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Handling Flat Fees Under California's New Ethics Rules

When California adopted new Rules of Professional Conduct effective November 1, 2018, it recognized a trend in legal services billing – flat fees. Flat fees are becoming more common as an alternative to the traditional billable hour, and as they rise in popularity outside of criminal law, where they have been common for a long time, the rules address them directly.

To understand how to handle billing arrangements if you charge flat fees, it is helpful to understand how the rules fit together.

Prior Rules

Before the new Rules, the Rules of Professional Conduct did not address flat fees directly. Rule 4-100 required that when a client entrusted the lawyer with funds not yet earned by the lawyer, even if they were earmarked for legal fees, those funds had to be held in trust.

The simple way to avoid having to hold flat fees in trust was to simply state in your fee agreement that the flat fee was earned upon receipt. With that, the flat fee was placed in the lawyer's operating account. In fact, many flat fee lawyers had no trust account at all.

In the event that representation was terminated before conclusion of the matter for which the client had paid the flat fee, the lawyer would be hard-pressed to enforce the "earned upon receipt" language. Even though that language sufficed to put the funds in the lawyer's operating account, lawyers still had to grapple with Rule 4-200 which prohibits the charging of an unconscionable fee. In other words, if pressed, the lawyer who could not prove that he had actually provided services to the client to earn that flat fee would find himself refunding at least a portion. (Rule 4-200(b)(1) provides that one factor to consider in determining whether a fee is unconscionable is the "amount of the fee in proportion to the value of services provided".)

This always-present possibility of a later refund is one reason why a best practice for flat fee lawyers is still to track time and activities performed on behalf of a client. But, the possibility of later having to refund fees did not mean that lawyers with "earned upon receipt" language in their fee agreements had to put the fees in a trust account.

New Rules

The new Rules of Professional Conduct take the existing obligations and add a couple of twists.

First, they keep the principle that if the lawyer does not complete the representation (for whatever reason), the fee may be partially refundable. The rules make this explicit in Rule 1.15(b). While some may view this as a change, it really is just a blatant statement of a fact that was always true, however more subtly stated. Rule 1.15(b) deals with the handling of the actual fee, which is discussed below, but as far as refunds are concerned, it clearly states that a flat fee is subject to refund if the fee is not earned or the services are not completed.

Second, the new rules highlight that most lawyers are going to need a trust account, even if it ultimately is rarely used. This is because we can no longer simply state that the fee is earned upon receipt and put the funds in our operating accounts. Instead, the default rule under Rule 1.15(a) is that all fees paid in advance (which include flat fees) must be placed into trust until earned.

There are ways to avoid placing the funds in trust, meaning that it is very possible that flat fee lawyers will use a trust account only occasionally. The funds may be placed in operating if the following disclosures are made to the client – (a) the client has a right to require the fee be placed in trust until earned, and (b) if representation is terminated before the services are fully rendered, the client is entitled to a refund of the unearned portion. These disclosures must be in writing. And, if the fee exceeds \$1,000, the client must sign off on these provisions and to the deposit of the fee into the operating account.

As to the potential refund, the lawyer and client are permitted by the comments to the rules to agree on when the fee is earned and may be withdrawn from trust. This is in comment 2 to Rule 1.15, which states in part, “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.” (Rule 1.5 discusses unconscionable fees, true retainers, flat fees (that they are generally allowed), and other details of specific types of fee arrangements.)

How to Handle Flat Fees Under the New Rules

It is critical that lawyers utilizing the flat fee model recognize that the new rules largely embrace flat fees, and the changes in how they are handled are a function of bringing flat fees into the light and more clearly under the umbrella of regulation. The rules are not discouraging flat fees.

There need to be some specific changes to flat fee lawyer fee agreements and practices in order to make sure they are in compliance with the new rules.

Any lawyer charging a flat fee should open a trust account if they do not already have one. It is pretty simple. Go to a bank approved by the State bar to hold IOLTAs. There is a list [here \(https://tinyurl.com/ycoj5m5k\)](https://tinyurl.com/ycoj5m5k). Take this [State Bar form \(https://tinyurl.com/yce96luf\)](https://tinyurl.com/yce96luf) with you. When you have the account open, visit your State Bar profile on the State Bar website. Click on "Report my IOLTA status" to notify the Bar you have the account. Once you have it open, you always have a place to deposit flat fees.

Fee agreements need to be revised to include the disclosures required in Rule 1.15(b). Remember that it can be a one-way notice from attorney to client if the fee is \$1,000 or less; the client must sign if the fee exceeds \$1,000. A best practice is to always have the client sign regardless of the amount.

Flat fee lawyers also need to figure out when and how they will earn their fee. This may be a bit confusing for lawyers who have been operating on the "earned upon receipt" model. Unless they have been challenged for a fee refund either by a disgruntled client directly or through fee arbitration or other proceeding, many flat fee lawyers have not attempted to parse out when they earn their fee. Now is the time.

Possibilities for when you earn the fee include that it is earned in stages throughout the matter, particularly in practice areas with clearly defined steps; that it is earned mostly on the front end, since most matters require a lot of work to get up to speed; that it is earned on a blended hourly rate; or even that it is not earned at all until the very end. Consider Rule 1.5's provisions, particularly that a fee cannot be unconscionable, when determining the answer to this question.

This step is important even if you get the client's consent to putting the entire flat fee in operating. You may never need to apply the details of when the fee is earned. If you get the client's consent to put the fee in operating and there is never a dispute over the fee or termination of representation, then the way your fee is handled will look no different than under the old rules. But in the event that you do need to defend your fee or refund a portion, it is far better to have these details worked out ahead of time. And, to avoid conflict with clients and possibly the Bar, include in the fee agreement details on when the fee is earned (and can be withdrawn, if consent to place it in operating is not obtained).

Finally, make sure that anyone assisting in billing and preparing fee agreements is up to speed on these new details. It is useful to actually read the rules, the standards, and the comments to them. Then you and anyone assisting you will have a greater understanding of exactly how they fit together and translate into practice.