

Nonrefundable Fees

The Substance, Not the Label, Matters

Grace M. Giesel

Occasionally, when I am dealing with the issue of nonrefundable fees in the law school course of Professional Responsibility, a student will tell me that a certain fee in a certain case is not refundable because the attorney told the client that the fee was nonrefundable. The issue of whether a fee paid to an attorney is refundable is a bit more complex than simply looking to the attorney's label. A client is not barred from recovering a part of a legal fee just because an attorney identifies it as nonrefundable to a client. Rather, the substantive nature of the client's payment determines whether the client's payment is refundable. Even so, many clients may be misled by the label used by attorneys and may not realize that they are entitled to recover at least some of the so-called nonrefundable fee.

Much of the confusion in this area results from a very loose use of the terms nonrefundable and retainer. Attorneys refer to payments as nonrefundable when the payments are, ultimately, refundable. Some practitioners who wrongly identify a fee as nonrefundable are, perhaps, bad actors who are intentionally trying to mislead clients. I speculate that most practitioners who wrongly identify a fee as nonrefundable simply do not understand the law of fees.

A Typical Case

A recent case decided by the Texas Court of Appeals highlights the problem. In *Cluck v. Commission for Lawyer Discipline*,¹ the Court affirmed a finding that the attorney engaged in professional misconduct. The attorney's divorce client signed a contract for legal services which stated: "In consideration of the legal services rendered on my behalf in the above matter I agree to pay [the attorney] a non-refundable retainer in the amount of \$15,000..." The agreement continued, "Lawyer fees are to be billed at \$150 per hour, first against non-refundable fee and then monthly thereafter. Additional non-refundable retainers as requested." Later in the agreement is the statement, "no part of the legal fee is to be refunded" "should the case be discontinued, or settled in any other matter [sic]."²

The client paid the \$15,000 fee but then requested that the attorney stop working on the matter after a little over a week passed. When the client wanted the attorney to re-



sume work, the attorney asked the client to sign another document amending the agreement to require another \$5,000 as a "non-refundable fee" and recognizing the attorney's hourly rate as \$200. The client signed and paid yet again. The attorney deposited the \$20,000 in his office operating account, not a client trust account. Two months after the initial engagement agreement, the client again requested that the attorney stop working on the matter. Later, the client requested a return of the \$20,000 less a reasonable fee for the work done by the attorney. The attorney refused any refund.³

The Texas Court of Appeals found that the \$20,000 was not a "true retainer" because it was not a fee charged to compensate the attorney for a lost opportunity of other employment.⁴ In addition, the fee was refundable because it was, in effect, an advance fee payment. As the Texas court stated, "A fee is not earned simply because it is designated as non-refundable."⁵ Finally, because the fee was not a "true retainer" but was an advance fee, the fee did not belong to the attorney until it was earned by the attorney working the hours and performing the tasks. Thus, the \$20,000 fee should have been deposited in the client trust account, not in the attorney's office operating account.⁶

Client's Right to Have Counsel of Choice

Most jurisdictions are very skeptical of any claim that a fee is not refundable because of the concern that clients, after paying an initial, nonrefundable fee, will feel overwhelming economic pressure to not discharge that attorney even if the client has lost confidence in the attorney. The concern is that the fee arrangement infringes on the client's right to an attorney of the client's choice. As a New York court stated in the case of *In re Cooperman*,⁷ nonrefundable fee agreements "diminish the core of the fiduciary relationship by substantially altering and economically chilling the client's unbridled prerogative to walk away from the lawyer."⁸ The *Cooperman* court held nonrefundable fee agreements unenforceable because such agreements contradict this important public policy.

Advances on Fees are Refundable if Not Earned

Any fee, regardless of label, that is really an advance on fees is refundable to the extent that the attorney has not yet done the acts or spent the time to earn the fees. Sometimes these arrangements are called special retainers. For example, suppose that an engagement arrangement provides, as does the arrangement in *Cluck*, that the client must pay as a nonrefundable fee an amount at the beginning of the relationship



and that the hours the attorney works on the matter will be charged against the initial sum. The reality of the situation is that the initial nonrefundable fee is the property of the client until the attorney works for the client, bills the client for the work done and the client does not object to the billing. The initial payment is the property of the client, and the attorney must deposit it in the client trust account until the attorney earns it. Once the attorney earns the fee, the attorney can, and should, transfer the earned portion of the initial fee to the attorney's own account. Rule 1.15(a) of the Kentucky Rules of Professional Conduct (Kentucky Supreme Court Rule 3.130 (1.15(a))), requires an attorney to keep property of clients separate from the attorney's property.⁹

If the client discharges the attorney before the attorney has charged enough time against the initial payment to deplete it entirely, then the client has the right to a return of the unused portion of the initial nonrefundable fee. Rule 1.16(d) of the Kentucky Rules of Professional Conduct (Kentucky Supreme Court Rule 3.130 (1.16(d))), requires the return. Rule 1.16(d) states:

Upon termination of representation, a lawyer shall take steps to the extent reasonably practicable to protect a client's interests, such as giving reasonable notice to the client, allowing time for employment of other counsel, surrendering papers and property to which the client is entitled and refunding any advance payment of fee that has not been earned.¹⁰

The same is true for any amount the client pays at the commencement of the engagement that is designated to be used for the expenses of the representation. If the client discharges the attorney before the entire initial amount paid is spent in handling the representation, the attorney must return the unspent portion to the client.

Flat Fees

Attorneys may charge flat fees for representations. Is a fee nonrefundable if the attorney requires payment of the flat fee at the beginning of the representation? Most courts do not find such arrangements *per se* unethical. Yet, a court may view the arrangement as another form of the advance fee situation. If an attorney charges a \$10,000 flat fee for a matter, payable at the start of the representation, and if the client terminates that representation short of completion of the matter, a court might reasonably find that the attorney has not earned the entire fee. The attorney would be required to return the unearned portion of the fee.

Lost Opportunity Cost Fees

There is a type of initial fee payment that, at least theoretically, may be nonrefundable in many jurisdictions, including Kentucky. This is the sort of initial fee the Texas Court of Appeals in *Cluck* referred to as a "true retainer."¹¹ Other courts and commentators might label this initial payment a general retainer. This initial payment is actually a fee paid to the attorney to ensure that the attorney is available to do the client's work. To the extent that the payment is intended by the parties to compensate the lawyer for the lost opportunity cost of the conflict created and the other representations the attorney can no longer handle, it is a fee earned by the attorney when paid and thus the attorney

need not refund it. Often these arrangements provide that the attorney will be available to do the client's work over a certain period of time if any need for representation should arise. If the need should arise, the attorney bills the client for the work done as an additional amount. For example, a bank might pay an attorney a fee to ensure that the attorney is available and will have no conflicts if the bank needs the representation of the attorney in regulatory matters. Some argue that the attorney earns this sort of fee when the client pays it. But if the attorney does not do as promised and does not stand ready for the entire contracted time, a court could conclude that even this payment is partially refundable.

When evaluating an attorney's claim that the initial fee is nonrefundable because it is a payment for lost opportunity cost, courts often apply a high level of scrutiny. For example, in *Cluck*, the Texas Court of Appeals concluded that the payment was not a payment for lost opportunity because the engagement agreement did not specify lost opportunity as the reason for the payment. In addition, since the attorney in *Cluck* was already retained at the time of the second "non-refundable" fee, there was no additional lost opportunity.¹²

In the case of *Columbus Bar Association v. Halliburton-Cohen*,¹³ the attorney required a divorce client to pay \$1,500, as stated in the engagement agreement, "for the lost opportunity cost to the attorney for her immediate and permanent inability to represent any other party in the case."¹⁴ The Ohio Supreme Court found that the attorney suffered no lost opportunity and thus the attorney did not earn the fee and should have returned it.¹⁵

All Fees Must Be Reasonable

A general constraint on any fee is the requirement in Rule 1.5(a) of the Kentucky Rules of Professional Conduct 1.5(a) (Kentucky Supreme Court Rule 3.130 (1.5(a))), that any fee charged must be reasonable, not excessive. This constraint applies to the initial payment for lost opportunity cost as it would to any other fee. So a fee may be generally nonrefundable but may be unethical because it is not reasonable.

Written Agreements Required in Kentucky

Kentucky Bar Association Ethics Opinion E-380 (1995) clarifies that in Kentucky non-refundable fees are not *per se* unethical. The Opinion cautions, however, that the fee must be reasonable in amount, the arrangement must be "fully explained to the client, orally, and in a written fee agreement," and the dollar amount of the fee must be stated.¹⁶

Nonrefundable fees have not been well received by the Kentucky discipline authorities. In *Kentucky Bar Association v. Adair*,¹⁷ the Kentucky Supreme Court permanently disbarred an attorney for many reasons, one of which was a repeated pattern of charging nonrefundable fees in divorce matters and not having the arrangements in writing even after being suspended for earlier identical conduct. In *Clendenin v. Kentucky Bar Association*,¹⁸ an attorney claimed that fees were nonrefundable. The court disciplined the attorney because the fee arrangement was not in writing and so could not be nonrefundable. In addition, the attorney violated Rule 1.15(a) of the Kentucky Rules of Professional Conduct (Kentucky Supreme Court Rule 3.130 (1.15(a))), because he did not deposit the fee in a client trust account. The attorney violated Rule 1.16(d) of the Kentucky Rules of Professional Conduct (Kentucky Supreme Court Rule 3.130 (1.16(d))), because he did not return the unearned fee, property of the client, to the client at the end of the representation.

The Duty of Honesty

Many jurisdictions, including Kentucky, allow an attorney to refer to a fee as nonrefundable. Many of these fees are ultimately determined to be refundable in whole or part. In labeling the fee as nonrefundable, attorneys should take heed of the general duty in Rule 8.3(c) of the Kentucky Rules of Professional Conduct (Kentucky Supreme Court Rule 3.130 (8.3(c))), not to "engage in conduct involving dishonesty, fraud, deceit or misrepresentation." To the extent that the labeling of the fee is dishonest or deceitful, this rule is implicated.

Conclusion

A few principles are clear. Regardless of the label on a fee, a fee that is compensation for lost opportunity cost may be nonrefundable because a court or discipline body may view it as a fee earned by the attorney when the client pays it. A fee that is in substance an advance of fees or costs is a refundable fee because it is not earned by the attorney when the client pays it. This fee only becomes nonrefundable when the attorney earns it. Any fee that an attorney labels nonrefundable in Kentucky must be explained to the client in writing. Always, a fee must be a reasonable fee. Any fee that is not yet earned by the attorney belongs to the client and must be kept separate from the attorney's property. The

usual method of separation is to deposit the fee in a client trust account. Such a fee is the property of the client until the attorney earns it. The attorney must return the fee if the client discharges the attorney before the attorney earns it. Finally, attorneys must be mindful of not engaging in dishonest or deceitful conduct in the labeling of fees as nonrefundable.

Grace M. Giesel is a James R. Merritt Professor and Distinguished Teaching Professor, at the University of Louisville Brandeis School of Law. ■

End Notes

¹ 2007 WL 135955 (Tex. Ct. App. 2007).

² *Id.* at *1.

³ *Id.*

⁴ *Id.* at *3-4.

⁵ *Id.* at *3 (quoting Tex. Comm. On Professional Ethics, Op. 431, 49 Tex. B.J. 1084 (1986)).

⁶ *Id.* at *4.

⁷ 633 N.E.2d 1069 (N.Y. 1994).

⁸ *Id.* at 1072.

⁹ See Kentucky Supreme Court Rule 3.130 (1.15(a)), which states:

A lawyer shall hold property of clients or third persons that is in a lawyer's possession in connection with a representation separate from a 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. The separate account referred to in the preceding sentence shall be maintained in a bank which has agreed to notify the Kentucky Bar Association in the event that any overdraft occurs in the account. 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.

¹⁰ Kentucky Supreme Court Rule 3.130 (1.16(d)).

¹¹ *Id.* at *4.

¹² *Id.* at *3.

¹³ 832 N.E.2d 42 (Ohio 2005).

¹⁴ *Id.* at 43.

¹⁵ *Id.* at 43-44.

¹⁶ Kentucky Bar Association Ethics Opinion E-380 (1995 (emphasis in original), accessible at www.kybar.org/documents/ethics_opinions/kba_e-380.pdf).

¹⁷ 203 S.W.3d 144 (Ky. 2006).

¹⁸ 114 S.W.3d 858 (Ky. 2003).



William C. "Bill" Boone

Mediator

40 years of trial experience involving plaintiffs and defendants in civil cases

105 S. Sherrin Avenue • Louisville, KY 40207

Phone: (502) 896-2301
Fax: (502) 893-8706