

Ethics Watch

Flat Fees: What Are They and What to Do With Them?

By Nathan M. Crystal

The S.C. Supreme Court's recent decision in a disciplinary case, *In re Halford*, #26924 (April 11, 2011), has caused concern in the profession about proper handling of "flat fees." In its original opinion the Court had indicated that flat fees must be deposited in the lawyer's trust account. After a petition filed by the South Carolina Association of Ethics Counsel, the Court reconsidered the original opinion. In the revised opinion the Court stated in a footnote:

Respondent stipulates that the deposit of "flat fees" into his operating account was a violation of the Rules of Professional Conduct. We accept the stipulation here for purposes of honoring the Agreement for Discipline by Consent. The handling of "flat fees" is a complex matter, and we do not intend in this opinion to set forth a categorical rule addressing "flat fees."

So the Court has eased but not eliminated the bar's concern about the handling of flat fees. This article addresses the issue. While I express specific views in the article, lawyers should understand, as the Court has said, that the issue of flat fees (and indeed, many fee issues) is complex and has not yet been addressed by the courts of this state.

What are "flat fees"?

A flat fee is a fixed payment for specified legal services. The flat fee, unlike the hourly fee, does not change based on the amount of time devoted to the matter. Flat fees can be advantageous to clients because they know the exact amount they will have to pay for legal services; the client does not receive a bill that is larger than he anticipated and can budget for payment of the fixed fee.

Flat fees can also be advantageous to lawyers because they give lawyers an incentive to perform services efficiently in either or both of two ways—by trying to resolve the matter as quickly as possible (subject to ethical restraints) and by delegating work to a subordinate lawyer in the firm with the lowest hourly rate who can competently perform the services.

On the other hand, flat fees can be disadvantageous to either lawyers or clients. From the perspective of the lawyer, the flat fee is risky because the lawyer may devote much more time to the matter than the lawyer anticipated, with the result that the lawyer receives payment at an effective hourly rate much lower than the lawyer normally charges. But, flat fees can also be disadvantageous to clients if the lawyer is able to resolve the matter with the expenditure of very little time. In this case the client might feel that the fee was unreasonable because the effective hourly rate for the work done becomes high. Of course, no one knows in advance how much work the case will require, so the flat fee can and should be viewed as a reasonable allocation of risk between lawyer and client. If the amount of time devoted to the matter turns out to be greater or less than anticipated, neither lawyer nor client should have a basis for complaint, at least in the normal situation involving reasonably sophisticated clients.

In addition, it is possible to craft modified flat fee arrangements that reduce the risks described above. For example, the fee agreement could provide for a flat fee of a specified amount, but if the amount of the fee based on the lawyer's time exceeds a certain amount (let's say 20 percent more than the amount of the flat fee), then the lawyer may charge the client for the time above

this amount at a reduced hourly rate. This hybrid flat fee arrangement reduces the risk to both lawyer and client from a pure flat fee agreement.

Flat fees can also be flexible with regard to the services performed. In the standard flat fee agreement in litigation, the lawyer agrees to handle the client's entire case (usually excluding appeals) for a fee of X dollars. However, the parties could agree to flat fee payments for various stages of the matter rather than the entire case. For example, the agreement could provide that the client agrees to pay a flat fee of V dollars for the lawyer's initial evaluation of the case and decision to undertake representation, W dollars for handling the discovery aspects of the case, X dollars for representation in any alternative dispute proceedings, Y dollars for preparing the case for trial, and Z dollars for trial of the case and any post-trial motions.

Flat fees should be distinguished from special and general retainers. A special retainer (sometimes called an advanced fee or security retainer) is a payment by the client in advance for services to be rendered by the lawyer. Flat fees, like special retainers, are usually paid in advance, but advance payment is not part of the definition of a flat fee; a lawyer could agree to charge the client a flat fee payable in stages or at the conclusion of the case. However, there is a crucial difference between the two forms of fees. The lawyer cannot contractually charge the client more than the flat fee for the services rendered (unless the lawyer and client have entered into a type of hybrid fee agreement discussed above); with the special retainer, however, the lawyer is entitled to charge the client for the services rendered at the lawyer's normal hourly rate. The fees are deducted from the

special retainer, but the lawyer can charge the client for any deficiency.

A general retainer, like the special retainer, is paid in advance. However, the essence of the general retainer is that the client is paying the lawyer for availability to provide services rather than for the services rendered; the fees for the services are charged separately and in addition to the general retainer. For example, a large corporation that engages in a substantial number of acquisitions might pay a firm that specializes in that type of work a monthly general retainer to be available to handle the client's matters when they arise. When a specific acquisition occurs, the client pays the firm for its services in addition to the general retainer. The general retainer usually contemplates an ongoing professional relationship. A lawyer could also charge a client an engagement retainer, which is a flat fee for undertaking representation in a matter. This fee is similar to a general retainer because it assures the lawyer's availability to handle a particular matter, but it is different from the general retainer in that it does not contemplate an ongoing relationship beyond the particular case.

The label that a lawyer attaches to a fee will not be determinative of how the fee should be classified. For example, a lawyer cannot transform a fee payment into a general retainer simply by attaching that label to the fee. A court will examine the nature of the agreement to determine if it is truly a general retainer. In *In re O'Farrell*, 942 N.E.2d 799 (Ind. 2011), the Indiana Supreme Court publicly reprimanded a lawyer for charging a nonrefundable engagement fee. The court rejected the lawyer's argument that the fee could be justified as a general retainer. The lawyer was unable to show any special circumstances warranting the use of a general retainer in a particular case; instead, the lawyer used the fee arrangement routinely. In essence, the court held that labels do not control. To be a general retainer there must be special circumstances warranting a payment to a lawyer for the lawyer's availability. Typically, these circum-

stances will involve either special expertise by the lawyer or special needs or desires of the client for that particular lawyer or both.

Where should flat fees be deposited?

To the extent that a flat fee represents payment for work to be performed, in my opinion it has not yet been earned and should therefore be deposited in the lawyer's trust account (unless the fee is specified to be nonrefundable, a point discussed below). This is my opinion, however; there is no case law in South Carolina on this issue, and I understand that the practice of many lawyers is to deposit flat fees in their operating account. For example, if the lawyer agrees to charge the client a flat fee of \$100,000 for handling the client's divorce through trial, then this fee should, in my opinion, be deposited in the trust account. Unless the agreement provided for withdrawal of a portion of the fee at various stages, the amount should be retained in trust until the completion of the case, when the lawyer should (and in fact must) withdraw the fee from trust. Of course, lawyers are ill-advised to have this type of fee arrangement with their clients because it means they will not be paid until the end of the case. Instead, the fee agreement should provide that the lawyer is entitled to withdraw portions of the flat fee on the completion of various stages of the case. An alternative withdrawal method would allow the lawyer to withdraw portions of the flat fee monthly based on the time devoted to the case each month and the lawyer's normal hourly rate; at the conclusion of the case the lawyer would withdraw the balance of the flat fee, if any. The lawyer could not charge the client any amount above the flat fee.

If the flat fee agreement with the client includes an engagement retainer, the lawyer may withdraw this amount when the client and lawyer have executed the engagement agreement. At that moment the engagement portion of the flat fee is earned.

What if the agreement provides that the fee is "nonrefundable"?

The fact that the lawyer designates the fee, regardless of type, to be nonrefundable is irrelevant with regard to whether the fee can be examined for reasonableness. Any fee arrangement may be reviewed by the South Carolina Resolution of Fee Disputes Board or by a court to determine whether it is unreasonable and to order repayment of the excess amount. Indeed, the South Carolina Rules of Professional Conduct specifically recognize the principle that "nonrefundable" fees are not truly nonrefundable. Rule 1.16(d) provides that on conclusion of a matter "The lawyer may retain a reasonable nonrefundable retainer" (emphasis added). See Robert M. Wilcox & Nathan M. Crystal, ANNOTATED SOUTH CAROLINA RULES OF PROFESSIONAL CONDUCT 65 (2010) (annotation on Nonrefundable Fees).

This analysis of reasonableness is independent of whether the fee is held in trust or has already been paid to the lawyer. If the lawyer completed a case and has withdrawn the entire flat fee from trust, the client could later challenge the reasonableness of the fee in an appropriate proceeding, and a court could order the lawyer to repay a portion of the fee.

However, the designation of the fee as nonrefundable is significant with regard to where the fee is to be deposited. Comment 4 to Rule 1.5 states:

The lawyer may deposit the nonrefundable fee immediately into the law firm's operating account. However, if, at the end of the representation, it would be unreasonable for the lawyer to retain the entire fee, the lawyer must then refund that portion of the fee that is unreasonable. See Rule 1.16(d) (emphasis added).

What is the effect of S.C. Code §40-5-390?

Code §40-5-390 provides "In any criminal case, an attorney may charge a nonrefundable flat fee." The S.C. Supreme Court has the constitutional and statutory author-

ity to regulate the practice of law— S.C. Const. Art. V, §4; S.C. Code §40-5-10—and could declare unconstitutional legislation that invades this authority. See *In re Richland County Magistrate's Court*, 389 S.C. 408, 699 S.E.2d 161 (2010). Of course, a court should attempt to interpret legislation to make it constitutional if at all possible. See *Stokes v. Denmark Emergency Medical Services*, 315 S.C. 263, 433 S.E.2d 850 (1993). Moreover, the statute is not that different from the Rules of Professional Conduct, which allow a lawyer to charge a reasonable nonrefundable fee. SCRPC 1.16(d). The Court could interpret the statute to mean that a criminal defense lawyer may charge such a fee, but the Court retains the power to determine whether the fee was reasonable and to order the lawyer to repay any amount that it finds to be unreasonable.

The statute does not state where the fee is to be deposited, whether in the trust account or the lawyer's operating account. In accordance with comment 4 to

Rule 1.5, quoted above, the lawyer is authorized to deposit the fee in the operating account.

The fact that both the Rules of Professional Conduct and statutory law allow nonrefundable flat fees to be deposited in the lawyer's operating account creates risks to clients. I was recently asked about an unfortunate situation in which a client paid a nonrefundable fee to a defense lawyer, who had deposited the funds in his general account. The lawyer died before the services were rendered, and there were no assets to repay the client. As this situation illustrates, if a nonrefundable fee is not deposited in a trust account, the client is at risk. Perhaps the client can obtain relief from the Lawyers' Fund for Client Protection, but the fund does not provide protection unless the lawyer engaged in "dishonest conduct." In my opinion allowing flat fees to be placed in the lawyer's operating account is bad policy; instead, the fee should be deposited in the trust account until the fee is earned. As discussed above, the lawyer's engagement agreement can

provide for payment out of trust as the lawyer completes various stages of the case so a lawyer may ethically receive a substantial portion of a flat fee before the end of the case.

What to do? Make your engagement agreement as clear as possible.

Given the lack of judicial guidance regarding the issues discussed in this article, lawyers must carefully draft their engagement agreements. In particular, if a lawyer wishes to be able to deposit a flat fee in the lawyer's operating account, the lawyer should clearly state that the fee is nonrefundable. If a lawyer decides to have an ordinary flat fee that is not stated to be nonrefundable, the lawyer should deposit it in trust and should provide in the engagement agreement for withdrawal on the happening of specified events in the litigation.

The author thanks Desa Ballard for her helpful comments on this article. The views expressed in this column are those of the author.

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