covered your litigation team's time records?

**MAYBE**

**(b)** If you decide to seek attorneys' fees under the software agreement, would you be required to turn over any of your work product to the plaintiff?

**MAYBE**

## Analysis

**(a)** Some courts conclude that a lawyer seeking attorneys' fees has put the lawyer's bills "at issue" and therefore must produce them to the adversary.[1] Other courts disagree.[2]

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[1] Energy Capital Corp. v. United States, 45 Fed. Cl. 481, 486-87 (2000) (finding that a party seeking attorneys' fees from the government had placed its attorneys' fees "at issue" under the Hearn doctrine, and ordering "whatever time records were available to the Plaintiff or under the Plaintiff's control" to be produced, relying on Ideal Elec. Sec. Co v. International Fidelity Ins. Co., 129 F.3d 143, 151-52 (D.C. Cir. 1997) and Potomac Elec. Power Co. v. California Union Ins. Co., 136 F.R.D. 1, 4-5 (D.D.C. 1990)); Ideal, 129 F.3d at 152 ("[C]laiming indemnification of attorney's fees from [defendant] and offering the billing statements as evidence of the same, [plaintiff] waived its attorney-client privilege with respect to

A recent decision carried this general doctrine a step further by finding that a party's mere request for attorney's fees in a complaint prevented the party from withholding the fee agreement or its lawyer's bills.[3]

**(b)** At least one court has indicated that a litigant's request for attorneys' fees even waives the privilege that would otherwise protect underlying documents. Newpark Envtl. Servs., L.L.C. v. Admiral Ins. Co., Civ. A. No. 99-331 Section "E" (2), 2000 U.S. Dist. LEXIS 1240, at *9-10 (E.D. La. Feb. 2, 2000) ("Because Newpark may only recover reasonable attorney's fees and will necessarily have to prove that its attorney's fees were reasonable and directly related to that defense, it will have to disclose the

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the redacted portions of the billing statements and any other communications going to the reasonableness of the amount of the fee award. If [plaintiff] opts to claim indemnity for attorney's fees from [defendant], it must disclose the billing statements itemizing those fees in its entirety, notwithstanding its claim that portions of the billing statements are privileged.") (citation omitted).

[2] DeHart v. Enos (In re Metropolitan Metals, Inc.), 206 B.R. 85, 87-88 (Bankr. M.D. Pa. 1997) (finding that special counsel for a Chapter 7 trustee had not waived the attorney-client privilege "in advancing his fee application" and making a "cursory reference" to a legal memorandum he prepared); In re JMP Newcor Int'l, 204 B.R. 963, 965-66 (Bankr. N.D. Ill. 1997) (finding that a law firm had not waived the privilege by seeking attorney fees; "Requests for fees are commonplace in bankruptcy cases. So are objections to those requests. Applying the Debtor's argument that work-product loses its privilege when there is a dispute about fees would mean that every time a committee objected to a debtor's professional's fee request, or a debtor objected to a lender's request for professional fees under § 506(c), that professional's opinion work-product would be discoverable. The practical effect of such a rule would be to defeat the fundamental policies that underlie the work-product privilege. In future cases, attorneys would know that their opinion work-product might be subject to disclosure. That knowledge would inhibit professionals in those future cases." (footnote omitted); finding that an unsecured creditor's committee lawyer had not placed its opinion work product "at issue" by seeking to establish the reasonableness of its fees), aff'd, Nos. 97 C 6775 and 95 B 27353, 1998 U.S. Dist. LEXIS 987 (N.D. Ill Jan. 22, 1998); Northwood Nursing & Convalescent Home, Inc. v. Continental Ins. Co., 161 F.R.D. 293, 298 (E.D. Pa. 1995) (finding no implied waiver of the attorney-client privilege despite a claim for attorney fees and an insured's allegation of an insurer's bad faith in handling a claim); Prudential Ins. Co. v. Coca-Cola Enters., Inc., No. 93 Civ. 1456 (KMW), 1993 U.S. Dist. LEXIS 9993, at *1 (S.D.N.Y. July 21, 1993) ("It is true that where a party places squarely at issue in litigation the substance of attorney-client communications, the privilege is waived. However, a demand for attorneys' fees, whether based on a fee-shifting statute or on a contractual obligation, does not by itself constitute a waiver" (citation omitted)); Mortgage Guar. & Title Co. v. Cunha, 745 A.2d 156, 158 (R.I. 2000) ("[T]he inclusion of attorneys' fees in the claim for damages does not in itself imply a waiver of the attorney-client privilege").

[3] Tonti Properties v. Sherwin-Williams Co., No. 99-892 SECTION "E" (2), 2000 U.S. Dist. LEXIS 5748, at *4 (E.D. La. Apr. 26, 2000) (although the opinion is not crystal-clear, it appears that the court reached this decision based on the claim for fees, rather than a judicial finding that the party was entitled to a fee award). The court also relied on the "at issue" doctrine to find that the party claiming entitlement to fees had waived the privilege.

substance of the work its counsel performed. Therefore, plaintiff has placed the communications contained within its attorney invoices at issue and thereby waived both its attorney-client privilege and work product protection."; finding that an insured had waived any attorney-client privilege or opinion work product claim that otherwise covered its files by seeking from its insurer its costs of defending and settling another lawsuit).

## Best Answer

The best answer to **(a)** is **MAYBE**; the best answer to **(b)** is **MAYBE**.

# Malpractice Damage Calculations

## Hypothetical 50

**[STEAL FROM CONFLICTS BETWEEN LAWYERS AND THEIR CLIENTS, PART II (3585340) -- WHEN COMPLETED]**

# Retaining Liens

## Hypothetical 51

**[STEAL FROM CONFLICTS BETWEEN LAWYERS AND THEIR CLIENTS, PART II (3585340) -- (File Ownership Hypo) WHEN COMPLETED]**

# Liability to Co-Counsel

## Hypothetical 52

**[1-11-11 -- MOVED FROM CONFLICTS II]**

Your firm frequently acts as co-counsel in plaintiffs' product liability cases. One of your new associates recently committed a fairly grievous act of malpractice in handling one such case -- resulting in dismissal of a potentially lucrative case against a product liability defendant. Now you worry about co-counsel suing your firm for the contingent fee that your firm's malpractice arguably cost the other firm.

May your co-counsel sue your firm to recover the contingent fee that your firm's malpractice cost it?

## MAYBE

## Analysis

The Restatement explains that law firms and their lawyers normally are not responsible for the acts of co-counsel.

> **[misc - 96 (18923872)]** A firm is not ordinarily liable under this Section for the acts or omissions of a lawyer outside the firm who is working with firm lawyers as co-counsel or in a similar arrangement. Such a lawyer is usually an independent agent of the client over whom the firm has no control, not a servant or independent contractor. This is especially likely to be the case when the second lawyer represents the client in another jurisdiction, in which that lawyer, but not the firm's lawyers, is a member of the bar. The firm may, however, be liable in some circumstances. Thus a firm may be liable to the client for the acts and omissions of the outside lawyer if the firm assumes responsibility to a client for a matter, for example pursuant to obligations in fee-sharing arrangements . . . or by assigning work to a temporary lawyer who has no direct relationship with the client. Such arrangements make the outside lawyer the firm's subagent . . . . In such circumstances, the outside lawyer may be liable to the firm for contribution or indemnity. A firm is liable to its client for acts and omissions of its own principals and employees relating to the outside lawyer, for example when it undertakes to recommend or supervise the

> outside lawyer and does so negligently or when its lawyers advise or participate in the outside lawyer's actionable conduct . . . . A firm may also be liable to a nonclient for the acts and omissions of an outside lawyer, for example when principals or employees of the firm direct or help perform those acts or omissions . . . .

Restatement (Third) of Law Governing Lawyers § 58 cmt. e (2000).

Although not many courts have addressed this scenario, at least one court adopted what it called a "bright-line rule" prohibiting such claims.

- **[E-139** Ok n 11/08**]** Mazon v. Krafchick, 144 P.3d 1168, 1172 (Wash. 2006) (holding that one co-counsel may not sue another co-counsel for the loss of an expected contingent fee based on the latter's errors; "We agree with the Court of Appeals' reasoning and adopt a bright-line rule that no duties exist between cocounsel [sic] that would allow recovery for lost or reduced prospective fees. As cocounsel [sic], both attorneys owe an undivided duty of loyalty to the client. The decisions about how to pursue a case must be based on the client's best interests, not the attorneys.' The undivided duty of loyalty means that each attorney owes a duty to pursue the case in the client's best interests, even if that means not completing the case and forgoing a potential contingency fee.").

## Best Answer

The best answer to this hypothetical is **MAYBE**.