



ETHICAL CONSIDERATIONS REGARDING RETAINER AND BILLING AGREEMENTS

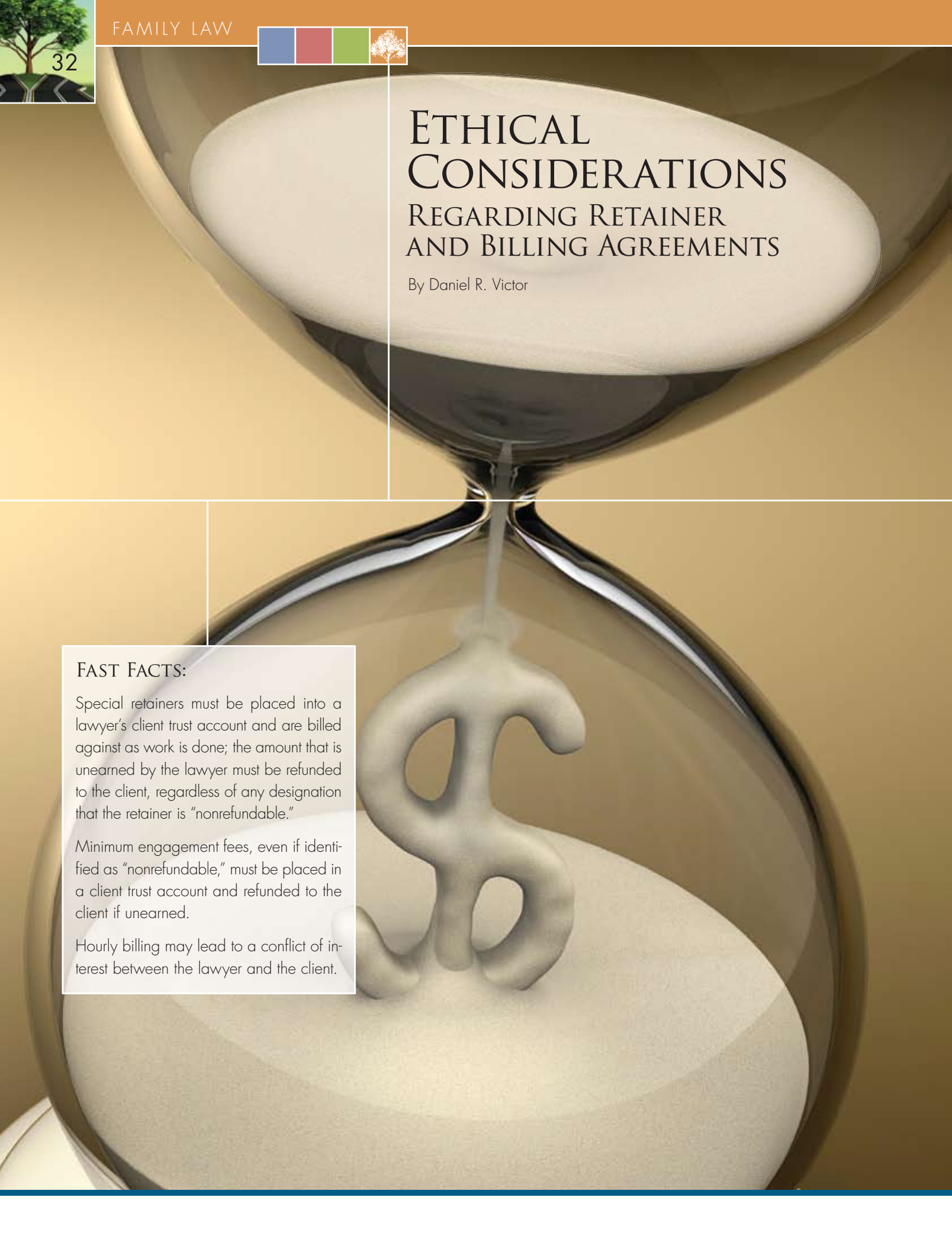
By Daniel R. Victor

FAST FACTS:

Special retainers must be placed into a lawyer's client trust account and are billed against as work is done; the amount that is unearned by the lawyer must be refunded to the client, regardless of any designation that the retainer is "nonrefundable."

Minimum engagement fees, even if identified as "nonrefundable," must be placed in a client trust account and refunded to the client if unearned.

Hourly billing may lead to a conflict of interest between the lawyer and the client.



This article examines ethical concerns in attorney-client billing arrangements, with specific consideration given to the recent Attorney Discipline Board (ADB) opinion issued on September 17, 2007.¹

THE COOPER OPINION

The recent ADB opinion governs retainers and attempts to clarify inconsistencies and omissions found throughout two decades of formal and informal ethics opinions, ADB opinions, and appellate court decisions.

According to *Cooper*, in the state of Michigan, a lawyer may charge a retainer, which may be nonrefundable. There are two distinct types of retainers: (1) general retainers and (2) special retainers. A general retainer is paid by the client to ensure that the lawyer is available to the client in the event that services are needed now or in the future. General retainers are earned on receipt and are not placed into the lawyer's trust account. The lawyer does not, after receiving the general retainer, "bill against it" as work is done for the client.

Unlike the general retainer, the special retainer is an advance payment for services the lawyer will perform in the future. The special retainer is not earned on receipt. It is placed into the trust account and withdrawn by the lawyer as services are provided. When the work is done, the money that has not been withdrawn from the trust account is refunded to the client.

Some lawyers have, in the past, charged a retainer that is a "hybrid" of the general and special retainers. It has been referred to as an advance payment for services, with a claim of "nonrefundability." A hybrid retainer served two useful purposes: (1) it allowed the lawyer to market and sell skill, experience, and reputation, while also acknowledging that acceptance of the employment would preclude other employment in the future;² and (2) by allowing the lawyer to bill against the retainer, it decreased the overall cost to the client compared to the much greater costs incurred by the client if the retainer paid was solely a general retainer.

Although *Cooper* states that it applied MRPC 1.5, the opinion seems to negate and ignore a logical reading of the rule itself. For example, the opinion states that "the potential complexity of a case that never gets going does not justify the retention of a fee paid in advance for specific services that were never performed."³ While this may be true in some cases, MRPC 1.5(a)(2) clearly recognizes the fact that in some cases, the lawyer will be precluded from other employment regardless of whether the case "gets going."

The *Cooper* opinion is also written very narrowly with regard to its treatment of advance fees paid based on the difficulty of the questions involved, when it states that "even were complexity a factor that justified the keeping of an advance fee, the di-

voice here is not complex."⁴ Then, despite recognizing that every matter is unique, the opinion decides to simply ignore MRPC 1.5(a)(1), which identifies complexity as the first factor to be considered when judging a fee's reasonableness. Although the opinion clearly recognizes the possibility that not all cases are as simple as the case it reviewed, the opinion neither addresses nor defines "complex cases," except when it refers to (and relies on) language in the informal ethics opinion it instantly overruled.⁵ If anything, the *Cooper* opinion may have created more confusion than clarity, especially for lawyers who traditionally do not charge general retainers.

POST-COOPER: BILLING OPTIONS

The problem many lawyers have now is that they cannot charge a nonrefundable retainer, in any amount, unless the retainer is solely in exchange for the lawyer's availability. Most clients cannot afford, nor will they accept, to pay a retainer and receive "nothing in return" but the lawyer's availability, and still have to pay the lawyer in exchange for services that will be provided.⁶ Charging and collecting these fees will not be easy. But what are the alternatives? If a fee agreement based solely on time expended is entered into, the lawyer must consider whether it will produce a fee that in totality is reasonable to the client and fair to the lawyer. Most clients want their matters handled quickly and with individual attention paid to their cases. In these

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cases, an hourly billing agreement may create a conflict if the lawyer does not first advise the client that a conflict of interest may exist by the very nature of the agreement. The lawyer must then obtain the client's consent to proceed with an hourly billing contract.⁷

Hourly billing may create a conflict of interest because it can be contrary to the client's goals. If a client is going through a divorce, for example, it is in the client's best interest to resolve the matter quickly, especially if children are involved, so that the family can start the post-divorce healing process. If the lawyer bills solely by the hour, it is in the lawyer's best financial interest for the case to take as long as possible, which runs up the client's bill and drags the divorce case out longer than it should to bring the matter to a conclusion. Furthermore, the lawyer has no incentive to accomplish in 15 minutes what could *justifiably* be done in an hour. Plus, in most cases, the final results obtained for the client will not be based on the number of hours spent on the



issues involved, but on the skill of the individual attorney hired to resolve those issues.

Aside from potentially being contrary to the client's interests, hourly billing also rewards inefficiency and incompetence, while penalizing effectiveness and skill. If lawyers are compensated solely on the basis of the time it takes them to accomplish their clients' goals, the more unfair hourly billing is for experienced lawyers. For example, when completing a service such as negotiating the terms of an agreement, if lawyer A is more experienced, more familiar with the law, and better prepared to take the case to trial if the negotiation fails, there is a greater likelihood that the matter will be resolved faster and to the client's satisfaction. Comparatively, if lawyer B is less experienced, less

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familiar with the law, and not as prepared to take the case to trial, there is a greater likelihood that the negotiation will take longer and will not be as satisfactory to the client. Under the hourly billing scheme, lawyer B would be paid more than lawyer A for taking longer to do a less efficient job. This is inherently unfair to the better lawyer and unfair to the client who is paying more for what is likely to be a less satisfactory result.

As a result of the inability to charge nonrefundable special retainers and the potential conflict of interest from only billing by the hour, reasonable billing in professional practice needs to be reevaluated to more accurately reflect the intent of all of the factors governing fees in MRPC 1.5.

BILLING IN PROFESSIONAL PRACTICE

It is not an anomaly for a professional's fee to be based on the service provided and the results obtained. When a company sends one of its vice presidents overseas to negotiate a deal for parts or labor, that company does not care how long it takes to do the job—in fact, the company would most likely prefer that the job is completed as soon as possible. Compensation is based on the results obtained for the company. Similarly, a surgeon who performs bypass surgery is not paid more money the longer the surgery lasts. Services provided by professionals have value in themselves, regardless of the amount of time it takes to finish the job. The value is usually agreed on between the professional and the client based on the services expected to be performed and the level of skill and expertise the client expects to receive. Most forms of employment in which people

are paid by the hour are actually for unskilled labor—not the other way around.

Although some might argue that value-based billing presents inherent problems for lawyers who can only justify their fees based on their hours, the concepts of service and value-based billing are neither new nor difficult to implement. To the contrary, hourly billing is a relatively new concept, introduced in the mid-twentieth century when law firms became corporations and the method of collecting fees had to be based on a commodity. Law firms needed to have something to track to predict incomes, expenses, and annual budgets. As larger law firms began to dominate the legal landscape, the hourly billing scheme became the standard across the country. Hourly billing was de-

signed with the law firm in mind—not the lawyer or the client—and most people working in large firms billing by the hour and being judged accordingly rarely have anything pleasant to say about this arrangement, usually because they feel that the number of hours they bill is not reflective of their actual contribution to the profession.

Before the corporatization and complexity of the practice of law, attorneys regularly relied on local fee schedules,

which outlined the recommended costs associated with individual issues. Fee schedules were reliable until 1938, when the Federal Rules of Civil Procedure were reformed. These changes were then adopted by the states, which drastically increased pre-trial workloads by extensively reworking the rules pertaining to discovery and trial preparation. The next 40 years were followed by a steady stream of successful sponsorship by the American Bar Association to influence lawyers to adopt hourly billing as their primary method of pricing their services.

The *Cooper* opinion has kindled the argument that it is time to start valuing the service we provide as lawyers—not just the time it takes to do our job. Every lawyer has the same amount of time to do the work that needs to be done—but it is the way the lawyer does the job based on his or her skill and the actual needs of the client that determines the value of the service the client receives. Clients will also benefit from not having to think about being charged per each six minutes of a conversation, per e-mail, per text message, per six minutes of a court appearance, and per the time it takes to engage in discovery. In the end, there is a greater likelihood that the total fee will be more reasonable if fees are based on the actual service provided, and not on the time involved.

The job of balancing reasonableness and profits is more difficult to accomplish by billing solely by the hour, as hourly billing is not designed to be inexpensive for the client—its purpose is to make money for the law firm. The client has virtually no control over the total expense of the hours billed. On the other hand, flat-fee and value-based billing agreements allow the client to have almost exclusive control over the total fee paid to

the law firm. Aside from fees and costs that the client may not be able to predict, when a client and a lawyer agree to a flat fee as the lawyer's compensation, the client can rely on the written fee agreement explaining exactly how much the client will pay. Flat fees are appropriate when the issues involved in the case are relatively common, allowing the client and the lawyer to predict what needs to be done from start to finish. A client can expect to pay a larger fee for a more experienced lawyer who has wisdom, insight, and experience, and a smaller fee for a less experienced lawyer who may take longer, and may not be able to handle complex issues as effectively. Flat fees are negotiated and paid either at the beginning or the end of the case, depending on how much money the client has available at the time the lawyer is retained.

Value-based billing also gives the client greater control over the total fee paid to the law firm. The most important similarity between flat-fee and value-based billing is that the total amount paid is negotiated by the client and the lawyer—it is never a surprise. The difference is simply that the total amount paid is negotiated *after* the conclusion of the matter. In some cases, it is impossible either to predict the total amount of work that will need to be done to bring a matter to conclusion or to know the level of skill that will be needed to handle an unpredictable issue. In these cases, it is appropriate for the fee to be based on the overall value of the services provided—once the client and the lawyer are aware of what needs to be done to resolve the issues presented.

Both of these fee structures were identified as ethical and common by the ADB in *Cooper*.⁸ In fact, because the client has more knowledge about and influence over a negotiated fee, hourly billing is increasingly criticized as unethical.⁹ Although some cases can take on lives of their own and involve more complexity than originally anticipated, most lawyers who have been practicing a few years in any one area of law can safely predict what work will need to be done to bring the case to conclusion—an important reason why hourly billing can punish lawyers who work quickly and efficiently because of their familiarity with that area of law.

The future of hourly billing may not be in jeopardy, but the fact that nonrefundable special retainers are now unethical makes hourly billing suspect in terms of reasonableness. Small and mid-size law firms may find that a client's decision not to pay a truly nonrefundable retainer large enough to justify taking the case have been left without many options, forcing them to enter into agreements that are not very palatable. Additionally, the likelihood that the total fee will wind up being "out of control" has increased exponentially, as many lawyers are now without any guarantees of minimum payment. At the very least, the *Cooper* opinion's treatment of hybrid retainers should be vacated. At the most, MRPC 1.5 should be amended to reflect the need for hybrid retainers as a measure of protection for both the lawyer and the client. ■

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FOOTNOTES

1. *Grievance Administrator v Cooper*, 06-36-GA (ADB 2007).
2. See MRPC 1.5(a).
3. *Cooper*, *supra* at 19.
4. *Id.*
5. Michigan Informal Ethics opinion RI-10, April 6, 1989.
6. For a more thorough and comprehensive critique of the need for hybrid retainers, please see the AAML amicus brief submitted to the Michigan Supreme Court in opposition to the *Cooper* opinion.
7. MRPC 1.7(b).
8. *Cooper*, *supra* at 10.
9. Turov, *The billable hour must die*, ABA J (August 2007), available at <http://www.abajournal.com/magazine/the_billable_hour_must_die/> (accessed May 7, 2008).

