THE BAR ASSOCIATION OF SAN FRANCISCO

Legal Ethics
Ethics Opinions

## OPINION 1980-1

"Flat" or "fixed" fee advances should be deposited in a firm's general account and should not be deposited in a trustee savings or checking account.

## QUESTION:

For many years, this Committee has observed that questions of professional ethics, as opposed to questions of professional discipline, usually require resolution of alternative proper courses of conduct for members of the legal profession. Instead of the alternatives presenting questions of "right" versus "wrong," questions of ethics usually involve choices between alternative courses of conduct, both of which may be "right," depending on one's sense of priorities for the alternative reasons for courses of conduct.

The inquiry to which this opinion responds presents such a question. If an attorney is paid a "flat" or a "fixed" fee for work to be done, should that money be deposited in a trust- account, to be withdrawn as the work is completed, or should it be deposited in the attorney's general account? The answer to this question turns on the resolution of the subsidiary question of whether funds so paid are held for the benefit of the client or are held for the benefit of the attorney. Seldom has a question more thoroughly divided The Bar Association of San Francisco Legal Ethics Committee.

## OPINION:

After months of deliberation, the Committee was unable to reconcile the alternative opinions which were expressed and has, for the first time, published a "majori ty" and a "minority" opinion response to an inquiry. The majority, in substance, have concluded that the money is held by the attorney for his or her own benefit but that the attorney is obliged to complete the services for which payment has been made. The minority have concluded that the money is delivered to the attorney as security for the eventual payment of fees on completion of the work, and the attorney must account to the client for those funds under rule 8-101.


- Majority Opinion
- Minority Opinion


### MAJORITY OPINION

#### QUESTION

May a "flat" or "fixed" fee, paid to the attorney for work to be done, properly be deposited in a firm's general account or should it be deposited in a trust account to be withdrawn as the work is completed? We are not dealing with funds paid by a client to the attorney as security for fees or for advanced fees or costs.

#### OPINION

In the opinion of the Committee such "flat" or "fixed" fees should not be deposited in a trustee savings or checking account, but put in the firm's general account.

#### DISCUSSION

Rule 8-101 provides in relevant part as follows:

> "(A) All funds received or held for the benefit of clients by a member of the State Bar or firm of which he is a member, including advances for costs and expenses, shall be deposited in one or more identifiable bank accounts labelled 'Trust Account', 'Client's Funds Account' or words of similar import, . . . and no funds belonging to the member of the State Bar or firm of which he is a member shall be deposited therein or otherwise commingled therewith except as follows: (emphasis

> supplied) (2) Funds belonging- in part to a client and in part presently or potentially to the member of the State -Bar or firm of which he is a member must be a member must be withdrawn at the earliest reasonable time after the member's interest in that portion becomes fixed. However, when the right of the member of the State Bar or firm of which he is a member to receive a portion of trust funds is disputed by the client, the disputed portion shall not be withdrawn until the dispute is finally resolved (emphasis supplied) . . . .

Rule 8-101(A) expressly requires that all funds received or held "for the benefit of the clients," including sums advanced to pay costs or expenses, be placed in a separate trust account. Rule 8-101 does not expressly deal with payments whether based on a flat or fixed fee paid to the attorney in exchange for certain described services or results (e.g., incorporation, will or dissolution).

Whether rule 8-101 requires fixed or flat legal fees to be placed in a separate trust account was raised but not decided in *Baranowski v. State Bar* (1979) 24 Cal.3d 153, 163-164. In that case the Court considered several charges of trust fund violations which had been consolidated for hearing before the Disciplinary Board. In tvvo of the matters the attorney had received advance fee payments from the client which the attorney had not placed in an identified and labelled trust account. The Disciplinary Board made a specific finding that the advance fee payments from each of these clients included advances for costs and expenses. The Supreme Court held this finding was unsupported by the evidence, stating:

> " . . . if the invocation of Rule 8-101 depends on the distinction between money for costs and money for fees, it is reasonable to conclude that the State Bar has failed to sustain its burden of proof in the matter.
>
> "The novel aspect of the issue is the seemingly implicit contention of the respondent State Bar that the issue of costs and expenses is irrelevant. Its argument would appear to be that any advance fee payment must be deposited in an .identifiable trust account until
> such time as it is earned. We need not, however, resolve the question of whether or not an advance fee payment is directly characterized as money 'received or held for the benefit of clients' witthin the meaning of rule 8-101 . . . ."

It would appear from discussion of Rule 8-101 in *Baranowski v. State Bar*, supra, that whether fee payments from clients for services to be performed in the future should be deposited in a trust account has not been decided in this State. The position taken by the State Bar, as reported in the Baranowski case, was that fees advanced, with or without costs, are not earned until services are actually performed. Therefore flat or fixed advance fee payments are funds held by an attorney in trust "for the benefit of clients" within the meaning of rule 8-101 until the services are performed and, thus, the fees "earned."
*Baranowski v. State Bar, supra*, 24 Cal.3d at 164, fn.4. whether fee payments from clients for services to be performed in the future should be deposited in a trust account has not been decided in this State. The position taken by the State Bar, as reported in the Baranowski case, was that fees advanced, with or without costs, are not earned until services are actually performed. Therefore flat or fixed advance fee payments are funds held by an attorney in trust "for the benefit of clients" within the meaning of rule 8-101 until the services are performed and, thus, the fees "earned." *Baranowski v. State Bar*, supra, 24 Cal.3d at 164, fn.4.

The Supreme Court in *Baranowski v. State Bar* (1979) 24 Cal.App. 3d 153, 164, refused to sustain the position taken by the State Bar of California, characterizing it as "novel." The Supreme Court stated that it was not going to resolve the question of whether an advanced fee payment is correctly characterized as money "received or held for the benefit of clients" within the meaning of rule 8-101. At this point (fn. 4) the Supreme Court stated that a classic "retainer fee" arrangement, i.e. a sum of money paid by a client to secure an attorney's availability over a given period of time, results in a fee being earned by an attorney when paid, since the attorney is entitled to the money regardless whether he actually performs any services for the client. The Supreme Court recognized that certain fees paid in advance of services which may be required in the future need not be deposited in a trust account. If an attorney enters into a classic retainer fee arrangement he is obligated to be available to the client for the prescribed period of time. If, for example, the attorney should retire or otherwise refuse to be available to the client, voluntarily or involuntarily, or if the attorney is unable to be available to the client, because of sickness or other reason, during the period of time encompassed by the classic retainer fee agreement, he would be required to refund to the client the unearned portion of the fees. Although the Supreme Court in the Baranowski case (fn. 4) indicated otherwise, it was dicta, and California rule 2-107 would appear to require a refund. This is essentially no different than a situation in which an attorney has agreed to render certain services to a client in exchange for a fixed fee which either includes or doesn't include costs. The client cannot require the attorney to account either for the fees or for the costs the attorney incurred. The client is

entitled to the services or work product of the lawyer and the payment by the lawyer of all costs incident to those services.

In all cases in which funds are received by an attorney, whether for costs advanced or fees advanced, in which the attorney is required to account subject to accounting to the client. Any interest earned on those funds would also belong to the client. A.B.A. Informal Opinion 545; Wise, Legal Ethics, p. 239 (1970).

Rule 8-101 states that funds received or held for the benefit of the client by an attorney must be deposited in an attorney's trust account. However, when the attorney has agreed to render services to a client for a fixed sum and to pay for all costs which may otherwise be chargeable (sic) to the client at another fixed or predetermined amount, all funds received belong to the attorney. A client has no right to require the attorney to account for either category of funds but merely to insist upon the rendering of services as contracted and the payment of all costs attributable thereto.

A.B.A. Code of Professional Responsibility DR 9-102(A) and its predecessor, Cannon 11, with the exception of costs advanced by the client, are similar to the California rule. One commentator states that DR 9-102(A)(2) is ambiguous about the question of whether money paid for services yet to be performed continues to belong to a client until the attorney actually performs the services. (See "Attorney Misappropriation of Client's Funds; a Study in Professional Responsibility," 10 Univ. of Mich. Journal of Law Reform (1977) 415, 436. Interestingly, the author, Gregory Dunbar Soule, in a footnote (fn. 135) of his article states that the Professional Ethics Committee of the Florida Bar Association, in interpreting DR 9-l02(A), presumes such payments are intended to be the property of the attorney upon receipt absent an understanding that the prepayment was to be a "fee security" deposit, Florida Bar Comm. on Professional Ethics, Advisory Opinion No. 76-77. For a contrary result (funds should be retained in trust account until earned) see Client Security and Attorney Disciplinary Commission News bulletin of the Iowa State Bar Association (Aug-Sept 1975) and Ethics Opinion 391, Feb. 1978, of the Texas State Bar Ethics Committee (Texas Bar Journal, April 1978, commencing at p. 322).

When the client pays the attorney a fixed fee for services to be performed, the fee belongs to the attorney, and the attorney is obligated to render services to the client. The rule is no different if the fee fixed includes costs (the risk of actual costs resting with the attorney). The basic underlying question is whether or not the money received by the attorney belongs to the client. It is our conclusion that the money belongs to the attorney, and the product of the attorney's services belongs to the client. Failure of the attorney to produce the product (i.e., render the services contracted for) and pay, if that be the case, costs attendant thereto would obligate the lawyer to refund to the client that portion of the fees unearned.

In the event services rendered and costs incurred were incomplete and in a condition having no value to the client, then all of the fees and costs would be refundable to the client.

Once the services have been completed, no accounting of the funds would be required. However, in those instances in which the attorney is required to deposit the clients' funds in his trust account, the attorney is required to account to the client, even after the services are rendered and the costs paid. In the latter case an accounting is mandatory, in the former none is required, nor does the client have a right to insist on an accounting.

Conversely, rule 8-101(A) mandates that funds belonging to the attorney shall not be deposited in the trustee account or otherwise commingled with client funds except as provided ill the rule. Commingling occurs, "when a client's money is intermingled with that of his attorney and its separate identity lost so that it may be used for the attorney's personal expenses or subjected to claims of his creditors." Black v. State Bar (1962) 57 Cal.2d 219, 255-226.

The purpose served by this provision of rule 8-101(A) is:

> ". . . to provide against the probability in some cases, the possibility in many cases, and the danger in all cases that such commingling will result in the loss of the client's money." *Hamilton v. State Bar* (1962) 57 Cal.2d 219, 225-226.

If a client makes an advance fee payment for legal services with the understanding that any unused portion will be returned to the client, it was the opinion of this Committee in 1973 (Opinion 1973-14) that the funds belong to the client and not to the attorney until the money has been earned. Accordingly, depositing such funds in the attorney's general account would involve commingling in violation of then rule 9 [rule 8-101] and Code of Professional Responsibility, Canon 9. In that same opinion, it was observed that where the attorney deposited such advance fees in a trust account and withdrew less than his earned fees thereby allowing portions of his earned fees, to remain mixed with the funds of the client, such funds are commingled in violation of the rule.

A more difficult situation arises where the client pays a fixed fee at the inception of the matter but with the additional understanding that it is "nonrefundable." Without deciding the propriety of such an arrrangement, the Committee observes that all contracts for legal services are subject to strict scrutiny as to their fairness to the client. A lawyer may be assumed to have superior knowledge concerning the nature and value of the services required, especially if the client is inexperienced in obtaining legal services. The agreement should always be clearly understood by the client for the protection of both the client and the attorney. The terms of the agreement should be reduced to writing before the lawyer renders services other than in the most exceptional cases. In fashioning any contract for legal services, the lawyer should be guided by the ethical considerations that the amount of the fee be reasonable in that the fee not exceed the value of the services rendered. DR 2-106. Relevant factors in determining the reasonableness of attorney's fees are set out in rule 2-l07(B) and DR 2-106(B).

In conclusion, the Committee recognizes that, in spite of an agreement that fees be flat, fixed, or even "nonrefundable," the attorney may not be able to complete the work for which the fees were paid for a variety of reasons. The attorney may be liable in such instances to return all or part of the fees received under contract principles or on the basis of quantum meruti.

Ordinarily, such issues are resolved in a civil action and not in a disciplinary proceeding. *Sullivan v. State Bar* (1955) 45 Cal.2d 112, 118; *Herrscher v. State Bar* (1935) 4 Cal.2d 399, 401-402. In any event, the attorney cannot enter into a fee agreement for, or charge, or collect an illegal or unconscionable fee regardless of the client's acquiescence. Rule 2-107.

**MINORITY OPINION**

The issue is whether a "flat" or "fixed" fee, received before work is done, may properly be deposited in a firm's general account. The conclusion of the majority that "flat" or "fixed" fees should be deposi ted in the firm's general account and not in a trust account places too narrow a construction on rule 8-101. Although as the majority opinion correctly points out, rule 8-101 does not expressly deal with advance payments whether based on a flat or fixed fee basis, the rule does expressly provide that advance fee payments from clients which include advances for costs and expenses must be treated as funds held for the benefit of the client in a separately identified trust account. The California Supreme Court confirmed this in *Baranowski v. State Bar* (1979) 24 Cal.3d 153, 163 stating:

> Rule 8-101 expressly requires that sums advanced to pay costs or expenses be placed in a separate trust account, ...

Baranowski posed two issues for the Supreme Court to decide; first, whether any portion ofthe flat fees advanced by the clients were for costs or expenses, and, if not, whether rule 8-101 nevertheless requires that unearned fees be placed in a separate trust account. Had the Supreme Court upheld the Disciplinary Board's finding that the payments included advances for costs and expenses, it would clearly have applied rule 8-101 to those advances. Having declared, however, that the finding of the Board was unsupported by the evidence, the Supreme Court choose not to decide the second issue.

It would therefore appear from the discussion of rule 8-101 in Baranowski that advance flat fee payments from clients which include advances for costs and expenses must be treated in accordance with rule 8-101.

> Money a client advances to cover 'costs and expenses' the attorney will later incur on the client's behalf, such as filing fees, is money held for the client's benefit and must be deposited in the attorneys' trust account.

Shank, "Are Advanced Fees Payment Clients' Funds?" 55 California State Bar Journal, p. 370 (September 1980).

Contrary to the opinion of the majority, advance flat or fixed fee payments should be distinguished from the common "retainer fee" arrangement. The Supreme Court in Baranowski made this distinction, defining a true retainer as a sum of money paid by a client to secure an attorney's availability over a given period of time. "Thus, such a fee is earned by the attorney when paid since the attorney is entitled to the money regardless of whether he actually performs paid since the attorney is entitled to the money regardless of whether he actually performs any services for the client. Baranowski v. State Bar, supra, 24 Cal.3d fn.4.

Further support for this distinction is found in rule 2-111(A)(3) which provides:

> "(3) A member of the State Bar who withdraws from employment shall refund promptly any part of a fee paid in advance that has not been earned. However, this rule shall not be applicable to a true

> retainer fee which is paid solely for the purpose of insuring the availability of the attorney for the matter."

Underlying the issue presented in the majority opinion is the question: At what point does the flat or fixed fee payment constitute the funds of the attorney rather than the funds of the client under rule 8-l0l?

Rule 8-l0l(A)(2) requires that funds belonging in part to a client and in part "presently or potentially" to the attorney must be deposited in a trust account and the portion belonging to the attorney "must be withdrawn at the earliest reasonable time after the member's interest in that portion becomes fixed." Although no California case has opined on the meaning of the term "fixed" in this context, an attorney's right to a fee is often discussed in terms of when the fee is "earned." Ordinarily the fee is not earned until the services for which the fee is paid have actually been' performed. Thus, rule 2-l0l(A)(3) provides that an attorney withdrawing from employment shall promptly refund any part of a fee paid in advance "that has not been earned." See also *Baranowski v. State Bar*, supra, 24 Cal.3d at 164, fn.4; *Zitney v. State Bar* (1966) 64 Cal.2d 787,791 [where an advance fee, part of which was nonrefundable, paid to an attorney to obtain a zoning variance was held not to be fully earned until the variance was obtained]; Disciplinary Rule ("DR") 2-110, A.B.A. Code of Professional Responsibility; Shank, "Are Advanced Fee Payments Clients' Funds?" 55 *California State Bar Journal*, p. 370 (September 1980); Ethics Opinion 391, February 1978, Texas State Bar Ethics Committee (*Texas Bar Journal*, April 1978, pp. 322-325).

Any portion of an advanced flat or fixed fee which represents payment for services not yet rendered and which is refundable for whatever reason belongs in part to the client at the time the funds come into the possession of the attorney and, therefore, must be deposited into a separate trust account in accordance with rule 8-101 (A).

There may be instances where both the client and the attorney agree that a flat or fixed fee is "earned" by the attorney at the time it is paid and before work is completed. However, the majority opinion encompasses any and all types of advanced flat or fixed fees and is not limited to that situation.

In its Opinion 1973-14, this Committee took the position that former rule 9 required the attorney to deposit in a separate trust account all unearned and refundable advance fee payments. It was the opinion of this Committee in 1973 that depositing advance fee payments in the attorneys' general account would involve commingling in violation of then rule 9 and cannon 9 of the A.B.A. Code of Professional Responsibility.

This Committee recognized in Opinion 1973-14 that requiring attorneys to account for advanced fee payments for services to be rendered in the future might impose an accounting burden for attorneys and suggested the possibility of an agreement with the client "that the initial retainer where the amount is relatively small and commensurate with services to be performed reasonably current with the receipt of the retainer will not be refundable, but will be applied toward work in progress." The retainer in that 'instance will then become the property of the attorney upon his receipt of it. The Committee cautioned however, that an advance of a large sum of money for services to be rendered ordinarily will be the clear subject of a trust fund deposit.

Consistent with this Committee's earlier opinion in 1973, the Texas State Bar Ethics Committee came to the same conclusion on the issue of whether a flat fee payable in advance for services to be performed may be deposited in the firm's general operating account. In its opinion the Texas State Bar Ethics Committee stated:

> If it should be determined subsequently by a Court that this advanced [flat] fee is refundable unless or until fully earned by the attorney, the attorney will have violated DR 9-102 if he fails to place those funds in a trust account.
>
> The better practice, then, would obviously be to place all funds whose nature or ownership is questioned or disputed into the 9-102 trust account. This practice has been recognized in a long line of New York County Lawyers' Association Ethics Opinions dealing with the handling of disputed funds [citation].
>
> The only real burden imposed upon the attorney in such a case involves some additional bookkeeping... Additional bookkeeping is a necessary burden of the profession. In light of the harm to the profession and the public caused by the loss of clients' funds and by the mere appearance of impropriety, it is a relatively small burden for the profession to bear.
>
> ***
>
> In response to this specific fact situation, the attorney is not entitled to full use of the fee until the fee has been earned.

Texas State Bar Ethics Committee, Opinion 391 (February 1978) Texas Bar Journal p. 322, 324-325 (April, 1978).

The majority's treatment of advanced fixed or flat fees would provide a means to circumvent the purpose and function of rule 8-101.

The California Supreme Court has often stated that the purpose served by rule 8-101(A) is:

> ". . . to provide against the probability in some cases, the possibility in many cases, and the danger in all cases that such commingling [of an attorney's funds with his clients'] will result in the loss of the clients' money." Peck v. State Bar (1932) 217 Cal. 47, 51; Black v. State Bar, supra, 225-226; Hamilton v. State Bar (1979) 23 Cal.3d 868, 876.

An advance fixed or flat fee payment, like any other money actually or potentially payable or refundable to a client, is subject to the risk of losing its identity or being lost if it is commingled with an attorney's own money.

> The appearance of impropriety is just as great if the attorney commingles his own money with advanced fee payments he has not yet earned as if he commingles his own money with any other funds payable to his client. Thus, the purpose of Rule 8-101 is promoted if advance fee payments are treated as client's funds which must be placed in a trust account until earned.

Shank, "Are Advanced Fee Payments Clients' Funds?" 55 California State Bar Journal, 370, 371 (September 1980).

Therefore, advance fixed or flat fee payments, whether including advances for costs and expenses, received before work is performed should be deposited in a separate trust account, provide that where there is a specific agreement with the client that the fee has been earned on payment to the attorney, the fee portion, but not any sums paid for anticipated costs, may be deposited in the firm's general account.

Dated: November 20, 1980.