

Advance Fee Retainers: Should We Change The Rules?

BY SARAH DIANE McSHEA

It has long been the rule in New York that lawyers are not required to place advance fee payments in their escrow accounts but may, instead, deposit them in their general funds. In 1985, the New York State Bar Association's Committee on Professional Ethics confirmed that lawyers are not required to deposit advance fee payments in escrow. The Committee said that advances paid to the lawyer are not "funds of a client." Of course, lawyer and client may agree that an advance fee payment will be deposited in the lawyer's escrow account, but this is not required by New York law. See, NYSBA Ethics Opinion 570. (Obviously, if an advance fee payment is escrowed, the funds will have to be treated in the same manner as other trust funds and the escrow record-keeping and account maintenance rules will apply.) Notably, the Committee held that advance fees are not client funds, even though a portion of these fees may be refundable if the lawyer does not earn the full amount.

[Editor's note: For a full discussion of DR 9-102, the Rule requiring a lawyer to deposit client funds in a special account, see A PRIMER ON TRUST ACCOUNTS, NYPRR April, 2001, p. 1.]

In 1989, Professor Lester Brickman, a member of the Committee which issued Opinion 570, wrote a scathing critique of the Opinion, which he characterized as the "minority view." ("The Advance Fee Payment Dilemma: Should Payments Be Deposited to the Client Trust Account or to the General Office Account?" 10 *Cardozo Law Review* 647 (1989)). Professor Brickman cited approximately 17 ethics opinions of city and state bar associations in other jurisdictions (some in the same jurisdiction) for the proposition that the "majority" of disciplinary jurisdictions require that advance fee payments be held in escrow. While his conclusions have been widely touted by recent supporters of a change in the New York rule, there has been no comprehensive survey of the 51 disciplinary jurisdictions and it is not at all clear that the New York rule is, in fact, the "minority" rule.

Repaying Unearned Balance

One argument against the New York rule is that lawyers may spend the retainer before they have completed their services to the client and may be unable to refund the unearned balance. Problems may also arise if a lawyer is discharged or withdraws before the retainer is fully earned. DR 2-110(a) (3)[22 N.Y.C.R.R. § 1200.15(a)(3)] requires a lawyer who withdraws from a representation to "refund promptly any part of a fee paid in advance that has not been earned." The obligation to refund is arguably the same when a client prematurely discharges a lawyer. Opponents of the New York rule argue that because some lawyers may be unable to make prompt refund of unearned retainers, all lawyers should be required to escrow advance retainers and withdraw their fees only after a bill has been rendered.

The issue is not simply an academic one. Many commentators continue to suggest that the New York Code of Professional Responsibility be amended to require attorneys to hold advance fee payments in

trust until earned. I believe that this change in the New York rules would be inadvisable and, in some cases, disastrous for client and lawyer alike.

NYSBA Ethics Opinion 570 has served for many years as clear and largely uncontroversial guidance for the New York Bar. At least one other ethics committee has held that lawyers are not required to escrow advance fee payments. See, Bar Association of Nassau County, Committee on Professional Ethics, Opinion 88-28 (1988). ("A lawyer who receives a retainer fee to be credited against hourly charges may deposit the fee in a business account and need not put the money in an escrow or attorney trust account.") In the absence of any compelling evidence that the present rule fails to protect the public, we should question the wisdom of such a significant change in the established custom and practice of the New York Bar.

The modern practice of law is fraught with difficulties, even for the most sophisticated practitioner. The ethics codes are frequently revised; new rules are announced in unlikely places; and significant changes arrive unheralded (e.g., the extension of disciplinary liability to law firms). The unfortunate result is that many otherwise ethical practitioners face potentially serious disciplinary action for conduct that was entirely proper the month before. The proposed change in the Code to require the deposit of advance fees in a trust account would mean that a lawyer who failed to escrow an advance retainer, or who removed an earned fee before a bill was rendered, would face disbarment for conversion of client funds. This risk might occur even if the lawyer had fully earned the advance retainer and was credit-worthy throughout the representation.

Clients Also Benefit From Existing Rule

Those who would require lawyers to hold advance fees in escrow until earned assume that only the lawyer benefits from the deposit of advances. In fact, their assumption is flatly wrong. In a wide range of representations, it may work to the client's benefit to permit the lawyer to deposit the advance into her general account.

The risks faced by both lawyer and client in requiring all advance fees to be deposited in escrow are exemplified by *SEC v. Credit Bancorp, Ltd.*, 109 F.Supp. 142 (S.D.N.Y. 2000). In that case, Baker & McKenzie was retained by Credit Bancorp to perform certain legal services. The firm deposited the initial \$100,000 advance retainer into its trust account and rendered one bill, which was paid from the trust account. It then received two additional \$100,000 payments, which it also deposited into its trust account. Due to a "clerical error," no further bills were rendered until the eve of an asset-freeze order in the pending action by the SEC. The firm issued an invoice just hours before the freeze order was entered, but it failed to withdraw the funds from its trust account. Judge Sweet held that because the funds were in the trust account, they were client property and, therefore, subject to the freeze order. This despite the fact that the firm had rendered more than \$300,000 in legal services, had clearly earned the money, and had rendered a bill for all its services. The firm became a general creditor, along with the client's other creditors.

Similarly, in *SEC v. Princeton Economic Int'l Ltd.*, 84 F.Supp.2d 443 (S.D.N.Y. 2000), the court held that "any funds that were still held in the client trust accounts 'at the hour of the signing of the freeze order' were still owned by the client company, rather than by the law firms, and therefore were subject to the freeze order." (Cited in *SEC v. Credit Bancorp Ltd.*, supra.) In the *Princeton Economic* case, even advance fees

deposited into the lawyers' operating accounts ultimately had to be turned over to the receiver appointed by the court. In directing three law firms to forfeit the advance fees paid by the defendant in related criminal and civil cases, Judge Owen concluded that the firms "knew or should have known that the monies received from alleged corporate malactors to pay the [defendant's] lawyers could be subject to forfeiture."

Proponents of a new advance fee escrow rule would require lawyers to remove funds from escrow only after they render a "reasonably detailed" bill to the client for services actually rendered. In a typical criminal defense representation, these requirements could prove devastating to the client.

Advantage To Clients In Criminal Proceedings

Many clients under criminal investigation or prosecution enter into flat fee or staged fee arrangements with counsel. These flat fees are usually paid in advance to the lawyer. The new proposal would require the lawyer to deposit the fees in an escrow account and then render a "reasonably detailed" bill to the client before withdrawing any portion of the advance payment. Retainer agreements and bills for legal services rendered are not protected by the attorney-client privilege. The lawyer's bills would therefore be subject to subpoena by the prosecutor, and their disclosure would, in most cases, be detrimental to the client's interests. Even when the client does not dispute the fees and has no argument with the lawyer, the bills may still be subpoenaed if there is an ongoing grand jury investigation — and, of course, there always is one.

Moreover, until billed and withdrawn from the lawyer's trust account, any advance fee payments in a criminal representation would be subject to asset-freeze or forfeiture orders. (As we saw in *SEC v. Princeton Economic Int'l Ltd.*, *supra*, even fees that are deposited into a lawyer's operating account and are fully earned may be subject to forfeiture.) The risk to clients is that the ability to retain counsel may be severely hampered if payment of legal fees remains uncertain throughout the representation. It is not unusual for clients to have ample funds at the beginning of a criminal investigation, but to become "financially challenged" as the investigation and prosecution drag on. Payment of a significant advance retainer to the lawyer, covering representation through the investigation and even trial, will in most cases enable the client to secure the services of counsel of choice. Many talented (and already busy) lawyers may be reluctant to assume responsibility for a matter if payment of fees is not assured by means of an advance retainer.

Similar issues frequently arise in bankruptcy matters. In *In re D.L.I.C.*, 120 B.R. 348 (Bankr.S.D.N.Y. 1990), Judge Schwartzberg held that if an advance fee remained the property of the debtor-client, it would be considered property of the debtor's estate. On the other hand, if the advance fee payment belonged to the lawyer, the debtor's estate would have no claim to it. Determination of ownership of the advance fee turned on state law. Citing State Bar Opinion 570, the court held that a New York lawyer may properly deposit advance fee payments in his general account and is not required to hold them in escrow until earned. If the money is in the lawyer's general account, "the client retains no interest in the retainer and it does not become the property of the [debtor's] estate." An advance fee payment does not remain the property of the debtor-client simply because the lawyer might, at some future time, be required to return a portion of that retainer.

In 1994, *Matter of Cooperman*, 83 N.Y.2d 465, 611 N.Y.S.2d 465 (1994), invalidated retainer agreements providing for non-refundable retainer fees. Some critics have argued that the reasoning of *Cooperman* would require lawyers to deposit advance fee payments in escrow, but this notion finds little support in the case law. In the seven years since *Cooperman* was decided, no New York court has held, even in *dicta*, that advance fee payments should or must be held in escrow. Indeed, such a dramatic change in New York law and practice would probably wreak havoc on the bar and have dire and unforeseen consequences for many clients.

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