NEW YORK STATE BAR ASSOCIATION

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Committee on Professional Ethics

Opinion 599 - 3/16/89 (7-88)

Topic: Nonrefundable minimum fee retainer agreements.

Digest: Improper for fee agreement to include a provision for a nonrefundable minimum, subject to narrow exceptions.

Code: EC 2-17, 2-18, 2-19; DR 1-102(A)(4); 2-106(A); 2-106(B)(1), (2) and (7); 2-110(A)(3); 2-110(B)(3) and (4).

QUESTION

May a lawyer's agreement with a client provide for payment of a fee based upon hourly charges or a nonrefundable fixed minimum fee paid in advance, whichever is greater?

OPINION

A lawyer proposes to enter into the following fee agreement with a client. The client will pay fees based on a fixed hourly charge multiplied by the hours spent on the matter. The client will pay a "retainer" in advance that will be credited against the hourly fees charged. If the total hourly fees are less than the retainer when the representation concludes, however, the lawyer will keep the entire retainer as a minimum fee for undertaking the representation. The lawyer asks if the proposed agreement is ethically proper.

The validity and fairness of fee agreements that include a provision for a "nonrefundable" retainer or minimum fee have been a source of continuing controversy, especially in matrimonial matters. Neither the Code of Professional Responsibility, nor the 1983 ABA Model Rules of Professional Conduct

that have replaced the Code in a number of states other than New York, deals directly with such agreements.

The Code contains basic requirements that are ethically applicable to all fee arrangements between lawyer and client. EC 2-17 states: "The determination of a proper fee requires consideration of the interests of both client and lawyer. A lawyer should not charge more than a reasonable fee . . . ." DR 2-106(A) provides: "A lawyer shall not enter into an agreement for, charge or collect an illegal or clearly excessive fee." EC 2-18 states: "The determination of the reasonableness of a fee requires consideration of all relevant circumstances, including those stated in the Disciplinary Rules. The fees of a lawyer will vary according to many factors, including . . . the nature of the employment [and] the responsibility involved . . . ."

DR 2-106(B) identifies the principal factors that are considered in determining the reasonableness of a fee. Those that may be relevant in the context of a nonrefundable or minimum fee are "(1) . . . the novelty and difficulty of the questions involved and the skill requisite to perform the legal service properly[;] (2) [t]he likelihood, if apparent to the client, that the acceptance of the particular employment will preclude other employment by the lawyer [;] [and] (7) [t]he experience, reputation and ability of the lawyer or lawyers performing the services."

With respect to withdrawal from employment, DR 2-110(A)(3) provides: "A lawyer who withdraws from employment shall refund promptly any part of a fee paid in advance that has not been earned." DR 2-110(B)(3) and (4) mandate the lawyer's withdrawal if "[t]he lawyer's mental and physical condition renders it unreasonably difficult to carry out the employment effectively" or if "[t]he lawyer is discharged by his or her client."

Paralleling the Code provisions are legal standards applicable to a lawyer's fees. "[A]s a matter of public policy, courts pay particular attention to fee arrangements between attorneys and their clients . . . . An attorney has the burden of showing that a fee contract is fair, reasonable, and fully known and understood by the client . . . ." *Jacobson v. Sassower*, 66 N.Y.2d 991, 993 (1985). "A client may always discharge his attorney, with or without cause, and in the absence of a contract providing otherwise an attorney discharged without cause is entitled to be compensated in quantum meruit." *Id.* citing Martin v. Camp, 219 N.Y. 170 (1916); *see also, e.g., Rubenstein v. Rubenstein*, 137 A.D.2d 514 (2d Dep't. 1988) (fairness and reasonableness of fee); *J.M. Heinike Associates v. Liberty National Bank*, 142 A.D.2d 929, 930 (4th Dep't 1988) (unconscionability of retaining prepaid fee following

withdrawal from employment in absence of good cause). *Cf.*, Brickman & Cunningham, *Nonrefundable Retainers: Impermissible Under Fiduciary, Statutory and Contract Law*, 57 Fordham L. Rev. 149 (1988).

Because the terms "retainer," "minimum fee" and "nonrefundable retainer" are used loosely to describe what are ethically distinct arrangements, it is important at the outset to distinguish those fee arrangements that our opinion does not address. We are not here dealing with the so-called "classic retainer" or "general retainer" more common in earlier times, which is paid to cover future services to be rendered over a specified period of time, or to compensate the lawyer for being available to the client and unavailable to the client's opponents in the future, or both. A "classic" or "general" retainer is generally understood to be earned upon receipt, even if the lawyer thereafter performs less work than contemplated, because the lawyer has earned the entire fee simply by engaging to be available to the client for future work. N.Y. State 570 n. 1 (1985); Wolfram, *Modern Legal Ethics* §9.2.2 (1986). Nor are we dealing with an advance payment of legal fees on a particular matter where both client and lawyer understand at the outset that the fees are not earned until the legal services are performed and are refundable to the extent not earned. Although fees paid in advance of services under those circumstances belong to the lawyer and need not be deposited in a trust account, upon termination of employment the lawyer must promptly return to the client any unearned portion of the fee. N.Y. State 570 (1985). Finally, we are not dealing with a fixed fee for the representation, payable regardless of how few or how many hours the lawyer must work to complete it.

Rather, we address in this opinion the ethical propriety of an agreement covering a specific legal matter that calls for an advance payment of a minimum fee that is not refundable to a client if the representation ends before the attorney expends the requisite number of hours that would, at the time charges specified in the retainer agreement, earn the minimum fee. The arrangement is something of a hybrid between a fixed fee for the representation and a fee based on hourly charges, with the client paying the greater.

It is equally important at the outset to distinguish the issues that are legal from those that are ethical, although the two may at critical junctures overlap. While this Committee does not pass upon questions of law, DR 2-106(A) expressly prohibits a lawyer from contracting for, charging or collecting an "illegal" fee. In *Jacobson v. Sassower*, 66 N.Y. 2d 991 (1985), the Court of Appeals held that a retainer agreement providing for a "nonrefundable"

advance payment of $2,500 to be credited against future hourly charges at the rate of $100 per hour could not be enforced "because it did not state clearly that the 'nonrefundable retainer of $2,500' was intended to be a minimum fee and that the entire sum would be forfeited, notwithstanding *any* event that terminated the attorney-client relationship prior to 25 hours of service" and because the attorney was otherwise unable to establish "that she explained the nature and consequences of the nonrefundable retainer clause to plaintiff before he executed the contract . . . . ." *Id.* at 993 (emphasis in original). Although plaintiff had also argued that nonrefundable retainers were *per se* improper, the court expressly found it "not necessary" to consider this issue, thus leaving open the question of whether "nonrefundable retainer agreements are against public policy and, therefore, void." *Id.* at 994.

The *Sassower* litigation had been brought in the Civil Court, which held the nonrefundable fee provision unenforceable, both because of ambiguity and because of "a strong public policy favoring the maintenance of a client's absolute trust and confidence in his attorney, and the promotion of public confidence in the legal profession." 113 Misc. 2d 279, 282 (1982).[1] Public policy was held to have been violated because nonrefundability would penalize a client for exercising the legal right to discharge a retained lawyer regardless of cause, thus constraining the client to keep a lawyer in whom the client has lost faith for fear of paying twice for legal services. *Id.* The Appellate Division affirmed, but solely on the ground of ambiguity. 107 A.D.2d 603 (1st Dep't. 1985).[2] As to the public policy issue, while noting that nonrefundable retainer agreements were "not to be encouraged,"[3] the court recognized that such agreements "are not, in all cases, unenforceable as a matter of law," stating:

> Whether enforcement of such a retainer should be denied as unconscionable or as having a chilling effect on a client's right to freely discharge his attorney should depend on a "full exploration of all the facts and circumstances [of the particular case], including the intent of the parties, and whether the fee demanded is out of proportion to the value of the attorney's services." (*Gross v. Russo* 47 AD2d 655.)

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1 *At least one other New York court has reached the same result for the same reasons Volkell v. Volkell*, N.Y.L.J. July 12, 1984, at 14, col. 3 (Sup. Ct., Queens Co.) (Miller, J.)

2 Before reaching the Appellate Division, the Civil Court judgment had been affirmed by the Appellate Term, 122 Misc.2d 863, (1st Dep't 1983), one judge dissenting *Id.* at 867. A similar dissent accompanied the Appellate Division opinion. 107 A.D.2d at 603. Both dissents concluded that under the circumstances the *Sassower* nonrefundability provision was valid.

3 It is not clear whether this caveat was grounded upon legal, ethical, or other considerations

Id. (bracketed matter added by Appellate Division.)

This Appellate Division opinion serves both to limit and clarify the scope of our ethical inquiry. Absent a controlling decision that a properly drafted and understood retainer agreement entitling a lawyer upon discharge to retain a minimum fee paid in advance would be *per se* violative of public policy, DR 2-106(A)'s prohibition of illegal fee agreements would only be implicated when enforcement of a fee agreement is found, after " 'full exploration of all the facts and circumstances (of the particular case),' " to be unenforceable (and, therefore, illegal) by reason of unconscionability, or as unduly chilling the right of discharge.

To the extent a finding of illegality is grounded upon the fact that "the fee demanded is out of proportion to the value of the attorney's services," DR 2-106(A)'s proscription against a "clearly excessive fee," as well as EC 2-17 and EC 2-18 governing reasonable fees, are squarely implicated, making it difficult to distinguish the legal issue from the ethical one. If the nonrefundable minimum fee that a particular agreement entitles a lawyer to retain is "clearly excessive" under the criteria spelled out in DR 2-106(B), as amplified by EC 2-18, then, *a fortiori*, it may not be ethically retained. Thus, the ethical conclusion like the public policy or legal one, will depend on a comprehensive consideration of the relevant facts and circumstances of the particular case. Since the determination of whether a fee is "clearly excessive" involves a factual inquiry into each case, the ethical proscription against "clearly excessive" fees is not compatible with a *per se* rule branding all minimum fee agreements unethical.

A more troubling ethical proscription, *vis-a-vis* the justification for a *per se* rule, is that contained in DR 2-110(A)(3), which requires a "lawyer who withdraws from employment" — which includes a discharged lawyer, DR 2-110(B)(4) — to "refund promptly any part of a fee paid in advance that has not been earned." In its Opinion 85-5 (1985), the Ethics Committee of Nassau County Bar Association regarded this provision as decisive, reasoning as follows:[4]

> It is well settled that a client has an absolute right, on public policy grounds, to discharge an attorney at any time, with or without cause; and that the attorney discharged without cause is limited to recovering in *quantum meruit* the reasonable value of services rendered. (*See*

[4] *The Civil Court in Sassower* addressed identical provisions in the ABA Model Code and reached the same ethical conclusion as Nassau on essentially the same grounds. See 113 Misc 2d at 285.

> Demov, Morris, Levin & Shein v. Glantz, 53 NY2d 553, 444 NYS2d 55 (1981)). An attorney who is discharged by a client must withdraw. DR 2-110(B)(4). The Code further mandates that upon withdrawal, an attorney "shall refund promptly any part of a fee paid in advance that has not been earned."
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> DR 2-110(A)(3). It therefore follows that the mere labeling of a fee as being "non-refundable" cannot make it so under our Code. Thus, it is the opinion of our Committee that since no fee advanced by a client is ever truly "non-refundable", the use of that term in a fee agreement would be a misrepresentation by the attorney and, therefore, improper. DR 1-102(A)(4). See also EC 2-19.

Accord, Nassau County Op. 86-3 (1986), indexed in ABA/BNA 901:6251. Ethics panels in other states have reached the same conclusion.[5]

The difficulty with this line of reasoning is that it begs the question. As the Court of Appeals noted in *Sassower*, "in the absence of a contract providing otherwise," a lawyer discharged by a client with or without cause is limited to a quantum meruit recovery. 66 N.Y.2d at 993. Moreover, where the contract does provide "otherwise," the lawyer may well have "earned" the minimum fee he seeks to retain on a ground other than hours of service, *e.g.*, his nonavailability to the client's adversary, his possible inability to accept other matters, or a combination of the factors enumerated in DR 2-106(B) "to be considered as guides in determining the reasonableness of a fee . . . ." To reach the Nassau result involves indulging the assumption that a fee can be "earned" only by hours of service; we are reluctant and, indeed, unwilling, to adopt a *per se* rule on that rationale.

The additional Nassau argument that use of the term "nonrefundable" would necessarily constitute an improper misrepresentation in violation of DR 1-102(A)(4) appears to be overstated. Nevertheless, we agree that the term "nonrefundable" is imbued with a connotation of absoluteness and finality that does not exist and is susceptible to client misunderstanding. Since it would be ethically impermissible for a lawyer to seek advance payment of a fee that would never be refundable, in whole or in part, under any circumstances whatsoever, the use of the term "nonrefundable" without explanation adequate under all the circumstances in scope, detail and emphasis would then be misleading and, therefore, unacceptable. We thus be-

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[5] Cleveland Op. 84-1 (1984), indexed in ABA/BNA 801:6952; Virginia Op. 510 (1983), indexed in ABA/BNA 801:8815; Michigan Op. CI-962 (1983), indexed in ABA/BNA 801:4873

lieve that such a provision would be improper in agreements with a client of limited education or experience, or with any client who for any reason is unlikely to have an adequate understanding of the circumstances, such as lawyer default, neglect or overreaching, that might entitle the client to a refund of part or all of the fee payment.

Our analysis does not, however, lead to the conclusion that in all situations minimum fee agreements would be violative of the Code. The essence of the matter is clarity — clarity that will assure the client's full understanding of the fee agreement proposal. We do not consider improper a fee agreement that calls for a specified minimum not thereafter refundable in the event of discharge, providing the following standards are met: (1) The specified minimum must not be excessive or unconscionable under the circumstances of the particular matter; (2) nonrefundability must be expressly conditioned on the absence of lawyer default; and (3) the agreement must clearly and unambiguously explain in language that is "fully known and understood by the client" the grounds that would entitle the client to a refund of the otherwise nonrefundable fee. *Cf. Jacobson v. Sassower*, 66 N.Y. 2d at 993. We also call attention to the court adopted standard that in cases of doubt or ambiguity, fee contracts will be construed most strongly against the lawyer and favorably to the client. *Id.*

A helpful statement of similar standards appears in Alaska Op. 87-1 (1987), indexed in ABA/BNA 901:1302:

> [A] non-refundable retainer may be charged to a client if the nature of the retainer as non-refundable is fully and clearly explained to the client, orally and in the written fee agreement, and if the fee is not excessive, considering the factors of DR 2-106 . . . .
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> [The] amount of the retainer should not be so great to unduly influence a client to pursue litigation contrary to public policy or the best interests of the client.
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> In making a disclosure to the client of the nature of the retainer, the attorney must take into consideration the state of mind of the client and the ability of the client to understand the fee agreement. The attorney must give examples of the kinds of circumstances under which the fee would not be returned, although the legal matter had not been pursued to completion. Special care needs to be taken in a divorce case or the like to make sure that the attorney is not taking advantage of the circumstances of the client in those kinds of matters,

nor creating a negative incentive to reconciliation or amicable settlement.

See also, Pennsylvania Op. 85-120, Indexed in ABA/BNA 901:73.

CONCLUSION

While we recognize that nonrefundable minimum fee provisions are subject to potential abuse, especially in matrimonial matters, we do not believe that such agreements are necessarily violative of the Code in all situations. A fee agreement may provide for a fixed minimum, but only if the agreement is expressly conditioned on the absence of lawyer default, the minimum amount is not excessive or unconscionable under the circumstances of the particular matter, and the client is fully advised of the grounds on which the agreement can be avoided. In the absence of such disclosure, adequate to assure complete understanding on the part of the client, it would be improper for a fee agreement to describe the fee or a portion thereof as "nonrefundable."