

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.
- Can an attorney renegotiate the terms of a flat fee agreement during the course of representation?

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 fixed amount that constitutes complete payment for the described services regardless of the amount of work ultimately involved. (Rule of Professional Conduct 1.5(e).)

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 other 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. In addition to certainty, flat fees can also address other potential issues with hourly billing, including bill padding, multiple attorneys working on the case, billing for in-house conferences. (See, State Bar Mandatory Fee Arbitration Program Arbitration Advisory 2016-02 [Analysis of Potential Bill Padding and Other Billing Issues].) 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 or may change during the representation.

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 current Rules of Professional Conduct, 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.

B. Impact of the Current Rules of Professional Conduct

The current Rules make it clear that an advance for fees must be deposited into a trust account. (Rule 1.15(a).) The current Rules also make clear that a lawyer may not "make an agreement for, charge, or collect a fee that is denominated as 'earned on receipt' or 'non-refundable, or in similar terms" unless the fee is a "true retainer." (Rule 1.5(d). Rule 1.5(d) defines a true retainer as "a fee that a client pays to a lawyer to ensure the lawyer's availability to the client during a specified period or on a specified matter, but not to any extent as compensation for legal services performed or to be performed." Where a flat fee is for legal services, it cannot be a true retainer and therefore must be deposited into a client trust account and the fee is subject to the rules applicable to client trust accounts.

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.

C. General principles regarding attorney-client fee agreements

“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* (2911) 193 Cal.App.4th 903, 913).

Attorneys have a professional responsibility to ensure that fee agreements are neither unreasonable nor written in a manner that may discourage clients from asserting any rights they may have against their attorney. (Los Angeles Co. Bar. Assn. Ethics, Op. No. 489; see also, *Ojeda v. Sharp Cabrillo Hospital* (1992) 8 Cal.App.4th 1, 17.)

Although considered an "arms-length" transaction, any lack of specificity in the fee agreement's language will be construed against the attorney. (*In re County of Orange* (1999) 241 B.R. 212, 221 [attorney fee contracts strictly construed against attorney]; *Matter of Lindmark* (Rev.Dept. 2004) 4 Cal. State Bar Ct.Rptr. 668, 676 [rule that ambiguities in contract interpreted against the drafter applies with Aextra force@ when contract is drafted by attorney]; *Severson & Werson v. Bolinger* (1991) 235 Cal.App.3d 1569 [fee agreement calling for Aregular hourly rates@ construed in client=s favor to preclude increase in rates without notice to client].)

A lawyer may not make “an agreement for, charge or collect an unconscionable or illegal fee.” (Rule of Professional Conduct 1.5(a). While fee agreements are generally not subject to Rule 1.8.1 (Business Transactions with a Client), all fee agreements are subject to scrutiny in accordance with Rule 1.5(b). Therefore, the amount of a flat fee is subject to scrutiny for unconscionability. The unconscionability determination is made based upon the facts and factors that exist at the time the contract is entered into, not whether it is unconscionable in light of subsequent events. (*Brobeck, Phleger & Harrison v. Telex Corp.* (9th Cir. 1979) 602 F. 2d 866; *Matter of Yagman* (Rev.Dept. 1997) 3 Cal. State Bar Ct.Rptr. 788, 800)

Business and Professions Code §6148(a) provides that in cases not involving a contingent fee in which it is reasonably foreseeable that 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 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. Specificity regarding the scope of services to be performed is key in connection with flat fee agreements as disputes can arise when the scope of the representation is ambiguous.

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.

While Rule of Professional Conduct 1.15(a) now makes it clear that an advance payment of fees shall be deposited into a trust account, Rule 1.15(b)(1) 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 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 client's agreement to deposit the flat fee in the lawyer's operating account and the disclosures required by paragraph (b)(1) must be set forth 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.

III. DISCUSSION

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.

Like any attorney-client relationship, attorneys providing services under a flat fee agreement have duty of competence and diligent representation. (Rules of Professional Conduct, Rules 1.1 [Competence] and 1.3 [Diligence].) A flat fee rewards efficiency, but an attorney who underestimates the time necessary to perform the specified services may seek to cut corners.

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.

An agreement for payment of a flat fee legal services must comply with Business & Professions Code §6148(a) and Rules of Professional Conduct, Rules 1.5 and 1.15. Business & Professions Code §6148 sets forth the *minimum* requirements for non-contingent fee agreements. Section §6148(a) provides that where it is reasonably foreseeable that the total expenses to the client will exceed \$1,000, the agreement must be in writing and contain the general nature of the legal services to be provided, the basis of compensation, including, but not limited to, hourly rates, flat fees, statutory fees, and the respective responsibilities of the attorney and the client as to performance of the agreement.

While Business & Professions Code §6148(a) only requires that the fee agreement contain “the general nature of the legal services to be provided,” in the case of an agreement for a flat fee it is especially important that the agreement clearly identify the scope of the services to be provided. (See, e.g.,) Attorneys have an obligation to inform clients of matters they are not handling where a reasonable client would rely on the attorney to advise them on such matters. (*Nichols v. Keller* (1993) 15 Cal.App.4th 1672, 1686-87; *Meighan v. Shore* (1995) 34 Cal.App.4th 1025, 1041.) Accordingly, a flat fee agreement should carefully identify the services which will be provided for the flat fee as well as what services are not included.

The current 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 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 in writing 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).)

Aside from the requirement that an attorney disclose that the client has a right to have the flat fee deposited into a trust account and that the client is entitled to a refund of any amount of the fee which is unearned if the representation is terminated, Rule 1.15(b) is silent as to whether an attorney is required to disclose other potential adverse consequences if the flat fee is not deposited into a trust account until the fee is earned. Reasonably foreseeable material risks where a flat fee is paid in advance include that the attorney may not have the funds available if a refund of an unearned flat fee is required and that funds in the lawyer’s operating account could be subject to attachment by the lawyer's creditors.

The current 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).) Rule 1.5(d) provides that a "lawyer may not 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, a representation in fee agreement entered into after the current Rules of Professional Conduct went into effect on November 1, 2018, that a flat fee is nonrefundable or fully earned on receipt may constitute deceit or an intentional misrepresentation under Rule of Professional Conduct 8.4(c).

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.

One of the most common situations giving rise to attorney-client disputes regarding flat fees is where the attorney's services are terminated before all of the work is completed. This can arise where a client exercises their right to terminate the lawyer's services, or where 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 Advisory 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 (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.

In the absence of an agreed upon method, the amount of unearned fee that must be returned if the representation terminates before the legal services are completed will depend

on a number of factors similar to the factors used in the evaluation of whether the fee paid to the lawyer represents the reasonable value of the lawyer's services and is not unconscionable. (Rule of Professional Conduct 1.5(b).)

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, including benchmarks or milestones which specify when a portion of the fee is earned.¹ Under this approach, the fee agreement may include milestones based upon the completion of specified tasks, the passage of time or other mutually agreed upon factors. However, because the terms of the agreement must be reasonable and fully explained to the client, milestones which provide for front-loading the entitlement to fees are subject to scrutiny. In addition, a milestone based solely on the passage of time may be unseasonable as it is not specifically tied to the performance of services.

Another option for determining earned fees in connection with flat fee services in the application of an hourly rate to the lawyer's services at the time the representation terminates. However, as a flat fee agreement is not based on providing legal services based on an hourly rate, this approach may not be appropriate as the number of hours spent on the client's case under a flat fee agreement may not be determinative of the reasonable value of the services in relation to the specified flat fee.

Another issue is whether an attorney can renegotiate a flat fee where the attorney miscalculated the complexity of the matter and the amount of time required to perform the agreed upon services. It is unsettled in California whether lawyer must comply with Rule 1.8.1 before negotiating a modified fee agreement with an existing client. The issue was addressed by Texas State Bar in Opinion No. 679 (2018). The question presented in that ethics opinion was whether a lawyer may renegotiate a flat fee for representing a client in litigation after the litigation is underway if the matter turns out to be greater in scope and complexity than the lawyer and client contemplated. The Texas State Bar Ethics Committee concluded that a lawyer may renegotiate a flat fee in a litigation matter after the litigation is underway if modification of the fee agreement is fair under the circumstances. The Texas Ethics Committee concluded that that the burden of proving fairness is the lawyer's and will depend upon factors such as the length of the lawyer-client relationship, whether the reason for the renegotiation could have been anticipated at the outset of the representation, and the client's level of sophistication. The Committee further concluded that before seeking to renegotiate a fixed fee, the lawyer should be mindful of the risks that the lawyer voluntarily

¹ Milestones have been approved in ethics opinions and case authorities from other jurisdictions. (See, San Diego County Bar Association Ethics Opinion 2019-03 – Refunding Unearned Advanced Flat Fees, p.5; *Matter of Gilbert* (2015 Colo. Supreme Court) 346 P.3d 1018, 1027; *In Re Mance* (2009 Dist. of Columbia) 980 A.2d 1196, 1204; DC Bar Ethics Opinion 355; Utah State Bar Ethics Opinion 2012-02.

assumed when proposing or agreeing to that fee—including the possibility that the fixed fee might not be adequate to compensate the lawyer when compared to other fee arrangements.

IV. POTENTIAL HYPOTHETICALS

Scenario One: Attorney and client enter into a written fee agreement pursuant to which the attorney agrees to represent client in criminal case for a flat fee of \$25,000. The full flat fee is paid in advance and is deemed in the agreement as earned on receipt and states that no portion of the fee will be refunded. The fee agreement does specify the scope of services, other than the general statement that Attorney will represent client in the criminal case. Client is dissatisfied with Attorney's services and terminates the representation after the Attorney has provides some services but before the case is completed.

Analysis of Scenario No. 1: The \$25,000 flat fee paid when the attorney and client entered into the fee agreement is an advance deposit because it relates to the performance of legal services and therefore is not a true retainer. The flat fee must therefore be deposited into a client trust account until the fee is earned, unless Attorney has made the written disclosures required by Rule 1.15((b)(1) and obtained Client's written consent to deposit the fee in Layer's operating account. The provision that the \$25,000 flat fee is deemed earned upon receipt violated Rule 1.5(d) and is not enforceable. Because the fee agreement did not include any milestones or enforceable provisions as to whether any portion of the fee is earned prior to completion of the entire agreement, attorney will only be entitled to recover a reasonable fee under quantum meruit and attorney will have the burden of proof.

Scenario Two: Attorney and client enter into a written fee agreement pursuant to which the attorney agrees to perform represent client in a tax dispute with the Internal Revenue Service for a flat fee of \$25,000. The full fee is paid in advance. The agreement does not include any milestones, but states that Attorney will prepare amended tax returns for the past 10 tax years, as needed, prepare original tax returns, as needed, and represent client in negotiations with the IRS regarding tax liability and penalties. After commencing the representation, Attorney advised client to not file amended returns for the any of the prior tax returns as doing so may not be in client's best interests, does not file new any original returns, but spends about 30 hours negotiating with the IRS but does not reach an agreement regarding tax liability. Client terminates Attorney's representation.

Analysis of Scenario No. 2: The \$25,000 flat fee paid when the attorney and client entered into the fee agreement must be deposited into a client trust account until the fee is earned, unless Attorney has made the written disclosures required by Rule 1.15((b)(1) and obtained Client's written consent to deposit the fee in Layer's operating account. When the representation is terminated, Attorney has only provided one of the three specified tasks because after the representation

commented Attorney advised Client that it may not be in Client's best interests to file amended returns and attorney did not prepare new original returns before the representation terminated. [NEED TO FINISH ANALYSIS]

Scenario Three: Attorney and client enter into a written fee agreement pursuant to which the attorney agrees to represent client in connection with a divorce for a flat fee of \$25,000. 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 \$400. Attorney files petition for dissolution, and other documents [NEED EXAMPLES]. Attorney and Client disagree with respect strategy and handling of the divorce and Attorney voluntarily withdraws from the representation.

Analysis of Scenario No. 3:

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.