

# ISBA Legal Ethics Committee Opinion No. 3 of 2015

## *Depositing flat fees into the trust account*

This formal opinion is disseminated in accordance with the charge of the Indiana State Bar Association's Standing Committee on Legal Ethics (the "Committee") and is advisory in nature. It is intended to guide the membership of the ISBA and does not have the force of law.

### **Issue**

The Committee has been asked whether a lawyer may deposit a "flat fee" into the lawyer's trust account and about the circumstances under which all or part of the flat fee may be removed from the lawyer's trust account and placed in the lawyer's operating account.

### **Brief answer**

The answer to these questions turns on the nature of the fee agreement between the lawyer and client, particularly the terms under which the "flat fee" is received. As a general proposition, the Committee concludes that a lawyer may not deposit into trust any portion of a fee that the lawyer has fully earned and which therefore is no longer the property of the client. Conversely, any fee not earned by a lawyer must be placed in trust. So, a "flat fee" that is not treated as fully earned on receipt must be placed in the lawyer's trust account. Conversely, when the arrangement between the lawyer and the client is that the fee is treated as "earned on receipt," and subject to refund only if the agreed services are not provided, it becomes property of the lawyer and must be deposited into the lawyer's operating account. The corollary to these rules is that lawyers should clearly define the terms upon which they accept a fee from a client so that there is no ambiguity about who owns what portion of funds paid to the lawyer by the client at any given point in the representation.<sup>1</sup>

### **Analysis**

The term "flat fee" refers to a fee paid for the completion of specific legal services to be performed regardless of how much time and effort the lawyer must expend in completing the services. See *Matter of Kendall*, 804 N.E.2d 1152, 1154 (2004); *Matter of Stanton*, 504 N.E.2d 1 (1987). As discussed in greater detail below, such a fee is different in structure from a "general retainer," which is for the purpose of ensuring the lawyer's availability, or an "advance fee," which is a payment made at the beginning of the representation, against which charges are credited as services are performed, on an hourly or other basis. See *Matter of O'Farrell*, 942 N.E.2d 799, 803 (2011).

The relationship between lawyer and client is fundamentally consensual, existing only after both attorney and client have agreed to the formation of the relationship. *Hacker v. Holland*, 570 N.E. 2d 951, 955 (1991). The relationship is generally determined by principles of contract and agency. *Brown v. St. Joseph County*, 148 F.R.D. 246, 250 (N.D. Ind. 1993). The scope of the attorney's representation of the client as well as the basis or rate of the fee must be communicated to the client before or within a reasonable time after commencing the representation unless the client is regularly represented by the lawyer on the same basis or rate. Ind. R. Prof. Cond. 1.5(b). Simply put, the client must consent to the lawyer's representation of the client and the terms of the representation, including the basis of the lawyer's fee. Flat fees implicate a variety of Rules of Professional Conduct, including rules affecting how the fee must be handled when received by the lawyer.

## A. Rule 1.15

Guidance on how a lawyer must handle flat fees begins with Ind. R. Prof. Cond. 1.15. While entitled “Safekeeping Property,” the Supreme Court has described Rule 1.15 as the “anti-comingling rule.” *Matter of Radford*, 698 N.E.2d 310, 313 (Ind. 1998). In relevant part, the Rule states:

(a) A lawyer shall hold property of clients or third persons that [is] in a lawyer’s possession in connection with a representation separate from the lawyer’s own property. Funds shall be kept in a separate account maintained in the state where the lawyer’s office is situated or elsewhere with the consent of the client or third person. Other property shall be identified as such and appropriately safeguarded. Complete records of such account funds and other property shall be kept by the lawyer and shall be preserved for a period of five years after termination of the representation.

...

(c) A lawyer shall deposit into a client trust account legal fees and expenses that have been paid in advance, to be withdrawn by the lawyer only as fees are earned or expenses incurred.

This rule requires that fees that a lawyer has earned (and any other funds belonging to the lawyer) must be segregated from client funds and that clients’ funds be placed in the lawyer’s trust account. *Matter of Kendall*, *supra*, 804 N.E.2d at 1155 (citing *In re McCarty*, 729 N.E.2d 98, 99 (Ind. 2000)); *see also Matter of Knobel*, 699 N.E.2d 1142 (1998) (lawyer violated Ind. R. Prof. Cond. 1.15(a) by failing to hold all client funds, including advance payment of costs and fees, separate from his own). When and if the funds in the trust account are earned by the lawyer, they must be transferred from the trust account to the lawyer’s control. *In re Quinn*, 738 N.E.2d 678, 681 (2000) (lawyer found to have violated Rule 1.15(a) by failing to promptly withdraw his fee from trust account).

## B. The duty to segregate fees

Without specifically overturning *Stanton*, the *Kendall* Court held that “Prof. Cond. R. 1.15(a) generally requires the segregation of advance payments of attorney fees.” *Kendall* at 1158 (emphasis added). As applied to the facts in *Kendall* where the fees were intended to be applied to future services on an hourly basis, the Court held that “except in the case of flat fees governed by *Stanton*,” which are fees designed to compensate the lawyer for services regardless of length or complexity, “a lawyer’s failure to place advance payments of attorney fees in a separate account violates this rule [1.15].” *Id.* at 1156, 1158. So, it seems clear that *Kendall* holds that any fee not fully earned needs to be placed in a trust account, but that flat fees may be treated as fully earned on receipt and deposited into the lawyer’s operating account if the lawyer and client agree to such an arrangement. *In re Quinn*, *supra* at 681, shows that any part of a fee that has been earned needs to be promptly withdrawn from the trust account.

## C. The importance of the fee agreement

The mandate of segregating fees a lawyer owns from client-owned funds places a premium on the language in the lawyer’s fee agreement. Regardless of the label a lawyer may attach to a fee, such as a “flat fee” or “retainer,” it is the substance of the agreement with the client that determines the nature of the fee. *Matter of O’Farrell*, at 803, 805. It seems incumbent upon the lawyer to clearly spell out when and how a fee is earned. *See generally* Ind. R. Prof. Cond. 1.5(b). While Rule 1.5 does not require a written fee agreement except in the case of a contingency fee, Ind. R. Prof. Cond. 1.5(c), prudence ordinarily indicates that the fee agreement should be in writing.

The Indiana Supreme Court has plainly stated that a flat fee is not refundable except for failure to perform the agreed legal services. *Matter of Kendall*, *supra* at 1162. The language needed for a flat-fee agreement does not need to be complex, as was illustrated in *In re Canada*, 986 N.E.2d 254 (2013). In that case the respondent charged a flat fee for representation of a criminal defendant to the conclusion of the case, with a written fee agreement stating that the fee was nonrefundable “unless there is a failure to perform the agreed legal services.” *Id.* at 254. The fee was paid when the client’s cash bond was released to the attorney after a plea agreement was negotiated. *Id.* The Court found no infirmity with the fee agreement and specifically noted that “the agreement properly advised Client that a refund was possible in the event of a failure to perform the agreed legal services.” *Id.* (citing *Kendall*, *supra* at 1160).<sup>2</sup>

But lawyers do not have carte blanche to enter into fee agreements allowing them to deposit all forms of prepaid fees into their operating accounts simply by describing them as “nonrefundable.” In *Matter of O’Farrell*, the Indiana Supreme Court disciplined a lawyer for using a fee agreement that contained a nonrefundable fee provision. The fee agreement before the Court provided that the fee would be applied against either the lawyer’s flat fee or the lawyer’s hourly rate charges and that no part of the fee would be refunded even if the agreed upon services were not completed by the lawyer. *Id.* at 805-807.

These facts produced the following holding by the Court:

The presence of this contract provision, even if unenforceable, could chill the right of a client to terminate Respondent’s services, believing the Law Firm would be entitled to keep the entire flat fee regardless of how much or how little work was done and the client would have to pay another attorney to finish the task. We conclude that Respondent violated Rule 1.5(a) by including an improper nonrefundability provision in her flat-fee agreements.

*Id.* at 806.

Evidently the infirmity in the fee agreement examined in *Matter of O’Farrell* was the absence of the caveat that saved the fee agreement in *In re Canada* – language alerting the client to the fact that a refund would be owed if the lawyer failed to perform the legal services as agreed.

In the course of its opinion in *O’Farrell*, the Court described three common fee arrangements:

(1) A “flat fee” is a fixed charge for a particular representation, often paid in full at the beginning of the representation; (2) an “advance fee” is a payment made at the beginning of a representation against which charges for the representation are credited as they accrue, usually on an hourly basis; and (3) a “general retainer” is payment for an attorney’s availability, which is earned in full when paid before any work is done.

*Id.*

“[A]dvance fees ... [are] to be earned in the future at an agreed rate ...” whereas fixed or “flat” fees are “advance fees that are agreed to cover specific legal services regardless of length or complexity.” *Matter of Kendall*, 804 N.E.2d 1152, 1154 (2004). It is noteworthy that the pivotal question in determining the character of a fee is whether a fee is accepted in return for a commitment to fulfill a defined set of obligations, irrespective of their ease or difficulty, as opposed to security for payment for services of an indeterminate amount and value.

## D. The duty to refund unearned fees

Turning to the treatment of flat fees specifically, it is necessary to look at *Matter of Stanton*, 504 N.E.2d 1 (1987). In *Stanton*, the lawyer charged flat fees in advance of work in a criminal case in which the Disciplinary Commission charged the lawyer with failing to deposit the funds in his trust account. *Id.* The Court rejected the Commission's argument, stating "[t]he above noted segregation of funds and accounting requirements are not applicable to attorney fees charged in advance for the performance of legal services." *Id.* Though the *Stanton* Court held that flat fees could be deposited in the lawyer's operating account, it also held "that upon termination of the professional relationship, unearned fees paid in advance must be returned," pursuant to Ind. R. Prof. Cond. 1.16. *Kendall*, 804 N.E.2d at 1155 (citing *Stanton*, 504 N.E.2d at 1).

There are many reasons why a lawyer may innocently fail to provide all of the services envisioned by a flat-fee agreement. An unexpected conflict of interest, an illness, a change of law, a family problem, or other circumstances can abruptly interfere with a lawyer's ability to complete an assignment. The fact that a lawyer may be fully entitled to a flat fee upon receipt does not abrogate the lawyer's separate duty to refund a part of that fee if the lawyer cannot fulfill his contract with the client. *See Stanton, supra* at 1.<sup>3</sup>

If the lawyer and client choose to incorporate a true flat-fee arrangement into the engagement, both the lawyer and the client need to understand that Rule 1.16 has engrafted onto this arrangement an ethical duty on the part of the lawyer to refund any part of the flat fee that the lawyer owns but is subsequently unable to fully earn. And Rule 1.5 requires that the lawyer make clear that a flat fee may not be regarded as nonrefundable. *O'Farrell, supra* at 806. This remains the case even though the refund of a flat fee that was treated as the lawyer's property on receipt would necessarily come from the lawyer's own funds.

## E. The importance of client consent

After reviewing cases from other jurisdictions, the Court in *Kendall* noted that a "majority of decisions" hold that client consent is a condition to the lawyer's right to deposit a flat fee into the lawyer's operating account. 804 N.E.2d at 1157-58. The Committee interprets this rule as requiring client consent to a flat-fee arrangement subject to Rule 1.15's anti-comingling requirements. While *Stanton* and *Kendall* stop short of holding that client consent is a requirement, the Committee rejects any suggestion that a lawyer is entitled to unilaterally determine the character of funds received from a client. The Committee believes that whenever a lawyer agrees to accept money from a client the lawyer and the client need to consent to the terms under which control over the money passes to the lawyer. If the payment is made pursuant to the creation of an attorney-client relationship, it is incumbent upon a lawyer to clearly define the financial terms of the lawyer's engagement so that the client understands (a) when funds paid to the lawyer will be considered fully earned by the lawyer, and (b) whether circumstances could create a duty on the lawyer's part to refund a portion of the fee. When this process gives rise to a payment that is considered the lawyer's property upon receipt, as in *Stanton*, the payment must be placed in the lawyer's operating account. Any payment not received as a flat fee that is treated as earned upon receipt must be placed in trust. Inevitably this process requires consent by both the lawyer and the client.

## Conclusions

As discussed above, the Committee has reached the following conclusions:

(a) A flat fee, paid in exchange for a commitment by the lawyer to perform a specific task or set of tasks, may not be deposited into a lawyer's client trust account if the client and lawyer have agreed that, upon receipt, it would become the property of the lawyer. Conversely, if an agreement for a flat fee provides that the lawyer has not earned the fee until the work is completed, any advance payment of the fee must be deposited in the lawyer's trust account and may not be withdrawn until earned.

(b) A lawyer must have a clear agreement with a client as to the ownership of fees received by the lawyer so that the fees can be properly allocated between the lawyer's trust account and operating account.

(c) A client must be notified that even a true flat fee that is treated as earned on receipt and deposited to the lawyer's operating account might result in a refund if the agreed-upon legal services are not completed by the lawyer.

1. The opinion of the Committee on this question is limited to the handling of money received by the lawyer as fees and does not apply to money received by the lawyer for advance payment of expenses, or reimbursement of expenses, to which different considerations apply. See *In re Thomas*, 30 N.E.3d 704, 709 (Ind. 2015) (client advance payments for expenses must be deposited into trust account and withdrawn only as the expenses are incurred).

2. The Court separately considered whether the lawyer improperly failed to refund part of the fee in light of the fact that the client discharged the lawyer in favor of another lawyer before the conclusion of the case. Noting that the lawyer spent considerable time on the case and negotiated a plea agreement, which the client initially viewed with favor, the Court found insufficient evidence to support the Disciplinary Commission's argument that the lawyer had not fully earned his fee. *Canada, supra* at 255.

3. If agreed work is not completed, the lawyer may also have duties to refund a portion of the fee or pay damages as a matter of contract law. This opinion does not address the contractual duties of the parties in such a situation.