ATTORNEY PROFESSIONALISM FORUM

To the Forum:

I recently received a $10,000 retainer to represent a client (Daniel Developer) in a real property development project. I anticipate the project will take about a year to 18 months to complete. I will be billing on an hourly basis every two months. It has been my practice to put these retainers in my escrow account but in discussing the matter with a couple of fellow attorneys, one expressed the opinion that these retainers should not be put into the escrow account and instead should be deposited into our firm's operating account. The other attorney said that the retainer payment belongs to the client and must be put into an escrow account. Which is it?

In addition, could I enter into a "flat fee" or "minimum fee" payment arrangement with Daniel Developer?

With regard to fee amounts, it has been my firm's practice to increase billing rates at the beginning of each calendar year. Am I required to inform Daniel Developer once our new billing rates take effect?

Last, if for some reason I do not use up the retainer given to me by Daniel Developer, am I required to refund the remaining amount to him?

Sincerely,

Andrew Advocate

Dear Andrew Advocate:

As set forth below, the New York Rules of Professional Conduct require that all financial transactions with clients be handled carefully by lawyers and law firms who must keep contemporaneous records. Moreover, be it for fees or other funds received from or on behalf of clients, lawyers and law firms must communicate what services they will provide, or have provided, to the client, as well as funds received from or disbursed on behalf of clients. Having said that, as long as the lawyer or law firm advises the client that the retainer payment will be treated as if it were earned at the time of the payment and that any unearned portion will be refunded to the client, New York allows the fees to be deposited into an operating account.

By far, the proper handling of client funds is one of the most sensitive ethical issues that attorneys face every day. Attorneys are reminded time and time again – from the moment they are admitted to practice – that there are strict procedures in place governing how an attorney handles money received from a client and, in particular, retainer fees meant to pay for legal services. Although attorneys should be intimately familiar with each and every part of the Rules of Professional Conduct, special attention must be given to Rule 1.15, which deals with, among other things, preserving identity of funds and property of others, fiduciary responsibility, and the prohibition against comingling and misappropriation of client funds or property. To use the words of Professor Roy Simon, "Rule 1.15 is the longest and most strictly enforced rule in New York's Rules of Professional Conduct." *See* Simon's New York Rules of Professional Conduct Annotated 598 (2012).

Rule 1.15(a) prohibits comingling and misappropriation of client funds or property and states that "[a] lawyer in possession of any funds or other property belonging to another person, where such possession is incident to his or her practice of law, is a fiduciary, and must not misappropriate such funds or property or commingle such funds or property with his or her own." The lawyer must maintain separate accounts for funds that are the client's property. *See* Rule 1.15(b). Generally speaking, retainers paid to an attorney are not considered a client's property, which means that retainers should not be deposited into an escrow account. As stated by one commentator, to the contrary New York "*requires* a lawyer to deposit advance retainer fees in the lawyer's own account (or the law firm's operating account) unless the lawyer and client have agreed that the lawyer may deposit them in the lawyer's or law firm's trust account." *See* Simon at 600 (emphasis added); *see also* N.Y. St. Bar Ass'n Op. 816 (2007). Opinion 816 is instructive since the Committee on Professional Ethics found that "[i]f 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." *Id*.

Accordingly, the payment you received from Daniel Developer for his upcoming real estate project appears to be an advance retainer, and therefore belongs to you and no longer to him. The attorney you spoke with who said that the retainer should be placed in your firm's operating account is correct, and you should no longer be depositing retainer payments into your firm's escrow account. Once the retainer is deposited in the operating account, the funds are outside the control of the

The Attorney Professionalism Committee invites our readers to send in comments or alternate views to the responses printed below, as well as additional hypothetical fact patterns or scenarios to be considered for future columns. **Send your comments or questions to: NYSBA, One Elk Street, Albany, NY 12207, Attn: Attorney Professionalism Forum, or by e-mail to journal@nysba.org.**

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client and its creditors and are under the control of the lawyer. The obligation to return an unearned part of a retainer is a separate matter (which we will address below). In essence, there is a debtor/creditor relationship between lawyer and client. But, as they say, "the devil is always in the details" so that isn't necessarily the end of our answer.

Perhaps this engenders some controversy, but it has been suggested that lawyers should open a third account dedicated to retainers. While it is important that we emphasize again and again that a third account is not required and that it is perfectly acceptable to deposit retainers in the operating account, a third "retainers only" account may have certain advantages that outweigh any additional bookkeeping burdens it may create. There are always bookkeeping issues when funds are deposited into an escrow account or an operating account. More often than not when an attorney deposits retainers into an escrow account (which should not be done), the attorney may lose track of which are the retainer funds and which are client escrow funds and before you know it the attorney is dipping into his or her account because the attorney believes these really are the retainer funds when in fact they are not. This sort of comingling would also constitute the misappropriation of client funds. The problem of putting retainer funds into the general operating account is, again, a bookkeeping issue. Funds in an operating account usually get spent – particularly by the small firm or single-practitioner firm. These funds get used for taxes, payroll, whatever. Granted attorneys should have the discipline not to do that but, they often lose track of which are the retainer funds and which are not. As seen in the example, if in fact the attorney is "fired" after a couple of weeks, he or she has to return the unused retainer. If the retainer funds have been spent out of the operating account, the attorney may not have the money to return unused retainer fees to the client.

The benefit of the third account is that funds are put in that account and withdrawn only as earned. Furthermore, the client has no control over these funds (as opposed to an escrow account), so if the attorney and client "split up" and the disenchanted client tells the attorney that the attorney cannot pay himself or herself, the attorney would be permitted to retain such funds as payment for services rendered. Retainers deposited in an escrow account are, arguably, client funds. They are "off limits" to the lawyer once the client says no you cannot pay yourself from the retainer, thus sacrificing the whole idea of having a retainer. If the retainer funds are deposited in the third type of account, the funds remain the attorney's and, pursuant to the well-drafted retainer agreement, the attorney may pay himself or herself. And, as opposed to putting retainer funds in a general operating account and perhaps having them dissipated, the balance of funds will be there to return to the client.

Your question mentioned escrow accounts, so it is important to point out the recent decision by the Court of Appeals in *In re Galasso*, 19 N.Y.3d 688 (2012). There various disciplinary charges were upheld against a lawyer who failed to detect the looting of his firm's escrow account by the firm's bookkeeper – who also happened to be his brother. The Court faulted the attorney for breaching his fiduciary duty to pay or deliver escrow funds, failing to supervise a non-lawyer employee, being unjustly enriched by the use of clients' funds for his personal benefit and failing to provide appropriate accounting to his firm's clients. "[A]lthough [the attorney] himself did not steal the money and his conduct was not venal, his acts in setting in place the firm's procedures, as well as his ensuing omissions, permitted his [brother] to do so"; and "[he] ceded an unacceptable level of control over the firm accounts to his brother, thereby creating the opportunity for the misuse of client funds." *Id.* In light of *Galasso*, we cannot stress enough the need for attorneys to implement and maintain strict financial controls and consistently maintaining those controls through regular supervision of the firm's staff, especially in matters involving the financial affairs of both the law firm and the clients it represents.

Your remaining questions provide us with an opportunity to discuss Rule 1.5, which governs fees and division of fees. Rule 1.5(a) states:

> (a) A lawyer shall not make an agreement for, charge, or collect an excessive or illegal fee or expense. A fee is excessive when, after a review of the facts, a reasonable lawyer would be left with a definite and firm conviction that the fee is excessive. The factors to be considered in determining whether a fee is excessive may include the following:
> (1) the time and labor required, the novelty and difficulty of the questions involved, and the skill requisite to perform the legal service properly;
> (2) the likelihood, if apparent or made known to the client, that the acceptance of the particular employment will preclude other employment by the lawyer;
> (3) the fee customarily charged in the locality for similar legal services;
> (4) the amount involved and the results obtained;
> (5) the time limitations imposed by the client or by circumstances;
> (6) the nature and length of the professional relationship with the client;
> (7) the experience, reputation and ability of the lawyer or lawyers performing the services; and
> (8) whether the fee is fixed or contingent.

Furthermore, Rule 1.5(d)(4) provides:

> (d) A lawyer shall not enter into an arrangement for, charge or collect:
> (4) a nonrefundable retainer fee; provided that a lawyer may enter into a retainer agreement with a client containing a reasonable

> minimum fee clause if it defines in plain language and sets forth the circumstances under which such fee may be incurred and how it will be calculated . . .

We should first turn to your questions whether it is appropriate to enter into a "minimum fee" payment arrangement with Daniel Developer and whether you are required to return to him the unused portions of the fee received from him. Rule 1.5(d)(4) incorporates, amongst other things, the finding by the Court of Appeals in *In re Cooperman*, 83 N.Y.2d 465 (1994) which essentially put an end to nonrefundable fees in New York holding that they generally violate a lawyer's obligation to return any unearned fee upon withdrawal. Although nonrefundable retainers are not permitted, *Cooperman* allows lawyers to charge a minimum fee "as long as the minimum fee is refunded if the work is not completed." *Id.*

The $10,000 payment you have received from Daniel Developer for his real estate project would be reasonable depending on the scope of the project and how much time it will take you to complete the tasks necessary to fulfill the objectives of your representation. If it is reasonable to expect that the legal services required to achieve your client's objectives would cost $10,000, then qualifying the $10,000 payment as a minimum fee would be reasonable under these circumstances. The factors outlined above as per Rule 1.5(a) are instructive in the determination of what would qualify as a reasonable fee. However, if for some reason Daniel Developer terminated your representation or you decided to withdraw from the representation before completing the project or triggering payment of the minimum fee, then you must refund whatever part of the minimum fee has not been earned, because nonrefundable retainer fees are prohibited.

Your letter mentions that it is your firm's practice to increase billing rates at the beginning of each calendar year (like many firms) and asks if you are required to inform Daniel Developer of any fee increases by your firm. Rule 1.5(b) states:

> A lawyer shall communicate to a client the scope of the representation and the basis or rate of the fee and expenses for which the client will be responsible. This information shall be communicated to the client before or within a reasonable time after commencement of the representation and shall be in writing where required by statute or court rule. This provision shall not apply when the lawyer will charge a regularly represented client on the same basis or rate and perform services that are of the same general kind as previously rendered to and paid for by the client. Any changes in the scope of the representation or the basis or rate of the fee or expenses shall also be communicated to the client.

Comment [2] to Rule 1.5 provides:

> When the lawyer has regularly represented a client, they ordinarily will have evolved an understanding concerning the basis or rate of the fee and the expenses for which the client will be responsible. In a new client-lawyer relationship, however, an understanding as to fees and expenses must be promptly established. Court rules regarding engagement letters require that such an understanding be memorialized in writing in certain cases. See 22 N.Y.C.R.R. Part 1215. Even where not required, it is desirable to furnish the client with at least a simple memorandum or copy of the lawyer's customary fee arrangements that states the general nature of the legal services to be provided, the basis, rate or total amount of the fee, and whether and to what extent the client will be responsible for any costs, expenses or disbursements in the course of the representation. A written statement concerning the terms of the engagement reduces the possibility of misunderstanding.

As Comment [2] suggests, the length of time of the relationship between the lawyer and client is a primary factor in determining the required level of understanding between the lawyer and client as to what fees and expenses will be incurred in connection with a given representation. If Daniel Developer happened to be a longtime client of your firm, then there should be a regular understanding between him and your firm as to the scope of the representation and the basis or rate of the fee and expenses for which he will ultimately be responsible. If, however, Daniel Developer is a new client, you must almost immediately establish a written understanding as to fees and expenses, which may be done by way of the required letter of engagement prescribed in 22 N.Y.C.R.R. part 1215.

In any case, when firms have a practice of annually increasing rates during the course of a representation, the firm should give advance notice to the client in the retainer agreement or engagement letter sent to the client at the outset of the representation by using language such as the following:

> We review our rates from time to time and may adjust them periodically, without notice to our client, based upon our determination of the value of each individual's services in the legal marketplace in which we serve our clients.

This puts the client on notice of your firm's practice and opens the door to a negotiation for a different arrangement if the client objects to the practice. Since you anticipate that Daniel Developer's project will take a year to 18 months to complete, we believe that your firm's practice of raising rates annually must be disclosed in the engagement letter or retainer agreement sent to Daniel Developer.

Sincerely,
The Forum by
Vincent J. Syracuse, Esq.,
Matthew R. Maron, Esq.,
Tannenbaum Helpern Syracuse & Hirschtritt LLP, and
Peter V. Coffey, Esq.,
Englert, Coffey, McHugh & Fantauzzi, LLP

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Anthony William Locascio
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John McMullan
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Deneal Michaels
Sarah E. Miller
Gaetano Alberto Mina Di Sospiro
Heidi Sasha Mohammed
Corbin J. Morris
Michael Patrick Murtagh
Karen Myszka Ostberg
Norey Lee Poquiz Navarro
Dustan Neyland
John Nicodemo
Robert Grant Niznik
Youngjin Noh
Justin Michael Nye
Thomas Francis Joseph O'Mullane
Folasade Charlotte Ogunmekan
Jose Florante Mogol Pamfilo
Parvan Petrov Parvanov
Emily Sara Pasternak
Priscilla Lindsey Pellecchia
Garth Gaff Philippe
Bui Van Quang
Patrick Joseph Quinn
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Alison Melani Reynolds
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Wendy Eileen Rutter
Ariel Lia Schneier
Edward W. Schroll
Rachel B. Sherman
Joseph Slaughter
Maura Abeln Smith
Tracy Ann Snow
Jennifer Snyder
Ryan Douglas Stai
Timo Steinbiss
Megan Ruth Sterback
Toneta Sula
Alexandra Jean Swifte
Chun-ju Tai
Ke Xin Cheryl Tan
Adaeze I. Udoji
Karyn Rita Weingarten
Harris Adam Weinstein
Elizabeth Redchuk Wellborn
Audra Marie White
Kirsten Kelly Wood
Harlan York
Madeline Zuckerman

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QUESTION FOR THE NEXT ATTORNEY PROFESSIONALISM FORUM:

I arrived at my office early one morning last week and found an unsolicited email on my server from Dr. Adam Zappel. In the email, Dr. Zappel wrote that a friend gave him my email address, and that he needs my help. Dr. Zappel had sought my representation in a prospective medical malpractice case and included information inculpating himself in the misdiagnosis of a 14-year-old, Tim Trouble, who as it turned out had been regularly indulging in his parents' liquor cabinet. What he thought was a simple case of alcohol poisoning, turned out to be an untreated burst appendix, which if not removed, could have resulted in Tim's death. Dr. Zappel wrote in his email to me that he had a drug problem at the time and had been regularly taking painkillers when he made the error. Worse, Nurse Hailey Honest witnessed the event and has said she will testify against him if the suit arises. This occurred where Zappel is in current residence, St. James Infirmary.

Currently, I represent Our Savior Hospital, where Dr. Zappel previously worked. Our Savior's administrator suspects Dr. Zappel may be planning a qui tam case alleging that Our Savior is engaged in up-coding cases of the common swine-flu to a more deadly flesh-eating disease.

I believe that it would be in Our Savior's interest to know that Dr. Zappel may be embroiled in litigation and had a substance-abuse problem. I am also worried that the unsolicited information in the email may conflict me out of defending the qui tam case.

I checked the Rules of Professional Conduct under Rule 1.18 which states that I cannot represent a client with interests materially adverse to those of a prospective client in a substantially related matter if I received information from the prospective client that could be "significantly harmful" to the prospective client. But, I also read that a person who gives adverse information without "any reasonable expectation that the lawyer is willing to discuss the possibility of forming a client-lawyer relationship . . . is not a prospective client."

I believe that the information I learned about Dr. Zappel could be harmful to him, and that the cases are substantially related since they both concern alleged misdiagnoses. My question to the Forum: is Dr. Zappel a prospective client?

Sincerely,
Vera Decent

In Memoriam

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Flushing, NY

William S. Calli
Utica, NY

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Broad Brook, CT

Benjamin S. Clark
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