

THE STATE BAR OF CALIFORNIA
STANDING COMMITTEE ON
PROFESSIONAL RESPONSIBILITY AND CONDUCT
FORMAL OPINION INTERIM NO. 20-0003
FLAT FEES AND TERMINATION

ISSUES: What are the ethical obligations of attorneys representing clients pursuant to a flat fee agreement where the representation is terminated before the legal services specified in the agreement have been completed or where the scope or complexity of the matter turns out to be greater than the attorney and client contemplated?

DIGEST: An attorney may agree agreement to charge a flat fee for legal services and should clearly state what services are covered by the fee and when the fee or portion thereof is earned.

AUTHORITIES

INTERPRETED: Rules 1.5, 1.15, 1.16, Business & Professions Code §6148

INTRODUCTION AND SCOPE

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 of paying for legal services on an hourly basis. 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 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 defense cases, immigration documents, wills, trusts and estate planning, uncontested divorces, certain transactional matters such purchase agreements and other contracts formation of a business entity, 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, and 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.

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.

A. Treatment of Flat Fees before Adoption of the Current Rules of Professional Conduct

The California Rules of Professional Conduct in effect prior to November 1, 2018, did not specifically address flat fees or whether fees paid in advance of services being provided had to be deposited into a client trust account.¹ Flat fee agreements often stated that the fee paid in advance was fully earned when paid and that it was non-refundable. Those types of provisions frequently resulted in fee disputes where the lawyer was terminated or did not provide all of the services required under the agreement but then refused to refund any portion of the fee. (See *In re Matter of Lais* (Rev. Dept. 1998) 3 Cal. State Bar Ct. Rptr. 907, 923 [provision in flat fee agreement that the fee was a “fixed, non-refundable retaining fee” was not a true retainer fee, and attorney’s failure to promptly refund any unearned part of the advanced fee promptly upon the termination of his services was a willful violation of Rule 3–700(D)(2)]; [Sarah: if this is frequent and common, can you add a citation to another case?] KB: The comment was based on experience in mandatory fee arbitration cases which frequently involved flat fee agreements, mostly in the criminal context, which stated that the fee was fully earned in advance or non-refundable.

¹ Prior to the adoption of the current Rules of Professional Conduct, courts in California were divided on whether fees paid in advance had to be deposited in the attorney’s client trust account [*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]; *T & R Foods, Inc. v. Rose* (1996) 47 Cal.App.4th Supp. 1 [pursuant to 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 an attorney’s general funds constituted a breach of fiduciary duties..]

B. Impact of the Current Rules of Professional Conduct

The current Rules of Professional Conduct (effective November 1, 2018) address flat fees and non-refundable advance payments of fees in several ways. Rule 1.5(e) specifically provides that a lawyer may make an agreement for, charge, or collect a flat fee for specified legal services and the rule 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.” Rule 1.5(e) further provides that a flat fee “may be paid in whole or in part in advance of the lawyer providing those services.”

Rule 1.5(d) expressly states 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) 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.”

Rule 1.15(a) now makes it clear that an advance payment of fees must be deposited into a trust account.² However, Rule 1.15(b) provides an exception for flat fees which allows a flat fee paid in advance to be deposited into the lawyer’s or law firm’s operating account, instead of a client trust account, provided: “(1) the lawyer of 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.” Rule 1.15(b)(2) states that 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) must be 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. Comment [3] to Rule 1.15 states that the option to deposit a flat fee paid in advance into a lawyer or law firm’s operating account does not alter the lawyer’s obligation under paragraph (d) or the lawyer’s burden to establish that the fee has been earned. Comment [3] to Rule 1.5 cites Rule 1.16(e)(2) and states that when the lawyer-client relationship terminates, the lawyer must refund the unearned portion of a fee. Accordingly, if a lawyer’s services are terminated before the contracted services have been completed, or the lawyer otherwise fails to complete the services, the lawyer must refund any

² Comment [3] to Rule 1.15 states that “[p]aragraph (b) does not apply to advance payment of costs and expenses.” Case law under former Rule 4-100(A), and current Rule 1.15(a), require that advances for costs or expenses must be deposited into attorney’s trust account. (*Stevens v. State Bar* (1990) 51 Cal.3d 283, 286-287 [placing advance payment of costs in lawyer’s business account violated former rule].)

unearned portion of the fee irrespective of whether the advance flat fee has been deposited into the lawyer's operating account.

A. General rules 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. (*Alderman v. Hamilton* (1988) 205 Cal.App.3d 1033, 1037.) Any ambiguity in a retainer agreement is construed in favor of the client and against the attorney. *Severson & Werson v. Bolinger* (1991) 235 Cal.App.3d 1569, 1572 [fee agreement calling for regular hourly rates construed in client's favor to preclude increase in rates without notice to client].); *Bird, Marella, Boxer & Wolpert v. Superior Court* (2003) 106 Cal.App.4th 419, 430-431.) (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. JF: CONSIDER DELETING OR MINIMIZING THIS PARAGRAPH AND TYING IT TO FLAT FEES. JF: I AM IN FAVOR OF TRIMMING DOWN AND SIMPLIFYING THE BACKGROUND SECTIONS. HERE, FOR INSTANCE, THIS FIRST SENTENCE IS NON CONTROVERSIAL SO I THINK ONE CASE CITE SHOULD SUFFICE. SB: While this sentence helps make the connection to flat fees, the prior sentence is duplicative of the opening paragraph of this section. I suggest shortening and combining with the opening paragraph. I have attempted to do so.

A lawyer may not make "an agreement for, charge or collect an unconscionable or illegal fee." (Rule of Professional Conduct 1.5(a). Rule 1.8.1 (Business Transactions with a Client) does not apply to the initial fee agreement unless the attorney also obtains a security or other pecuniary interest adverse to the client. Even if Rule 1.8.1 does not apply, all fee agreements are subject to scrutiny of the unconscionability factors set forth 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 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 sets forth the **minimum** requirements for non-contingent fee agreements. While section 6148(a)(2) only requires that the fee agreement state "the general nature of the legal services to be provided,"

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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. 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.

DISCUSSION

Like any attorney-client relationship, attorneys providing services under a flat fee agreement have duties 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 giving rise to concerns regarding the duties of diligence and competence.

A flat fee must 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.

A. Disclosure of the risks of depositing an advance payment of a flat fee into the lawyer's operating account.

Where a flat fee is paid in advance of the performance of legal services, the default rule is that the fee must be deposited into the lawyer or law firm's trust account until the fee is earned. (Rule 1.15(a).) However, Rule 1.15(b)(1) provides that a flat fee paid in advance may be deposited into the lawyer or law firm's operating account provided the lawyer or law firm disclose to the client in writing that the client has the right to have the flat fee deposited into a trust account until it 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 have not been completed.

Even though Rule 1.15(b) allows a flat fee paid in advance to be deposited into the lawyer's operating account if the Rule 1.15(b) written disclosures are provided to the client, the flat fee paid in advance is not earned until services have been provided, and hence remains the property of the client. However, implicit in the authorization to deposit a flat fee paid in advance into an operating account, is that the lawyer may spend that money even though some or all of the fee may be subject to refund if the representation is terminated or the agreed-upon services have not been completed.

Rule 1.15(b) is silent as to whether a lawyer or law firm is required to disclose potential adverse consequences if the flat fee is not deposited into a trust account until

the fee is earned. However, depositing a flat fee into an operating account presents reasonably foreseeable adverse consequences to the client where the money is spent by the lawyer but a refund is required because an operating account lack the safeguards provided by trust accounts, including the protections in Rule 1.15(d). For example, a reasonably foreseeable material risk where a flat fee paid in advance is deposited into the attorney's operating account is that the attorney may not have the funds available if a refund of an unearned flat fee is required. Another risk of the flat fee being deposited into the lawyer's operating account is that the funds could be subject to attachment by the lawyer's creditors. JF: CAN WE PROVIDE AN EXAMPLE OF AN ADVERSE CONSEQUENCE FOR CONTEXT? KB: Those are discussed in the prior paragraph

While Rule 1.15(b) does not use the term consent, implicit in the requirement that the client sign the disclosure for a flat fee in excess of \$1,000 is that the client thereby consents to the funds being deposited into the lawyer's operating account. However, in the absence of disclosure of the potential consequences of a flat fee paid in advance being deposited into the lawyer or law firm's operating account a client may not understand the risks associated with having the advance fee being treated as the property of the attorney by it being placed in the operating account.

Courts in other jurisdictions have held that consent to deposit an advanced payment of a flat fee into the law firm's operating account either must be informed consent or clearly explain the potential risks to the client. The court in *In re Mance* (D.C. 2009) 980 A.2d 1196, 1207, applying the District of Columbia Rules of Professional Conduct, imposed an "informed consent" standard where the flat fee will be deposited into the attorney's operating account. The court in *Mance*, held that a flat fee must be held in the lawyer's trust account until earned unless the client gives informed consent to a different arrangement. The court stated that a bare mention of a trust account option will usually be insufficient unless accompanied by some explanation of the features that distinguish a trust account from an operating account. In reaching that conclusion, the court quoted from a Colorado case, *In re Sather* (Colo, 2000) 3 P.3d 403, 413-414. The court in *Sather* stated that while in some instances a client may agree to allow the attorney to treat funds paid in advance of legal services as property of the attorney, "at a minimum such arrangement will be construed against the attorney and in favor of the client." The court further stated that "the fee agreement must clearly explain the basis for this arrangement and explain how the clients' rights are protected by the arrangement." KB: Consider deleting this discussion if Committee does think this it is proper to discuss greater disclosure than is required in the Rule. SB: If we decided to remove, then we should also consider revising prior paragraph. If we keep this paragraph, I believe we need to provide a more detailed analysis of how California's Rule 1.15 compares to DC's and Colorado's. I believe California Rule 1.15(b) is unique so these out-of-state cases are not analogous. If additional disclosures were required by Rule 1.15, they would have been specified in subsection (b).

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224 **B. When is a flat fee earned?**

225 Clients have the absolute right to terminate their lawyer's services at any time with or
 226 without cause. (*Fracasse v. Brent* (1972) 6 Cal.3d 784, 790; *Matter of Van Sickle* (Rev.Dept. 2006)
 227 4 Cal. State Bar Ct.Rptr. 980, 989.) The current rules make it explicit that with the sole exception
 228 of a true retainer, all attorney's fees paid in advance are refundable if the lawyer does not
 229 complete the legal services or the representation is terminated before the work is done. (Rule
 230 1.5(d) and 1.16(e)(2).) Thus, a representation in fee agreement entered into after the current
 231 Rules of Professional Conduct went into effect on November 1, 2018, that a flat fee is
 232 nonrefundable or fully earned on receipt violates Rule 1.5(d) and may constitute deceit or an
 233 intentional misrepresentation under Rule of Professional Conduct 8.4(c).

234 While the current rules are clear that a flat fee paid in advance is not earned on receipt,
 235 the rules do not provide guidance as to when a flat fee, or portion thereof, is earned or how to
 236 calculate the amount of an unearned fee which must be refunded if the lawyer's services are
 237 terminated or otherwise not completed. However, one of the most common situations giving
 238 rise to attorney-client disputes regarding flat fees is where the attorney's services are terminated
 239 before all of the work is completed. This can arise where a client exercises their right to terminate
 240 the lawyer's services, or where the lawyer withdraws from the representation before the agreed
 241 upon work is fully performed. Because a discharged attorney may recover in quantum meruit
 242 for the reasonable value of services rendered, in either situation, a determination will have to be
 243 made regarding the reasonable value of the services performed by the attorney before the
 244 representation terminated.

245 Whether a fee is reasonable, unreasonable or unconscionable is often a matter of degree
 246 and involves the assessment of a multiplicity of factors. (State Bar Mandatory Fee Arbitration
 247 Program Arbitration Advisory 1998-03, p.3.) As noted in Advisory 1998-03, the factors considered
 248 under former Rule 4-200(B) [current Rule 1.5(b)] for determining an unconscionable fee are
 249 generally identical to the factors considered in analyzing the reasonableness of a fee. Those
 250 factors include comparison of fee charged to value received (Rule 1.5(b)(3), whether the fee is
 251 fixed or contingent (Rule 1.5(b)(11) and whether the client gave informed consent to the fee
 252 (Rule 1.5(b)(13). As described by one court, the question is whether the client got what she or he
 253 paid for. (*Shaffer v. Superior Court* (1995) 33 Cal.App.4th 993, 1002.) However, a reasonable fee
 254 should never exceed the contract fee. (*Cazares v. Saenz* (1989) 208 Cal.App.3d 279, 287.) Thus,
 255 in the flat fee scenario, where the representation terminates before all of the services have been
 256 provided, the maximum the attorney can recover is the specified flat rate fee.

257 Comment [2] to rule 1.15 states: "Subject to rule 1.5, a lawyer or law firm may enter into
 258 an agreement that defines when or how an advance fee is earned and may be withdrawn from
 259 the client trust account." This comment suggests that a lawyer and client may agree to a method
 260 for determining when a flat fee is earned and what portion of an unearned fee must be refunded
 261 if services in the flat fee agreement are not completed before the termination of the lawyer's

services. However, any such provision in a fee agreement must not be unconscionable under Rule 1.5 and should be proportionate to the reasonable value of the lawyer's services.

Business & Professions Code §6148 should also be considered in connection with a provision in a fee agreement which defines when or how an advance fee is earned and may be withdrawn from the client trust account. Section 6148(a)(1) requires that the fee agreement state the "basis of compensation including, but not limited to, hourly rates, statutory fees or flat fees, and other standard rates, fees, and charges applicable to the case." Section 6148(b) applies to bills and requires that "bills rendered by an attorney to a client shall clearly state the basis thereof. Bills for the fee portion of the bill shall include the amount, rate, basis for calculation, or other method of determination of the attorney's fees and costs." When applied to a flat fee agreement which provides that the fee will be paid in advance of services being rendered, with the exception of a flat fee for a single specific service, Business & Professions Code §6148(a) and (b) may require that the fee agreement set forth when the fee is earned.

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.³ 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 is 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.

³ 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.

C. Ethical concerns regarding renegotiation of a flat fee agreement during the course of the representation.

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 a lawyer must comply with Rule 1.8.1 before negotiating a modification of a fee agreement with an existing client. Whether former Rule 3-300, or current Rule 1.8.1, applies to the renegotiation of a fee agreement during the course of the representation in general, and a flat fee agreement in particular, has not specifically been addressed in prior California State Bar ethics opinions. In 2008, the Committee on Professional Responsibility and Conduct issued a proposed Formal Opinion regarding the ethical ramifications associated with modification of an attorney fee agreement (Proposed Formal Opinion Interim No. 05-0001). The Committee concluded that Rule 3-300 does not apply to a modification of a fee agreement unless the agreement confers on the attorney an ownership, security, possessory or other pecuniary interest adverse to the client. The Committee concluded that while Rule 3-300 did not per se apply to a modification of a fee agreement after the attorney-client relationship has commenced, any modification is subject to close scrutiny and must be fair, reasonable and fully explained to the client. However, the Board of Trustee's Committee on Regulations, Admissions and Discipline did not approve the proposed opinion. Nevertheless, where the lawyer obtains a pecuniary interest adverse to the client as a result of the renegotiation, the lawyer must comply with Rule 1.8.1.⁴

Texas State Bar in Opinion No. 679 (2018) addressed 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 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. The Committee concluded that its version of the rule regarding business transactions with a client did not apply to renegotiating a flat fee agreement, but noted that

⁴ Rule 1.8.1 provides that a lawyer shall not enter into a business transaction with a client, or knowingly acquire an ownership, possessory, security or other pecuniary interest adverse to the client unless the terms are fair and reasonable to the client and fully disclosed to the client in writing and in a manner that should reasonably have been understood by the client, the client is advised in writing to seek the advice of an independent lawyer of the client's choice, and the client provides informed written consent to the terms of the transaction.

general principle that all transactions between a client and lawyer should be fair and reasonable to the client so the modification must still be on terms that are fair and reasonable to the client.

The Utah State Bar Ethics Advisory Committee, in Opinion No. 20-01, similarly addressed whether a lawyer may permissibly renegotiate the terms of a flat fee agreement if, after commencing the representation, the circumstances, scope or complexity of the matter becomes materially different and greater from what the lawyer unilaterally contemplated at the commencement of the representation. The Utah Committee concluded that renegotiation of the fee agreement was not permitted under these circumstances, unless the lawyer complied with Rule 1.8(a) of the Utah Rules of Professional Conduct.⁵ However, the Committee stated that its opinion would be different if the scope of the engagement was enlarged by the client, or was not reasonably foreseeable or contemplated by the lawyer and the client as included in the original scope of work contemplated when the parties entered into the original fee agreement. The Committee also noted that its opinion would be altered where the client misrepresented the facts or issues or there was a mutual mistake of fact.

Unlike hourly or contingent fee agreements, a flat fee agreement contemplates full payment for all of the specified services regardless of the amount of the work ultimately performed. As a result, a mid-stream renegotiation of a flat fee agreement which requires that the client pay more than the terms of the original agreement presents different considerations. In most cases, the attorney will be in the better position to estimate the time required to perform services under a flat fee agreement when the parties are negotiating the terms of the original agreement. If the attorney underestimates the amount of time necessary to perform the specified services and seeks to modify the fee, the client may not want to change representation and feel compelled to agree to the higher fee and is therefore at a disadvantage in negotiating with their attorney. **SB: We should consider whether attorney may withdraw under Rule 1.16(b) if client refuses to agree to renegotiation. I don't think permissible withdrawal is authorized so the client wouldn't necessarily be at a disadvantage.**

If the modification is the result of the attorney underestimating the amount of work required to perform the agreed upon services, a mid-stream modification may not be fair or reasonable as the attorney as the attorney was in the position to have had the experience and sophistication to evaluate and set the flat fee before entering into the agreement. If, however, the client has misrepresented the facts and the scope of the engagement is greater than anticipated when the attorney set the flat fee, then a mis-stream modification may be fair and reasonable to the client. Similarly, where a situation enlarging the services necessary to perform

⁵ Utah Rule 1.8(a) is substantively the same as California Rule 1.8.1, which governs business transactions with a client and pecuniary interests adverse to a client.

the agreed services was not foreseeable by both the lawyer and the client, a mis-stream modification may be fair and reasonable to the client.

If the client does not agree renegotiate the fee the attorney may seek to withdraw from the representation under Rule 1.16(b). [I believe we need more of an analysis and conclusion here]

IV. FACTUAL SCENARIOS AND ANALYSIS OF EACH

Scenario One: Attorney and client enter into a written fee agreement pursuant to which the attorney agrees to represent client in a criminal case involving an alleged robbery for a flat fee of \$25,000. The full flat fee is paid in advance and is deemed in the fee agreement as earned on receipt and states that no portion of the fee will be refunded. The fee agreement does not specify the scope of services, other than the general statement that Attorney will represent client in the criminal case. After the arraignment and preliminary hearing, client is dissatisfied with Attorney's services and terminates the representation. Client requests a refund of the flat fee, but attorney declines to refund any portion of the fee because the fee agreement states that was fully earned on receipt and that no portion of the fee will be refunded.

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). The provision that the \$25,000 flat fee is deemed earned upon receipt and is not refundable violates Rule 1.5(d) and is not enforceable.

Because the client has the right to terminate the attorney and attorney has not performed all the legal services specified in the agreement, the client is entitled to a refund of the portion of the fee that has not been earned. As the fee agreement did not include any milestones or other provisions regarding 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 a quantum meruit analysis and attorney will have the burden of proof as to the reasonableness of the fee.

Scenario Two: Client consults attorney for representation in a marital dissolution action. Client represents that the parties are in agreement regarding their divorce and the division of property. Attorney agrees to handle the case through execution of a marital settlement agreement for a flat fee of \$10,000. Other than the provision regarding execution of a marital settlement agreement, the fee agreement does not include milestones for when any portion of the fee is earned. After commencing the representation and obtaining financial disclosures, the attorney discovers that the parties do not agree regarding the division of marital property and that the case will likely have to go to trial. Attorney wants to renegotiate the flat fee to more

fairly cover the likely time and expense of a trial regarding disputed property issues, but client refuses.

Analysis of Scenario No. 2: Similar to contingent fee agreements, a flat fee agreement involves a certain amount of risk by both parties. There is risk to the lawyer that time required may exceed what the lawyer might have earned under an agreement to bill hourly for the lawyer's services. There is risk to the client that the client may end up paying more than the client would have paid under an hourly fee agreement if the lawyer is able to complete the representation for less time than anticipated when the parties entered into the agreement. Renegotiation to increase the amount of the fee for the services specified in the agreement because the attorney underestimated the amount of time necessary to perform the specified services raises ethical concerns and should be subject to close scrutiny as the client may not want to change representation if the attorney withdraws during the representation and is therefore at a disadvantage in negotiating with their attorney. Additionally, in most cases the attorney will have been in the better position to estimate the time required to perform services under a flat fee agreement when the parties are negotiating the terms of the original agreement, and renegotiating the terms of the agreement after the representation has commenced may be an undue burden for the client. However, in the situation presented in this scenario, the attorney relied on the client's representation that the parties were in agreement regarding the division of property and their intent to enter into a marital settlement agreement. Accordingly, renegotiation of the flat fee is ethically permissible under the circumstances provided that the modified fee is fair, reasonable and not unconscionable. If the client refuses to renegotiate the fee, the attorney may seek to withdraw under Rule 1.16(b)(4) or (5). SB: See above comment and next comment. I don't believe the client is necessarily at a disadvantage unless Rule 1.16(b) authorizes withdrawal under these circumstances. SB: What subsection do you believe applies here? If the agreement specified that the flat fee was based on the negotiation of a settlement only and did not include trial, then subsection (5) may apply. Or perhaps subsection (4) could apply if the client misrepresented the facts. But, under the facts, it is not clear that lawyer would be permitted to withdraw if the client refuses to renegotiate.

Scenario Three: Over a ten-year period, client has filed tax returns for some years, but not every year. As a result, the Internal Revenue Service ("IRS") has commenced an audit and indicated that it may pursue criminal charges against the client. Client consults with attorney regarding the dispute with the IRS and potential criminal exposure. Attorney and client enter into a written fee agreement pursuant to which the attorney agrees to represent client in the tax dispute with the IRS for a flat fee of \$50,000. The full fee is paid in advance of attorney performing any services. The agreement does not include any milestones, but states that Attorney will prepare amended tax returns for the past 10 years, if needed, and represent the client in negotiations with the IRS regarding tax liability, penalties and collection, and in a criminal action if charges are filed. After commencing the representation, attorney advises client to not

file amended returns for the any of the prior tax years as doing so may not be in client's best interests. Attorney spends about 20 hours negotiating with the IRS, but has not reached an agreement regarding the client's tax liability. Client terminates Attorney's representation and demands a refund of the \$50,000 flat fee. Attorney claims that language "if needed" disclosed that amended returns may not be necessary. Attorney further claims that even though negotiations with the IRS were not successful as of the date of termination by the client, attorney has performed the services set forth in the fee agreement and is entitled to keep the entire flat fee.

Analysis of Scenario No. 3 The \$50,000 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 thereby obtained Client's agreement to deposit the fee into attorney's operating account. When Client terminates the representation, attorney has only partially performed one of the tasks because after the representation commenced Attorney advised Client that it may not be in Client's best interests to file amended returns. The more limited scope of services provided were the result of the attorney's post-retention judgment that filing amended returns may not be in the client's best interests. Attorney's decision is not based on any new information, but rather based on a more thorough analysis of the previously filed returns and the risks to the client associated with filing amended returns. The mere proviso "if needed," is not sufficient to disclose to the client the scope of the services the attorney would actually perform under the agreement to earn the \$50,000 flat fee. Rather, whether amended returns will be filed, and hence the scope of services attorney will actually provide, is left to the post-engagement decision of the attorney. [This needs a clearer conclusion about potential fee entitlement under these circumstances where certain tasks remain to be completed and others are unknown; given timing of termination, it is unclear if charges will be filed]SB: If it reasonable not to file amended returns and client agrees, then this provision does not appear problematic. Should we also discuss Rule 1.2 to decision on whether to file amended tax returns?

Scenario Four: Client consults with attorney for potential representation in connection with real property transaction. Attorney has been experiencing financial difficulties arising from a failed business investment unrelated to attorney's law practice. Attorney proposes to handle client's case for a flat fee of \$15,000. Attorney sends a proposed fee agreement which requires that client pay the full flat fee in advance of the attorney performing any of the services covered by the agreement. The fee agreement does not include any provision as to where the Advance payment of the flat fee would be deposited nor when any portion of the fee may be earned. In a cover letter, attorney states that client has the right to require that the flat fees be deposited into the attorney's trust account until the services have been completed, and that client is entitled to a refund of any amount of the fee that has not been earned if the representation is terminated before the services are completed, but states that attorney intends to deposit the flat fee into attorney's operating account unless otherwise instructed by client. Client signs and returns the flat fee agreement and pays the \$15,000 flat fee without responding to attorney's

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statement in the cover letter that the funds will be deposited into the operating account upon receipt.

Attorney spends ten hours meeting with the client and preparing a draft agreement for the transaction, but client has questions regarding some of the terms of the agreement. While attorney is discussing the proposed terms, attorney's financial difficulties get worse and results in the garnishment of attorney's operating account. Client becomes dissatisfied with attorney's representation, terminates attorney and demands that attorney refund the flat fee, but attorney states that the funds are no longer available because his operating account has been garnished and he does not have funds necessary to refund the portion of the flat fee.

Analysis of Scenario No. 4: Because the flat fee exceeded \$1,000, Attorney was required to disclose in a writing signed by Client that Client had the right to require that flat fee be deposited into Attorney's trust account until the fee was earned. (Rule 1.15(b)(2).) While Client signed and returned the fee agreement, the Rule 1.15(b) disclosure was in the separate cover letter, which Client did not sign or return. Attorney's failure to make written disclosure in a writing signed by Client that Client had the right to have the advance payment of the flat fee deposited into Attorney's trust account violated Rule 1.15(b)(2).

When Attorney entered into the fee agreement and deposited the advance payment of the flat fee in Attorney's operating account, Attorney was aware that her/his financial difficulties arising from the failed business investment unrelated to Attorney's law practice could result in creditors seeking to garnish or attach Attorney's bank accounts. ADD DISUCSSION WHETHER FAIURE TO DISCLOSE THIS RISK WAS BREACH OF FIDUCIARY DUTIES OR DUTY TO COMMUNICATE.

[It seems like the rest of this section is still in progress]

CONCLUSION

REDLINE

THE STATE BAR OF CALIFORNIA
STANDING COMMITTEE ON
PROFESSIONAL RESPONSIBILITY AND CONDUCT
FORMAL OPINION INTERIM NO. 20-0003
FLAT FEES AND TERMINATION

ISSUES: What are the ethical obligations of attorneys representing clients pursuant to a flat fee agreement where the representation is terminated before the legal services specified in the agreement have been completed or where the scope or complexity of the matter turns out to be greater than the attorney ~~the attorney~~ and client contemplated?

~~**DIGEST:**~~

DIGEST: An attorney may agree agreement to charge a flat fee for legal services and should clearly state what services are covered by the fee and when the fee or portion thereof is earned.

AUTHORITIES

INTERPRETED: Rules 1.5, 1.15, 1.16, Business & Professions Code §6148

INTRODUCTION AND SCOPE

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 of paying for legal services on an hourly basis. 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 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).)

~~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.~~

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 defense cases, immigration ~~matters~~documents, wills, trusts and estate planning, uncontested divorces, certain transactional matters such purchase agreements and other contracts formation of a business entity, 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, and 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.

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.

A. Treatment of Flat Fees before Adoption of the Current Rules of Professional Conduct

The California Rules of Professional Conduct in effect prior to November 1, 2018, did not ~~did not~~ specifically address flat fees or whether fees paid in advance of services being provided had to be deposited into a client trust account.¹ Flat fee agreements often stated that the fee paid in advance was fully earned when paid and that it was non-refundable. Those types of provisions frequently resulted in fee disputes where the lawyer was terminated or did not provide all of the services required under the agreement but then refused to refund any portion

¹ Prior to the adoption of the current Rules of Professional Conduct, courts in California were divided on whether fees paid in advance 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; T & R Foods, Inc. v. Rose (1996) 47 Cal.App.4th Supp. 1 [pursuant to 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 an attorney's general funds constituted a breach of fiduciary duties. ~~[Dena: trim some of the history]~~.. [

of the fee. (See, ~~e.g.~~ *In re Matter of Lais* (Rev. Dept. 1998) 3 Cal. State Bar Ct. Rptr. 907, 923 [provision in flat fee agreement that the fee was a “fixed, non-refundable retaining fee” was not a true retainer fee, and attorney’s failure to promptly refund any unearned part of the advanced fee promptly upon the termination of his services was a willful violation of Rule 3–700(D)(2) ~~)]~~; [Sarah: if this is frequent and common, can you add a citation to another case?] KB The comment was based on experience in mandatory fee arbitration cases which frequently involved flat fee agreements, mostly in the criminal context, which stated that the fee was fully earned in advance or non-refundable.

B. Impact of the Current Rules of Professional Conduct

The current Rules of Professional Conduct (effective November 1, 2018) address flat fees and non-refundable advance payments of fees in several ways. Rule 1.5(e) specifically provides that a lawyer may make an agreement for, charge, or collect a flat fee for specified legal services and the rule 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.” Rule 1.5(e) further provides that a flat fee “may be paid in whole or in part in advance of the lawyer providing those services.”

Rule 1.5(d) expressly states 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) 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.”

Rule 1.15(a) now makes it clear that an advance payment of fees must be deposited into a trust account.² However, Rule 1.15(b) provides an exception for flat fees which allows a flat fee paid in advance to be deposited into the lawyer’s or law firm’s operating account, instead of a client trust account, provided: “(1) the lawyer of 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.” Rule 1.15(b)(2) states that 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~~ must be set forth in a writing signed by the client.

² Comment [3] to Rule 1.15 states that “[p]aragraph (b) does not apply to advance payment of costs and expenses.” Case law under former Rule 4-100(A), and current Rule 1.15(a), require that advances for costs or expenses must be deposited into attorney’s trust account. (*Stevens v. State Bar* (1990) 51 Cal.3d 283, 286-287 [placing advance payment of costs in lawyer’s business account violated former rule].)

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. Comment [3] to Rule 1.15 states that the option to deposit a flat fee paid in advance into a lawyer or law firm's operating account does not alter the lawyer's obligation under paragraph (d) or the lawyer's burden to establish that the fee has been earned. Comment [3] to Rule 1.5 cites Rule 1.16(e)(2) and states that when the lawyer-client relationship terminates, the lawyer must refund the unearned portion of a fee. Accordingly, if a lawyer's services are terminated before the contracted services have been completed, or the lawyer otherwise fails to complete the services, the lawyer must refund any unearned portion of the fee irrespective of whether the advance flat fee has been deposited into the lawyer's operating account.

C.A. General rules 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.) Any ambiguity in a retainer agreement is construed in favor of the client and against the attorney. ~~;~~ Severson & Werson v. Bolinger (1991) 235 Cal.App.3d 1569, 1572 [fee agreement calling for regular hourly rates construed in client's favor to preclude increase in rates without notice to client]. JF CONSIDER DELETING OR MINIMIZING THIS PARAGRAPH AND TYING IT TO FLAT FEES. ; Bird, Marella, Boxer & Wolpert v. Superior Court (2003) 106 Cal.App.4th 419, 430-431.) JF1 JF: I AM IN FAVOR OF TRIMMING DOWN AND SIMPLIFYING THE BACKGROUND SECTIONS. HERE, FOR INSTANCE, THIS FIRST SENTENCE IS NON CONTROVERSIAL SO I THINK ONE CASE CITE SHOULD SUFFICE. (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. SB: While this sentence helps make the connection to flat fees, the prior sentence is duplicative of the opening paragraph of this section. I suggest shortening and combining with the opening paragraph. I have attempted to do so. ~~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).~~

~~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.)~~ JF2

~~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].)~~ JF3

A lawyer may not make “an agreement for, charge or collect an unconscionable or illegal fee.” (Rule of Professional Conduct 1.5(a). Rule 1.8.1 (Business Transactions with a Client) does not apply to the initial fee agreement unless the attorney also obtains a security or other pecuniary interest adverse to the client. Even if Rule 1.8.1 does not apply, all fee agreements are subject to scrutiny of the unconscionability factors set forth 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 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.

~~Business & Professions Code~~ Section 6148 sets forth the **minimum** requirements for non-contingent fee agreements. While ~~Business & Professions Code §~~[section 6148\(a\)\(2\)](#) only requires that the fee agreement state “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. 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. ~~—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.~~

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 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.~~ (JE4)

Like any attorney-client relationship, attorneys providing services under a flat fee agreement have duties 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 giving rise to concerns regarding the duties of diligence and competence.

A flat fee must 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.

A. Disclosure of the risks of depositing an advance payment of a flat fee into the lawyer's operating account.

Where a flat fee is paid in advance of the performance of legal services, the default rule is that the fee must be deposited into the lawyer or law firm's trust account until the fee is earned. (Rule 1.15(a).) However, Rule 1.15(b)(1) provides that a flat fee paid in advance may be deposited into the lawyer or law firm's operating account provided the lawyer or law firm disclose to the client in writing that the client has the right to have the flat fee deposited into a trust account until it 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 have not been completed.

Even though Rule 1.15(b) allows a flat fee paid in advance to be deposited into the lawyer's operating account if the Rule 1.15(b) written disclosures are provided to the client, the flat fee paid in advance is not earned until services have been provided, and hence remains the property of the client. However, implicit in the authorization to deposit a flat fee paid in advance into an operating account, is that the lawyer may spend that money even though some or all of the fee may be subject to refund if the representation is terminated or the agreed-upon services have not been completed.

Rule 1.15(b) is silent as to whether a lawyer or law firm is required to disclose potential adverse consequences. JF: CAN WE PROVIDE AN EXAMPLE OF AN ADVERSE CONSEQUENCE FOR CONTEXT? KB: Those are discussed in the prior paragraph

~~if the flat fee is not deposited into a trust account until the fee is earned.~~
~~Depositing~~However, depositing a flat fee into an operating account presents reasonably foreseeable adverse consequences to the client where the money is spent by the lawyer but a refund is required because an operating account lack the safeguards provided by trust accounts,

including the protections in Rule 1.15(d). For example, a reasonably foreseeable material risk where a flat fee paid in advance is deposited into the attorney's operating account is that the attorney may not have the funds available if a refund of an unearned flat fee is required. Another risk of the flat fee being deposited into the lawyer's operating account is that the funds could be subject to attachment by the lawyer's creditors.

~~Rule 1.15(b) is silent as to whether a lawyer or law firm is required to disclose other potential adverse consequences, if the flat fee is not deposited into a trust account until the fee is earned.~~ While Rule 1.15(b) does not use the term consent, implicit in the requirement that the client sign the disclosure for a flat fee in excess of \$1,000 is that the client thereby consents to the funds being deposited into the lawyer's operating account. However, in the absence of disclosure of the potential consequences of a flat fee paid in advance being deposited into the lawyer or law firm's operating account a client may not understand the risks associated with having the advance fee being treated as the property of the attorney by it being placed in the operating account.

Courts in other jurisdictions have held that consent to deposit an advanced payment of a flat fee into the law firm's operating account either must be informed consent or clearly explain the potential risks to the client. The court in *In re Mance* (D.C. 2009) 980 A.2d 1196, 1207, applying the District of Columbia Rules of Professional Conduct, imposed an "informed consent" standard where the flat fee will be deposited into the attorney's operating account. The court in *Mance*, held that a flat fee must be held in the lawyer's trust account until earned unless the client gives informed consent to a different arrangement. The court stated that a bare mention of a trust account option will usually be insufficient unless accompanied by some explanation of the features that distinguish a trust account from an operating account. In reaching that conclusion, the court quoted from a Colorado case, *In re Sather* (Colo, 2000) 3 P.3d 403, 413-414. The court in *Sather* stated that while in some instances a client may agree to allow the attorney to treat funds paid in advance of legal services as property of the attorney, ~~they cautioned that~~ "at a minimum such arrangement will be construed against the attorney and in favor of the client." The court further stated that "the fee agreement must clearly explain the basis for this arrangement and explain how the clients' rights are protected by the arrangement."

B. When is a flat fee earned?

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.) The current rules make it explicit that with the sole exception of a true retainer, all attorney's fees paid in advance 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 of 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

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on November 1, 2018, that a flat fee is nonrefundable or fully earned on receipt violates Rule 1.5(d) and may constitute deceit or an intentional misrepresentation under Rule of Professional Conduct 8.4(c).

While the current rules are clear that a flat fee paid in advance is not earned on receipt, the rules do not provide guidance as to when a flat fee, or portion thereof, is earned or how to calculate the amount of an unearned fee which must be refunded ~~is~~if the lawyer's services are terminated or otherwise not completed. However, 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)~~(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.

Comment [2] to rule 1.15 states: "Subject to rule 1.5, a lawyer or law firm may enter into an agreement that defines when or how an advance fee is earned and may be withdrawn from the client trust account." ~~That~~This comment suggests that a lawyer and client may agree to a method for determining when a flat fee is earned and what portion of an unearned fee must be refunded if services in the flat fee ~~services~~agreement are not completed before the termination of the lawyer's services. However, any such provision in a fee agreement must not be unconscionable under Rule 1.5 ~~employment~~ and should be proportionate to the reasonable value of the lawyer's services.

Business & Professions Code §6148 should also be considered in connection with a provision in a fee agreement which defines when or how an advance fee is earned and may be withdrawn from the client trust account. Section 6148(a)(1) requires that the fee agreement state the "basis of compensation including, but not limited to, hourly rates, statutory fees or flat fees, and other standard rates, fees, and charges applicable to the case." Section 6148(b) applies to bills and requires that "bills rendered by an attorney to a client shall clearly state the basis

thereof. Bills for the fee portion of the bill shall include the amount, rate, basis for calculation, or other method of determination of the attorney's fees and costs.” When applied to a flat fee agreement which provides that the fee will be paid in advance of services being rendered, with the exception of a flat fee for a single specific service, Business & Professions Code §6148(a) and (b) may require that the fee agreement set forth when the fee is earned.

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.³ 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 is 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.

C. Ethical concerns regarding renegotiation of a flat fee agreement during the course of the representation.

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 a lawyer must comply with Rule 1.8.1 before negotiating a modification of a fee agreement with an existing client. Whether former Rule 3-300, or current Rule 1.8.1, applies to the renegotiation of a fee agreement during the course of the representation in general, and a flat fee agreement in particular, has not specifically been addressed in prior California State Bar ethics opinions. In 2008, the Committee on

³ 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.

Professional Responsibility and Conduct issued a proposed Formal Opinion regarding the ethical ramifications associated with modification of an attorney fee agreement (Proposed Formal Opinion Interim No. 05-0001). The Committee concluded that Rule 3-300 does not apply to a modification of a fee agreement unless the agreement confers on the attorney an ownership, security, possessory or other pecuniary interest adverse to the client. The Committee concluded that while Rule 3-300 did not per se apply to a modification of a fee agreement after the attorney-client relationship has commenced, any modification is subject to close scrutiny and must be fair, reasonable and fully explained to the client. However, the Board of Trustee's Committee on Regulations, Admissions and Discipline did not approve the proposed opinion. ~~However~~ Nevertheless, where the lawyer obtains a pecuniary interest adverse to the client as a result of the renegotiation, the lawyer must comply with Rule 1.8.1.⁴

~~The issue was addressed by~~ Texas State Bar in Opinion No. 679 (2018). ~~The question presented in that ethics opinion was~~ addressed 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 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. The Committee concluded that ~~it's~~ its version of the rule regarding business transactions with a client did not apply to renegotiating a flat fee agreement, but noted that general principle that all transactions between a client and lawyer should be fair and reasonable to the client so the modification must still be on terms that are fair and reasonable to the client.

The ~~issue was also address by the~~ Utah State Bar Ethics Advisory Committee, in Opinion No. 20-01. ~~The issue, similarly~~ addressed ~~in that opinion is~~ whether a lawyer may permissibly renegotiate the terms of a flat fee agreement if, after commencing the representation, the circumstances, scope or complexity of the matter becomes materially different and greater from what the lawyer unilaterally contemplated at the commencement of the representation. The Utah Committee concluded that ~~the fact after commencing the representation, the circumstances, scope or complexity of the matter becomes materially different and greater from~~

⁴ Rule 1.8.1 provides that a lawyer shall not enter into a business transaction with a client, or knowingly acquire an ownership, possessory, security or other pecuniary interest adverse to the client unless the terms are fair and reasonable to the client and fully disclosed to the client in writing and in a manner that should reasonably have been understood by the client, the client is advised in writing to seek the advice of an independent lawyer of the client's choice, and the client provides informed written consent to the terms of the transaction.

~~what the lawyer contemplated that the time of commencement of the representation does not permit a renegotiation of the fee agreement~~renegotiation of the fee agreement was not permitted under these circumstances, unless the lawyer complied with Rule 1.8(a) of the Utah Rules of Professional Conduct.⁵ However, the Committee stated that its opinion would be different if the scope of the engagement was enlarged by the client, or was not reasonably foreseeable or contemplated by the lawyer and the client as included in the original scope of work contemplated when the parties entered into the original fee agreement. The Committee also noted that ~~their~~its opinion would be altered where the client misrepresented the facts or issues or there was a mutual mistake of fact.

~~Whether former Rule 3-300, or current Rule 1.8.1, applies to the renegotiation of a fee agreement during the course of the representation in general, and a flat fee agreement in particular, has not specifically been addressed in prior California State Bar ethics opinions. In 2008, the Committee on Professional Responsibility and Conduct issued a proposed Formal Opinion regarding the ethical ramifications associate with modification of an attorney fee agreement (Proposed Formal Opinion Interim No. 05-0001). The Committee concluded that Rule 3-300 does not apply to a modification of a fee agreement unless the agreement confers on the attorney an ownership, security, possessory or other pecuniary interest adverse to the client. The Committee concluded that while Rule 3-300 did not per se apply to a modification of a fee agreement after the attorney-client relationship has commenced, any modification is subject to close scrutiny and must be fair, reasonable and fully explained to the client. However, the Board of Trustee's Committee on Regulations, Admissions and Discipline did not approve the proposed opinion.~~

Unlike hourly or contingent fee agreements, a flat fee agreement contemplates full payment for all of the specified services regardless of the amount of the work ultimately performed. As a result, a mid-stream renegotiation of a flat fee agreement which requires that the client pay more than the terms of the original agreement presents different considerations. In most cases, the attorney will be in the better position to estimate the time required to perform services under a flat fee agreement when the parties are negotiating the terms of the original agreement. If the attorney underestimates the amount of time necessary to perform the specified services and seeks to modify the fee, the client may not want to change representation ~~feel~~and feel compelled to agree to the higher fee^[SB9] and is therefore at a disadvantage in negotiating with their attorney.

~~IV. POTENTIAL HYPOTHETICALS~~

If the modification is the result of the attorney underestimating the amount of work required to perform the agreed upon services, a mid-stream modification may not be fair or reasonable as the attorney as the attorney was in the position to have had the experience and sophistication to evaluate and set the flat fee before entering into the agreement. If, however,

⁵ Utah Rule 1.8(a) is substantively the same as California Rule 1.8.1, which governs business transactions with a client and pecuniary interests adverse to a client.

the client has misrepresented the facts and the scope of the engagement is greater than anticipated when the attorney set the flat fee, then a mis-stream modification may be fair and reasonable to the client. Similarly, where a situation enlarging the services necessary to perform the agreed services was not foreseeable by both the lawyer and the client, a mis-stream modification may be fair and reasonable to the client.

If the client does not agree renegotiate the fee the attorney may seek to withdraw from the representation under Rule 1.16(b). [I believe we need more of an analysis and conclusion here]

IV. FACTUAL SCENARIOS AND ANALYSIS OF EACH

Scenario One: Attorney and client enter into a written fee agreement pursuant to which the attorney agrees to represent client in a criminal case involving an alleged robbery for a flat fee of \$25,000. The full flat fee is paid in advance and is deemed in the fee agreement as earned on receipt and states that no portion of the fee will be refunded. The fee agreement does not specify the scope of services, other than the general statement that Attorney will represent client in the criminal case. After the arraignment and preliminary hearing, client is dissatisfied with Attorney's services and terminates the representation. Client requests a refund of the flat fee, but attorney declines to refund any portion of the fee because the fee agreement states that was fully earned on receipt and that no portion of the fee will be refunded.

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). The provision that the \$25,000 flat fee is deemed earned upon receipt and is not refundable violates Rule 1.5(d) and is not enforceable.

Because the client has the right to terminate the attorney and attorney has not performed all the legal services specified in the agreement, the client is entitled to a refund of the portion of the fee that has not been earned. As the fee agreement did not include any milestones or other provisions regarding 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 a quantum meruit analysis and attorney will have the burden of proof as to the reasonableness of the fee.

Scenario Two: Client consults attorney for representation in a marital dissolution action. Client represents that the parties are in agreement regarding their divorce and the division of property. Attorney agrees to handle the case through execution of a marital settlement agreement for a flat fee of \$10,000. Other than the provision regarding execution of a marital settlement agreement, the fee agreement does not include milestones for when any portion of the fee is earned. After commencing the representation and obtaining financial disclosures, the

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attorney discovers that the parties do not agree regarding the division of marital property and that the case will likely have to go to trial. Attorney wants to renegotiate the flat fee to more fairly cover the likely time and expense of a trial regarding disputed property issues, but client refuses.

Analysis of Scenario No. 2: Similar to contingent fee agreements, a flat fee agreement involves a certain amount of risk by both parties. There is risk to the lawyer that time required may exceed what the lawyer might have earned under an agreement to bill hourly for the lawyer's services. There is risk to the client that the client may end up paying more than the client would have paid under an hourly fee agreement if the lawyer is able to complete the representation for less time than anticipated when the parties entered into the agreement. Renegotiation to increase the amount of the fee for the services specified in the agreement because the attorney underestimated the amount of time necessary to perform the specified services raises ethical concerns and should be subject to close scrutiny as the client ~~as the client~~ may not want to change representation if the attorney withdraws during the representation and is therefore at a disadvantage in negotiating with their attorney. [SB10] Additionally, in most cases the attorney will have been in the better position to estimate the time required to perform services under a flat fee agreement when the parties are negotiating the terms of the original agreement, and renegotiating the terms of the agreement after the representation has commenced may be an undue burden for the client. However, in the situation presented in this scenario, the attorney relied on the client's representation that the parties were in agreement regarding the division of property and their intent to enter into a marital settlement agreement. Accordingly, renegotiation of the flat fee is ethically permissible under the circumstances provided that the modified fee is fair, reasonable and not unconscionable. If the client refuses to renegotiate the fee, the attorney may seek to withdraw under Rule 1.16(b)-(4) or (5). [SB11]

Scenario Three: Over a ten-year period, client has filed tax returns for some ~~year~~ years, but not every year. As a result, the Internal Revenue Service ("IRS") has commenced an audit ~~any~~ and indicated that it may pursue criminal charges against the client. Client consults with attorney regarding the ~~disputed~~ dispute with the ~~Internal Revenue Service~~ IRS and potential criminal exposure. Attorney and client enter into a written fee agreement pursuant to which the attorney agrees to represent client in the tax dispute with the ~~Internal Revenue Service~~ IRS for a flat fee of \$50,000. The full fee is paid in advance of attorney performing any services. The agreement does not include any milestones, but states that Attorney will prepare amended tax returns for the past 10 years, if needed, and represent the client in negotiations with the IRS regarding tax liability, penalties and collection, and in a criminal action if charges are filed. After commencing the representation, attorney advises client to not file amended returns for the any of the prior tax years as doing so may not be in client's best interests. Attorney spends about 20 hours negotiating with the IRS, but has not reached an agreement regarding the client's tax liability. Client terminates Attorney's representation and demands a refund of the \$50,000 flat fee. Attorney claims that language "if needed" disclosed that amended returns may not be necessary. Attorney further claims that even though negotiations with the IRS were not successful as of the date of termination by the client, attorney has performed the services set forth in the fee agreement and is entitled to keep the entire flat fee.

Analysis of Scenario No. 3 The \$50,000 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 thereby obtained Client's agreement to deposit the fee into attorney's operating account. When Client terminates the representation, attorney has only partially performed one of the tasks because after the representation commenced Attorney advised Client that it may not be in Client's best interests to file amended returns. The more limited scope of services provided were the result of the attorney's post-retention judgment that filing amended returns may not be in the client's best interests. Attorney's decision is not based on any new information, but rather based on a more thorough analysis of the previously filed returns and the risks to the client associated with filing amended returns. The mere proviso "if needed," is not sufficient to disclose to the client ~~that~~the scope of the services the attorney would actually perform under the agreement to earn the \$50,000 flat fee. Rather, whether amended returns will be filed, and hence the scope of services attorney will actually provide, is left ~~entirely~~ to the post-engagement decision of the attorney. ~~[SB12]~~ [This needs a clearer conclusion about potential fee entitlement under these circumstances where certain tasks remain to be completed and others are unknown; given timing of termination, it is unclear if charges will be filed]

Scenario Four: Client consults with attorney for potential representation in connection with real property transaction. Attorney has been experiencing financial difficulties arising from a failed business investment unrelated to attorney's law practice. Attorney proposes to handle client's case for a flat fee of \$15,000. Attorney sends a proposed fee agreement which requires that client pay the full flat fee in advance of the attorney performing any of the services covered by the agreement. The fee agreement does not include any provision as to where the Advance payment of the flat fee would be deposited nor when any portion of the fee may be earned. In a cover letter, attorney states that client has the right to require that the flat fees be deposited into the attorney's trust account until the services have been completed, and that client is entitled to a refund of any amount of the fee that has not been earned if the representation is terminated before the services are completed, but states that attorney intends to deposit the flat fee into attorney's operating account unless otherwise instructed by client. Client signs and returns the flat fee agreement and pays the \$15,000 flat fee without responding to attorney's statement in the cover letter that the funds will be deposited into the operating account upon receipt.

Attorney spends ten hours meeting with the client and preparing a draft agreement for the transaction, but client has questions regarding some of the terms of the agreement. While attorney is discussing the proposed terms, attorney's financial difficulties get worse and results in the garnishment of attorney's operating account. Client becomes dissatisfied with attorney's representation, terminates attorney and demands that attorney refund the flat fee, but attorney states that the funds are no longer available because his operating account has been garnished and he does not have funds necessary to refund the portion of the flat fee.

Analysis of Scenario No. 4: ~~Attorney's cover letter to the client complies with the disclosure requirements of Rule 1.15(b)(1). However, because~~ Because the flat fee ~~is~~

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528 ~~over~~exceeded \$1,000, ~~client's agreement to deposit the flat fee~~Attorney was required to disclose
529 in ~~attorney's operating~~a writing signed by Client that Client had the right to require that flat fee
530 be deposited into Attorney's trust account ~~must be in writing~~until the fee was earned. (Rule
531 1.15(b)(2).) While ~~client~~Client signed and returned the fee agreement, the Rule 1.15(b)
532 disclosure was in the separate cover letter, which ~~client~~Client did not sign or return, ~~and~~.
533 Attorney's failure to make written disclosure in a writing signed by Client that Client had the fee
534 agreement did not include any provision as to whereright to have the advance payment of the
535 flat fee ~~would be~~ deposited ~~or when any portion of the fee may be earned~~into Attorney's trust
536 account violated Rule 1.15(b)(2).

537 When Attorney entered into the fee agreement and deposited the advance payment of
538 the flat fee in Attorney's operating account, Attorney was aware that her/his financial difficulties
539 arising from the failed business investment unrelated to Attorney's law practice could result in
540 creditors seeking to garnish or attach Attorney's bank accounts. ADD DISUCSSION WHETHER
541 FAIURE TO DISCLOSE THIS RISK WAS BREACH OF FIDUCIARY DUTIES OR DUTY TO COMMUNICATE.

542
543 [It seems like the rest of this section is still in progress]

CONCLUSION