

Preliminary Issue Outline for Opinion Regarding Flat Fees**I. ISSUES/QUESTIONS**

- When is a flat fee paid in advance earned?
- How to determine the amount of a flat fee which is unearned and must be refunded to the client if the lawyer is terminated or does not complete the legal services required under the agreement?
- What obligations does a lawyer have to explain when the flat fee will be earned?
- Unconscionability issues in connection with flat fee agreements.

II. BACKGROUND AND AUTHORITIES**A. Background**

A flat or fixed fee is an alternative to the more traditional hourly fee agreement. A flat-fee agreement is a fee arrangement pursuant to which the client agrees at the inception of the representation to pay a fixed sum in exchange for which the attorney agrees to provide a specified service or group of services. The fee is a set amount which constitutes complete payment for the services to be provided regardless of the amount of work ultimately involved.

Flat fee agreements have traditionally been used in situations where the legal work is routine or the amount of legal work is predictable such as in criminal cases, wills and estate planning documents, certain transactional matters, bankruptcy cases and routine legal services. A flat fee provides a client with a measure of certainty as to the cost of a lawyer's services in that it represents the maximum amount that will be charged for the services to be performed. However, flat fee agreements can be problematic when the attorney-client relationship ends prior to the specified services being completed or where the scope of services to be provided is ambiguous.

Prior to the adoption of the current Rules of Professional Conduct in November 2018, California's rules did not explicitly address flat or fixed fees. New Rule of Professional Conduct 1.5(e) provides that a lawyer may make an agreement for, charge, or collect a flat fee for specified legal services. Rule 1.5(e) defines a flat fee as "a fixed amount that constitutes complete payment for the performance of described services regardless of the amount of work ultimately involved, and which may be paid in whole or in part in advance of the lawyer providing those services."

A flat fee paid at the outset of representation before any service have been provided is essentially an advance fee deposit because it is paid before the fee has been earned. Prior to the adoption of the new Rules of Professional Conduct effective November 1, 2018, courts in California were divided on whether an advance deposit for fees had to be deposited in the attorney's client trust account. In *Baranowski v. State Bar* (1979) 24 Cal.3d 153, the Supreme

Court declined to resolve the question of whether or not an advance fee payment had to be deposited into an attorney's client trust account. Two courts after *Baranowski*, declared that it was undecided in California whether, under former Rule 4-100, an advance payment for services or a security deposit must be deposited into the client trust account (*SEC v. Interlink Data Network* (9th Cir. 1996) 77 F.3d 1201, n.5; *Katz v. Worker's Comp. Appeals Bd.* (1981) 30 Cal.3d 353, n.2.) However, in *T & R Foods, Inc. v. Rose* (1996) 47 Cal.App.4th Supp. 1, the Appellate Department of the Los Angeles County Superior Court held that under Rule 4-100 an advance fee must be deposited into an attorney's trust account, and that an attorney's failure to segregate the advance fee or security deposit from his general funds constituted a breach of fiduciary duties.

The new Rules make it clear that an advance for fees must be deposited into a trust account. (Rule 1.15(a).) However, Rule 1.15(b) sets forth an exception which provides that a flat fee paid in advance may be deposited into the lawyer's or law firm's general operating account, instead of a client trust account, provided that (1) the lawyer/law firm "discloses to the client in writing (i) that the client has a right under paragraph (a) to require that the flat fee be deposited in an identified trust account until the fee is earned, and (ii) that the client is entitled to a refund of any amount of the fee that has not been earned in the event the representation is terminated or the services for which the fee has been paid are not completed; and (2) if the flat fee exceeds \$1,000.00, the client's agreement to deposit the flat fee in the lawyer's operating account and the disclosures required by paragraph (b)(1) are set forth in a writing signed by the client.

Rule 1.16(e)(2) provides that a lawyer shall promptly refund any part of a fee which is not earned upon termination of the representation. Because a flat fee does not depend on the amount of time spent in connection with the legal representation, questions arise as to when the fee is earned and how to determine the portion of the fee which must be refunded to the client where the fee is paid in advance and the attorney does not complete the services specified in the agreement.

B. Authorities

"Attorney fee agreements are evaluated at the time of their making and must be fair, reasonable and fully explained to the client. Such contracts are strictly construed against the attorney." (*Alderman v. Hamilton* (1988) 205 Cal.App.3d 1033, 1037; *Severson & Werson v. Bolinger* (1991) 235 Cal.App.3d 1569, 1572; *Bird, Marella, Boxer & Wolpert v. Superior Court* (2003) 106 Cal.App.4th 419, 430-431.) Any ambiguity in a retainer agreement is construed in favor of the client and against the attorney. (*Banning Ranch Conservancy v. Superior Court* (2011) 193 Cal.App.4th 903, 913).

Business and Professions Code §6148(a) provides that in cases not involving a contingent fee in which it is reasonably foreseeable that the total expense to the client will exceed \$1,000, the fee agreement must be in writing. Thus, an agreement for a flat fee in excess of \$1,000 must be in writing unless one of the exceptions in Section 6148(d) applies. Section 6148(a)(2) and (3) further require that the written agreement set forth the general

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nature of the legal services to be provided to the client and the respective responsibilities of the attorney and client as to the performance of the agreement.

Rule of Professional Conduct 1.5(a) provides that a lawyer shall not make an agreement for, charge, or collect an unconscionable or illegal fee.

Rule of Professional Conduct 1.5(e) provides that a lawyer may make an agreement for, charge, or collect a flat fee for specified legal services. A flat fee is a fixed amount that constitutes complete payment for the performance of described services regardless of the amount of work ultimately required to complete those services.

Rules of Professional Conduct 1.15(b) provides that a flat fee paid in advance for legal services may be deposited in a lawyer's or law firm's operating account if the lawyers discloses to the client in writing that the client has a right to have the flat fee deposited into a trust account until the fee is earned and that the client is entitled to a refund of any amount of the fee that has not been earned in the event the representation is terminated or the services for which the fee has been paid are not completed. If the flat fee exceeds \$1,000, the attorney must obtain the client's consent to deposit the flat fee in the lawyer's operating account in a writing signed by the client.

Rule of Professional conduct 1.16(e)(2) provides that a lawyer promptly shall refund any part of a fee or expense paid in advance that the lawyer has not earned or incurred.

San Diego County Bar Association Ethics Opinion 2019-03 – Refunding Unearned Advanced Flat Fees.

III. DISCUSSION AND POTENTIAL HYPOTHETICALS

As lawyers and clients explore alternatives to the traditional billable hour, agreements to charge a flat fee have become more common. Clients seeking flat-fee agreements typically do so to avoid the uncertainty and potentially negative consequences or paying for legal services on an hourly basis. A flat fee is a fee for a set amount for performance of agreed legal services. A lawyer earns a flat fee by performing the services for which the fee was charged, and that fee is the maximum amount that will be charged for the services to be performed. Flat fees are based on factors independent of the actual number of hours involved in a representation and they provide the client a degree of certainty about the cost of the legal services.

A flat fee must nevertheless be earned by performing the specified services, and, like any fee agreement, a flat fee is subject to review for unconscionability. Where the fee is paid in advance, flat fee agreements give rise to ethical considerations as to where the fee must be deposited, when the fee is earned, and what portion of the fee is refundable if the representation is terminated or the lawyer does not complete the specified services.

The new Rules of Professional Conduct make clear that an advance fee deposit must be deposited into an "identifiable bank account labeled "Trust Account" or words of similar

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import.” (Rule 1.15(a).) However, the rules have an exception for a flat fee, pursuant to which a flat fee paid in advance may be deposited into a lawyer or law firm’s operating account if the lawyer discloses to the client that that the client has a right to have the fee deposited and held in a trust account until the fee is earned, and that the client is entitled to a refund of any amount of the fee which has not been earned in the event the representations is terminated or the services have not been completed. (Rule 1.15(B)(1).) Where the fee exceeds \$1,000, the disclosures must be in writing and signed by the client. (Rule 1.15(b)(2).)

The new rules also make it explicit that with the sole exception of a true retainer, all attorney’s fees are refundable if the lawyer does not complete the legal services or the representation is terminated before the work is done. (Rule 1.5(d) and 1.16(e)(2).) Thus, where an attorney is retained pursuant to a flat fee agreement and does not complete the specified services or the representation is terminated the client is entitled to a refund of the unearned portion of the fee.

Clients have the absolute right to terminate their lawyer’s services at any time with or without cause. (*Fracasse v. Brent* (1972) 6 Cal.3d 784, 790; *Matter of Van Sickle* (Rev.Dept. 2006) 4 Cal. State Bar Ct.Rptr. 980, 989.) Even if a flat fee is deemed non-refundable or earned on receipt, if the client terminates the attorney’s representation before the services have been completed under a flat fee agreement, the attorney must refund the unearned portion of the fee in that situation.

Rule 1.5(d) makes clear that a “lawyer may make an agreement for, charge, or collect a fee that is denominated as ‘earned on receipt’ or ‘non-refundable,’ or in similar terms, only if the fee is a true retainer and the client agrees in writing after disclosure that the client will not be entitled to a refund or all or part of the fee charged.” Thus, unless a fee agreement is a true retainer, clients are entitled to a refund of unearned or unconscionable fees regardless of language used in the fee agreement. In light of the provisions in Rules 1.5(d) and 1.15(b), language in a fee agreement which designates that a flat fee is non-refundable or is fully earned on receipt may constitute a misrepresentation under Rule of Professional Conduct 8.4(c).

One of the most common situations giving rise to attorney-client disputes regarding flat fees is where the attorney’s services terminate before all of the work is completed. This can arise where a client exercises their right to terminate the lawyer’s services or the lawyer withdraws from the representation before the agreed upon work is fully performed. Because a discharged attorney may recover in quantum meruit for the reasonable value of services rendered, in either situation a determination will have to be made regarding the reasonable value of the services performed by the attorney before the representation terminated.

Whether a fee is reasonable, unreasonable or unconscionable is often a matter of degree and involves the assessment of a multiplicity of factors. (State Bar Mandatory Fee Arbitration Program Arbitration Advisoryt 1998-03, p.3. As noted in Advisory 1998-03, the factors considered under former Rule 4-200(B) [current Rule 1.5(b) for determining an unconscionable fee are generally identical to the factors considered in analyzing the reasonableness of a fee. Those factors include comparison of fee charged to value received

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(Rule 1.5(b)(3), whether the fee is fixed or contingent (Rule 1.5(b)11) and whether the client gave informed consent to the fee (Rule 1.5(b)13). As described by one court, the question is whether the client got what she or he paid for. (*Shaffer v. Superior Court* (1995) 33 Cal.App.4th 993, 1002.) However, a reasonable fee should never exceed the contract fee. (*Cazares v. Saenz* (1989) 208 Cal.App.3d 279, 287.) Thus, in the flat fee scenario where the representation terminates before all of the services have been provided, the maximum the attorney can recover is the specified flat rate fee.

There are several approaches which may be used to determine the amount of an unearned fee under a flat fee agreement where the representation terminates before all of the services have been provided.

Discuss milestone approach, benchmarks, segments

Discuss flat fees and duty of competence and diligent representation

Scenario One: Attorney and client enter into a written fee agreement pursuant to which the attorney agrees to represent client in X [e.g., criminal case, family law case, estate planning] matter for a flat fee. The full flat fee is paid in advance and is deemed in the agreement as earned on receipt and no portion of the fee will be refunded. Attorney's representation is terminated before the case is completed.

Scenario Two: Attorney and client enter into a written fee agreement pursuant to which the attorney agrees to perform three specified tasks in connection with X matter for a flat fee. The full fee is paid in advance. After commencing the representation, the attorney advises client that two of the tasks should not be performed because they may not be in client's best interests. As a result, attorney completes one of the three tasks covered by the agreement.

Scenario Three: Attorney and client enter into a written fee agreement pursuant to which the attorney agrees to represent client in X matter for a flat fee. The agreement provides that if the representation is terminated before the work is completed the lawyer will be entitled to a reasonable fee based on the lawyer's hourly rate of \$XXXX.

Scenario Four: Attorney and client enter into a written fee agreement pursuant to which the attorney agrees to draft X agreement for a flat fee. Attorney prepares a draft of the agreement but client and attorney disagree regarding some of the terms. Client declines to sign the agreement and terminates attorney.