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"Advance Payment Retainers: Whose Property? What Account?"
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An advance payment retainer is a sum provided by the client to cover payment of legal fees expected to be earned during the course of a client representation; to the extent the legal fees advanced are not earned during the representation, the lawyer agrees to return them to the client. But to whom does an advance payment retainer belong: the lawyer or the client? To what account should the funds be deposited: the lawyer's or law firm's operating account or the client trust account?

How the lawyer or law firm that receives the retainer treats it may vary from one lawyer or law firm to another. The New York Rules of Professional Conduct (the Rules) do not mandate what the lawyer should do with the funds although there are ethics opinions providing guidance. Regardless, some attorneys consider the funds to be the client's property (until the fees are earned) that should be deposited in the client trust account. Other attorneys view the advance payment as their own and place the funds in their operating account, not to be commingled with any client funds. And still other attorneys decide to open a separate sub-account in the client's name to avoid any confusion or issues should the client change his mind about the engagement soon after making the retainer payment. While none of these options are per se unethical, some present greater benefits to the lawyer or client, and all present ethical duties that the attorney and law firm should be aware of.

Client's or Lawyer's Funds?

What Were Drafters Thinking? N.Y. State Bar Opinion 570 (1985) noted that the drafters of the Code of Professional Responsibility[1] did not consider advance payments of fees to be client funds necessitating their deposit in a trust account. The opinion observed that "Normally, when one pays in advance for services to be rendered or property to be delivered, ownership of the funds passes upon payment, absent an express agreement that the payment be held in trust or escrow, and notwithstanding the payee's obligation to perform or to refund the payment. The lawyers who drafted the Code should not lightly be assumed to have overlooked these fundamental principles in choosing the language of DR 9-102(A)."[2]

Rules Are Not Explicit. The Rules dealing with legal fees (Rule 1.5), holding funds as a fiduciary (Rule 1.15), and withdrawal from representation (Rule 1.16) do not specifically refer to advance fee retainers. Rule 1.5(d) prohibits a lawyer from entering into an arrangement to charge or collect a nonrefundable retainer fee. Rule 1.15 governs "funds…belonging to another person." Rule 1.16(e) mentions advance fee payments and imposes a complementary obligation by requiring a lawyer who withdraws from representing a client to "refund promptly any part of a fee paid in advance that has not been earned." However, that provision does not identify from

which account the funds should be returned. Thus, the Rules are not explicit; the Rules do not require that the advance payment retainer be placed in the client trust account, but the Rules also do not prohibit the attorney and client from agreeing to treat the fee advances as client funds for deposit into the client trust account until the fees are earned through services rendered.

Ethics Opinions

The New York State Bar Association Committee on Professional Ethics has twice addressed the question whether a lawyer may ethically accept an advance payment retainer and place such funds in the lawyer's or law firm's operating account.[3] In N.Y. State Bar Opinion 816 (2007), the committee affirmed the standards delineated in Opinion 570 that fees paid to a lawyer in advance of services rendered do not constitute client funds and need not be deposited in a client trust account, though the lawyer is obliged to promptly return any portion of the fee advance that is not earned during the representation because the client retains an interest in such unearned portion. Any interest earned on fees placed in the lawyer's or law firm's operating account may be retained by the lawyer or law firm.

Opinion 816 suggests that at the outset of the representation the lawyer should discuss the advantages and disadvantages of advance payment retainers, and reach an agreement regarding the treatment of such advances as either client funds to be deposited into a client trust account or instead as the lawyer's or law firm's funds to be deposited into the lawyer's or law firm's operating account.

Ethical Ramifications: Opinion 816 noted that, "If the parties agree to treat advance payment of fees as the lawyer's own, the lawyer may not deposit the fee advances in a client trust account, as this would constitute impermissible commingling. On the other hand, the lawyer may agree to treat advance payment of legal fees as client funds and deposit them in a client trust account; in that event any interest earned on the funds while in the client trust account must be remitted to the client." Opinion 570 cautioned, that "once a lawyer agrees to treat a fee advance as client property, the lawyer is bound by that agreement and all of its consequences." Opinion 570 also warned that in the event the attorney and client have such an agreement, the attorney must ensure compliance with the specific rules applicable to client funds and trust accounts. These rules include the prohibition against withdrawing any portion of the lawyer fees that is disputed by the client, Rule 1.15(b)(4), and all of the detailed accounting, recordkeeping and reporting requirements of Rule 1.15(c) and (d), and of the applicable Appellate Division rules.[4]

Possible Benefits: Opinion 570 observed that the primary reason for lawyers to require advance fee payments is to not be subject to a client's refusal to pay for legal services after they are rendered. If fee advances were required to be deposited in a client trust account, it would follow that this purpose of requiring advance payment could be easily defeated by a client who, after services are rendered, disputes a justly earned fee. Under Rule 1.15(b)(4), the disputed portion of the fee would have to be retained in the client trust account, and would not be available to the lawyer, until the dispute was resolved.

Opinion 816 added that an advance retainer may be mutually beneficial to the lawyer and client: it may benefit the lawyer by helping to ensure payment for services rendered, at least to the extent of the advance, and may also benefit the client who may wish to hire counsel to defend the

client from judgment creditors. If instead the lawyer deposited such a retainer in a client trust account, the funds would remain the property of the client and might be subject to claims of the client's creditors, thereby making it difficult for a debtor client to retain counsel.

What the Model Rules Say

While the New York Rules are silent on what a lawyer must or should do when a client pays an advance retainer for legal services, the American Bar Association Model Rules of Professional Conduct are explicit. Model Rule 1.15(c) provides that "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 subsection was added to the Model Rules in 2002 because of reports that "the single largest class of claims made to client protection funds is for the taking of unearned fees."[5]

Treatment by Other States

New Jersey agrees with New York that absent a clear understanding that the retainer fee be separately maintained, the funds need not be deposited in a client trust account.[6] The Illinois Supreme Court defined an "advance payment retainer" as a present payment to the lawyer in exchange for the commitment to provide legal services in the future; ownership of this retainer passes to the lawyer immediately upon payment.[7]

However, jurisdictions differ in analyzing the character of advance retainers and the point at which legal fees paid to a lawyer become the lawyer's property. State bar association ethics opinions in many states require that fees paid in advance of the performance of legal services are client funds until earned and therefore must be placed in a client trust account. For example, the Bar Association of San Francisco in Informal Opinion 1973-14 concluded that "Since the understanding is that any unused portion of the retainer is to be returned to the client, it necessarily follows that the retainer fund belongs to the client and not to the attorney until it has been earned. Accordingly, it appears that any deposit of such a retainer in the attorney's general account involves commingling and is in express violation of both RPC, Rule 9, and CPR Canon 9."

Similarly, the Indiana State Bar Association Legal Ethics Subcommittee in Opinion No. 4 of 1977 concluded that "retainer amounts, which are amounts advanced against anticipated legal fees, at the time of the initial advance, are 'funds of clients'" that "must be deposited in one or more identifiable bank accounts in accordance with Disciplinary Rule 9-102(A) and Disciplinary Rule 9-102(A)(2); said advances may not be deposited in a firm name account or otherwise commingled with the funds of the attorney or his law firm."

In addition, the Massachusetts Bar Association in Opinion No. 78-11 concluded that a lawyer "is required to keep the retainer separate from his own funds until he has earned it," and "must keep careful records regarding the retainer, and must account for the funds when the matter is concluded."

Conclusion

A New York lawyer may place advance retainers in the lawyer's or law firm's operating account or in a client trust account. The New York Rules of Professional Conduct, unlike the Model Rules, do not expressly require any specific treatment of advance fee payments. New York ethics opinions conclude that a lawyer may ethically deposit advance retainers in the lawyer's or law firm's operating account unless the client and lawyer have expressly agreed that it be placed in a client trust account. New York lawyers and law firms should be aware that depending on how they treat advance retainers, there may be additional obligations under the Rules that they need to comply with. Moreover, out-of-state lawyers who are admitted to practice in New York, and multi-office law firms that have New York offices, should be familiar with New York's rather unique treatment of advance retainers.

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Endnotes:

1. In April 2009, the Code of Professional Responsibility was replaced with the Rules of Professional Conduct.

2. The old Code provision, DR 9-102, is substantially similar to the new Rule provision, Rule 1.15.

3. Although these opinions predated the adoption of the Rules of Professional Conduct, the Code provisions they reference are virtually identical to the corresponding Rule provisions.

4. 22 NYCRR §603.15 (1st Dept.); 22 NYCRR §691.12 (2d Dept.); 22 NYCRR §1022.6 (4th Dept.).

5. American Bar Association, A Legislative History: The Development of the ABA Model Rules of Professional Conduct, 1982-2005, at 342 (2006).

6. *Matter of Stern*, 92 N.J. 611, 458 A.2d 1279 (N.J. 1983); New Jersey Advisory Committee on Professional Ethics, Opinion 644 "Nonrefundable Retainers," 126 N.J.L.J 966 (1990).

7. *Dowling v. Chicago Options Assocs.*, 226 Ill.2d 277, 286-87 (Ill. 2007).

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