FILE NO._____

STATE OF MINNESOTA

IN SUPREME COURT

In Re Petition to Amend Rules 1.5(b) and 1.15(c)(5), Minnesota Rules of Professional Conduct.	**PETITION OF THE MINNESOTA STATE BAR ASSOCIATION AND THE LAWYERS PROFESSIONAL RESPONSIBILITY BOARD**

TO: THE HONORABLE JUSTICES OF THE SUPREME COURT OF THE STATE OF MINNESOTA:

Petitioners Minnesota State Bar Association (MSBA) and Lawyers Professional Responsibility Board (LPRB) respectfully request this Court to adopt the amendments to Rules 1.5(b) and 1.15(c)(5), Minnesota Rules of Professional Conduct (MRPC), set forth below. In support of this petition, petitioners would show the Court the following:

1. Petitioner MSBA is a not-for-profit corporation of lawyers admitted to practice law before this Court and the lower courts of the State of Minnesota.

2. Petitioner LPRB is a Board established by this Court to oversee the lawyer discipline system.

3. This Court has the exclusive and inherent power and duty to administer justice and adopt rules of practice and procedure before the courts of this state and to establish standards for regulating the legal profession. This power has been expressly recognized by the Legislature. *See* Minn. Stat. § 480.05.

4. This Court has adopted the MRPC by way of establishing standards of practice for lawyers licensed in the State of Minnesota to practice law. These Rules have been amended from time-to-time.

5. Petitioners request that the following amendments to Rules 1.5(b) and 1.15(c)(5), MRPC, be adopted:

RULE 1.5: FEES

(b) The scope of the representation and the basis or rate of the fee and expenses for which the client will be responsible shall be communicated to the client, preferably in writing, before or within a reasonable time after commencing the representation, except when the lawyer will charge a regularly represented client on the same basis or rate. Any changes in the basis or rate of the fee or expenses shall also be communicated to the client. ~~All agreements for the advance payment of nonrefundable fees to secure a lawyer's availability for a specific period of time or a specific service shall be reasonable in amount and clearly communicated in a writing signed by the client.~~ Except as provided below, fee payments received by a lawyer before legal services have been rendered are presumed to be unearned and shall be held in a trust account pursuant to Rule 1.15.

(1) A lawyer may charge a flat fee for specified legal services, which constitutes complete payment for those services and may be paid in whole or in part in advance of the lawyer providing the services. If agreed to in advance in a written fee agreement signed by the client, a flat fee shall be considered to be the lawyer's property upon payment of the fee, subject to refund as described in Rule 1.5(b)(3). Such a written fee agreement shall notify the client:

(i) of the nature and scope of the services to be provided;

(ii) of the total amount of the fee and the terms of payment;

(iii) that the fee will not be held in a trust account until earned;

(iv) that the client has the right to terminate the client-lawyer relationship; and

(v) that the client will be entitled to a refund of all or a portion of the fee if the agreed-upon legal services are not provided.

(2) A lawyer may charge a fee to ensure the lawyer's availability to the client during a specified period or on a specified matter in addition to and apart from any compensation for legal services performed. Such an availability fee shall be reasonable in amount and communicated in a writing signed by the client. The writing shall clearly state that the fee is for availability only and that fees for legal services will be charged separately. An availability fee may be considered to be the lawyer's property upon payment of the fee, subject to refund in whole or in part should the lawyer not be available as promised.

(3) Fee agreements may not describe any fee as nonrefundable or earned upon receipt but may describe the advance fee payment as the lawyer's property subject to refund. Whenever a client has paid a flat fee or an availability fee pursuant to Rule 1.5(b)(1) or (2) and the lawyer-client relationship is terminated before the fee is fully earned, the lawyer shall refund to the client the unearned portion of the fee. If a client disputes the amount of the fee that has been earned, the lawyer shall take reasonable and prompt action to resolve the dispute.

RULE 1.15: SAFEKEEPING PROPERTY

(c) A lawyer shall:

(1) promptly notify a client or third person of the receipt of the client's or third person's funds, securities, or other properties;

(2) identify and label securities and properties of a client or third person promptly upon receipt and place them in a safe deposit box or other place of safekeeping as soon as practicable;

(3) maintain complete records of all funds, securities, and other properties of a client or third person coming into the possession of the lawyer and render appropriate accounts to the client or third person regarding them;

(4) promptly pay or deliver to the client or third person as requested the funds, securities, or other properties in the possession of the lawyer which the client or third person is entitled to receive; and

(5) except as specified in Rule 1.5(b)(1) and (2), deposit all fees received in advance of the legal services being performed into a trust account and withdraw the fees as earned.~~, unless the lawyer and the client have entered into a written agreement pursuant to Rule 1.5(b)~~

6. The above described amendments were approved by the MSBA General Assembly at its April 29, 2010, meeting on the Report and Recommendation of the MSBA's Rules of Professional Conduct Committee. Prior to that meeting, comment on the proposed rule changes was solicited from all MSBA Sections, and the MSBA's Judiciary, Court Rules and Administration, and Professionalism Committees. Input and comment was also solicited from the Minnesota Association of Criminal Defense Lawyers, the American Association of Matrimonial Lawyers, the Minnesota Bankruptcy Court Practice Committee, and an informal group of ethics partners and general counsel at large law firms. Input and comment was also solicited via the MSBA's Solo/small firm listserv. The majority of comments received were favorable and some changes to the initially proposed changes were made to address concerns raised by the Minnesota Bankruptcy Court Practice Committee.

BACKGROUND

7. The general rule in Minnesota, as in most jurisdictions, has always been that funds paid to a lawyer at the outset of a representation, before the lawyer completed any work, had to be deposited in a trust account and withdrawn as the lawyer worked on the client's matter and earned the fees. *See* Rule 1.15, MRPC. There has also long been an exception to this rule for fees paid to make sure a lawyer was "available" to work for a client or for fees paid for a specific task. As the Minnesota Supreme Court said nearly 20 years ago in *In re Lochow*, 469 N.W.2d 91 (Minn. 1991),

> We are fully aware that there may be cases when the client's desire to have a particular attorney represent him or her will necessitate an immediate commitment. That attorney will possibly have to forgo representation of other clients and might lose other business while the

> attorney commits him- or herself to the client now seeking representation. Such a retainer fee, if reasonable, may be immediately earned. However, the purpose of the retainer fee and the consent of the client for the payment and use thereof must be reduced to writing and approved by the client. Furthermore, attorney fees for payment of services to be performed in the future must be placed in a trust account and removed only by giving the client notice in writing of the time, amount, and purpose of the withdrawal, together with a complete accounting thereof.

Id. at 98.

8. The Court's comments in *Lochow* led the LPRB to draft an ethics opinion regarding such advance fees. Opinion 15, adopted in 1991, stated the rule as:

> Funds paid to a lawyer pursuant to an availability or non-refundable retainer agreement are not required to be deposited into a trust account or held in trust. All availability or non-refundable retainer agreements must be in writing and signed by the client. *Lochow,* 469 N.W.2d at 98. All availability or nonrefundable retainer agreements must include a final paragraph immediately above the client signature line which informs the client that: (1) the funds will not be held in a trust account; and (2) the client may not receive a refund of the fees if the client later chooses not to hire the lawyer or chooses to terminate the lawyer's services

Opinion 15 essentially codified the use of the term "nonrefundable" to refer to advance fees that were exempt from the general rule requiring that they be placed in a trust account. When major revisions were made to the MRPC in 2005, several LPRB opinions, including Opinion 15, were repealed and their contents embedded directly into the text of the MRPC. As part of this change, Rule 1.5(b) was amended to read "All agreements for the advance payment of nonrefundable fees to secure a lawyer's availability for a specific period of time or a specific service shall be reasonable in amount and clearly communicated in a writing signed by the client."

9. Traditionally, advance availability fees and advance fees for a specific service (commonly referred to as "flat fees") were relied on primarily by certain segments of the bar. Lawyers practicing criminal and bankruptcy law, in particular,

relied on advance fees because permission to withdraw for nonpayment of fees would not likely be granted by the court, a criminal investigation could be pending for an indeterminate period of time, and funds held in trust in a bankruptcy would become property of the estate upon filing a petition. In flat fee matters for a particular service, such as transactional matters, the ability to clearly define the representation's scope and cost allowed the clients to evaluate the fee agreement in such a way that the risk of misuse of funds not deposited in the trust account was offset by the disclosure to, and consent by, the client.

10. A number of authorities have discussed the distinction between a fee paid to secure the lawyer's availability in the future and a fee paid for specific services to be rendered in the future. The Restatement (Third) of the Law Governing Lawyers § 34, cmt. e (2000), discusses the types of retainers that are considered earned upon receipt. The Restatement calls such retainers "engagement retainer fees," defined as:

> [A] fee paid, apart from any other compensation, to ensure that a lawyer will be available for the client if required. An engagement retainer must be distinguished from a lump-sum fee constituting the entire payment for a lawyer's service in a matter and from an advance payment from which fees will be subtracted . . . . A fee is an engagement retainer only if the lawyer is to be additionally compensated for actual work, if any, performed. * * *
>
> An engagement retainer fee satisfies the requirements of this Section [that a lawyer's fee be reasonable] if it bears a reasonable relationship to the income the lawyer sacrifices or expense the lawyer incurs by accepting it, including such costs as turning away other clients (for reasons of time or due to conflicts of interest), hiring new associates so as to be able to take the client's matter, keeping up with the relevant field, and the like.

11. Similarly, Geoffrey C. Hazard, Jr., & W. William Hodes, "The Law of Lawyering," § 8.5 (3d ed. 2001), explains that:

> Several situations may be imagined in which a substantial nonrefundable fee - better understood as a minimum fee - might be justified. For example, a client might wish to prevent anyone else from retaining the lawyer in connection with a particular matter. Or a client might anticipate needing legal services in the future and wish to insure the lawyer's availability at the time, in effect 'taking an option' on the lawyer's services. Under those and similar conditions, it is not unreasonable for the lawyer to be compensated for the other business opportunities thus foregone.

12. In contrast, fees paid to a lawyer who intends to apply the funds against fees for services to be rendered, whether those fees are flat fees or hourly fees, are typically considered advance fees. They do not truly qualify as availability or general retainers, which may be considered earned upon receipt. *See Cluck v. Comm'n for Lawyer Discipline,* 214 S.W.3d 736, 740 (Tex. 2007) *(quoting* Tex. Comm. On Prof'l Ethics Op. 431, "If a fee is not paid to secure the lawyer's availability and to compensate him for lost opportunities, then it is a prepayment for services and not a true retainer. . . . A fee is not earned simply because it is designated as nonrefundable"); *Ryan v. Butera, Beausang, Cohen & Brennan,* 193 F.3d 210, 216 (3d Cir. 1999). The *Ryan* court explained:

> The distinction between general and specific retainers is well established. A retainer is general "where the services being purchased are the attorney's 'availability' to render a service if and as needed in a specific time frame" and thus is "earned when paid." On the other hand, a retainer is special or specific "where the funds paid are for a specific service." In that circumstance, the retainer remains the client's property if the contemplated services are not provided. *See In re Gray's Run Tech., Inc.,* 217 B.R. 48, 52-53 (Bankr. M.D. Pa. 1997); *see also Kelly [v. MD Buyline, Inc,],* 2 F. Supp. 2d [420] 425-27 [(S.D.N.Y. 1998)].

13. Other jurisdictions observe these distinctions:

- Colorado Rule 1.5(g) specifically provides that "Nonrefundable fees and nonrefundable retainers are prohibited."

- Iowa Rule 45.9 defines a special retainer as a fee charged for the performance of contemplated services rather than for the lawyer's availability and provides that "A lawyer may not charge a nonrefundable special retainer or withdraw unearned fees [from a trust account]."

- The New Hampshire comment to Rule 1.15 notes that "Rule 1.5 does not permit a retainer for services that is absolutely non-refundable because such an agreement is inconsistent with the Rule's requirement that a fee must always be reasonable."

- The Alaska Bar Association in Opinion 2009-1, opined that "Regardless of how a fee is characterized, e.g. 'a nonrefundable retainer', 'a fee earned upon receipt', a 'flat fee', a 'minimum fee', etc., these factors [the reasonableness factors set forth in Rule 1.5(a)] continue to apply to the lawyer's fee. If unreasonable, the fee is improper. It is for that reason that a lawyer's characterization of amounts paid to the lawyer as being 'nonrefundable' is fundamentally misleading."

14. Regarding "flat" or "fixed" fees, an exception exists regarding fees charged for a particular service. In such matters, the lawyer promises to perform the service for a certain fee. In some situations, it would not serve the client's interests to require that such fees be placed in trust because they could be subject to the claims of a third party, such as in bankruptcy or in an appeal from a money judgment where the client does not intend to pay for a supersedeas bond. Conceptually, it is also understandable that there is little risk to the client when paying a lawyer a relatively small fee for work that will be accomplished within a short period of time after the lawyer is hired. As noted above, the ability to clearly define the representation's scope and cost allows the client to evaluate the fee agreement in such a way that the risk of misuse of funds not deposited in the trust account is offset by the disclosure to, and consent by, the client.

15. Some jurisdictions, despite prohibiting "nonrefundable" fees, permit flat fees paid in advance for a specific service to be considered the property of the lawyer:

- Washington Rule 1.5(f)(2), which is very close to the proposed rule, allows lawyers to charge a flat fee for specified services that is received in advance of the lawyer completing the work. The fee may be considered the lawyer's property upon receipt, as long as the client signs an agreement advising the client that a portion of the fee may be refundable if the lawyer does not perform the promised services.

- Wisconsin Rule 1.15(4)(m) permits flat fees to be considered the property of the lawyer with similar disclosures to the client of the refundability of the fee in the event the services are not completed.

- Washington D.C. Rule 1.15(d) allows clients to give informed consent to the general rule designating advance fees as the property of the lawyer. *Accord In re Mance,* 980 A.2d 1196, No. 06-BG-890, Slip. Op. at 18-20 (D.C. Sept. 24, 2009).

CONCERNS WITH THE CURRENT RULES

16. The problem with Minnesota's current Rule 1.5 appears to rest primarily in its use of the term "nonrefundable" for certain fees paid in advance and not deposited in the trust account. In every representation there is the possibility that the lawyer will not complete the agreed-upon services. Even where the lawyer anticipates completing the work in the very near future, it is possible that the lawyer, because of other unexpected matters related to other clients or events in the lawyer's personal life, will not complete the work. Similarly, a lawyer who has accepted an availability retainer may cease to become available to the client because the lawyer decides to give up the private practice of law, dies, or becomes disabled. In each of these cases, the client should be entitled to some refund as a matter of contract law. Calling these fees "nonrefundable" regardless of future circumstances is inaccurate and could be misleading.

17. In many cases, a client pays a flat fee in advance for a service and then the client decides to terminate the representation. As the Restatement discusses, there is often an opportunity cost to a lawyer in accepting a particular representation and

turning down other representations. To avoid confusion, a lawyer's retainer agreement with the client should maintain the distinction between flat fees and availability fees by setting forth the portion of the fee that is attributable to the lawyer's availability (including opportunity costs, commitments to hiring additional staff, etc.) and what portion is attributable to the service the lawyer has promised to perform. It would be contrary to the public interest, however, to allow lawyers to enter into retainer agreements that suggest the entire retainer is nonrefundable under all circumstances, particularly where an early discharge by the client would result in a windfall to the lawyer without a concomitant acceptance of risk, loss of other work, or completion of some part of the work for which the client hired the lawyer.

18. The idea that a fee paid for services to be rendered in the future may be considered nonrefundable also contradicts other provisions of the MRPC. For example, Rule 1.16(d) requires that, upon termination of a representation, the lawyer must refund to the client any advance payment of fees that has not been earned. Rule 1.5(a) prohibits lawyers from charging an unreasonable fee. A fee charged that exceeds the value of the services rendered - whether or not that fee is designated as nonrefundable - is unreasonable.

19. To continue to permit lawyers to designate advance fee payments as nonrefundable will not only perpetuate the inherent contradiction between the provisions of Rule 1.5(b) and those of Rules 1.16 and 1.5(a), but it also does a disservice to clients who are unfamiliar with the MRPC. A client who signs an agreement designating an advance fee payment as nonrefundable is at a serious disadvantage in attempting to obtain a refund if the services promised are not delivered.

20. Over the years since the adoption of Opinion 15 and the amendments to Rule 1.5(b), the Office of Lawyers Professional Responsibility (OLPR) has seen a rise in complaints from clients focused on a lawyer's refusal to refund a portion of an advance

fee even in situations where little work was performed and either the client or the lawyer decided to prematurely terminate the representation. More troubling, is that the OLPR has also noticed that many lawyers in areas of practice that are typically conducted on a per diem basis, such as family law, have taken to labeling the client's initial retainer payment as "nonrefundable" and depositing it directly into the lawyer's business account, even though the lawyer still intends to charge by the hour for a representation that is not limited to a specific service.

21. The LPRB is concerned that this practice harms the public because it impinges on the right and ability of clients, who may be of limited means, to discharge their lawyer because they fear the loss of the advance retainer. Characterizing retainers as "nonrefundable" to short-circuit the general rule that unearned fees be placed in a trust account until earned, undermines the fiduciary nature of the lawyer-client relationship. While the traditional use of availability and flat fee contracts with lawyers has a proper place among the types of services lawyers provide to clients, particularly in criminal and bankruptcy law practices, the concept that a fee paid in advance to a lawyer is, under all circumstances "nonrefundable," is antithetical to the requirement that all fees be reasonable.

22. With these concerns in mind, the LPRB approached the MSBA Rules of Professional Conduct Committee in early 2009 to form a joint task force to review the language of Rule 1.5(b) and develop amendments that would preserve the spirit of the rule and the Court's holding in *Lochow* but also protect the rights of clients. The current suggested amendments to Rules 1.5 and 1.15 are primarily the work of that joint task force, with some amendments by the MSBA Rules of Professional Conduct Committee.

RATIONALE FOR PROPOSED CHANGES

23. The proposed amendments to Rules 1.5 and 1.15, MRPC, are intended to eliminate the contradiction between the various provisions of the rules that arises when a fee paid in advance is designated as nonrefundable, and to inform lawyers and clients more clearly of their rights and obligations when a fee is paid in advance.

24. During deliberations regarding the proposed rule changes, it was recognized that fidelity to the general proposition in Rule 1.15, MRPC, regarding funds belonging to clients, would require that all advance fees paid for services to be rendered in the future remain the property of the client paying the fee and, thus, should be held in a trust account until earned. This concept, in fact, remains in the proposed changes to Rule 1.5(b). However, the provisions of proposed Rule 1.5(b)(1), (2), and (3) are intended to acknowledge the long and accepted practice in Minnesota of permitting some advance fees to be treated as the property of the lawyer, subject to refund if they are not ultimately earned. As discussed above, other jurisdictions have adopted rules reflecting this compromise between the sanctity of the general rule and the realities of modern law practice. *See* Ill. R. Prof'l Conduct 1.15(c); La. R. Prof'l Conduct 15(f); Wash. R. Prof'l Conduct 1.5(f); Wis. R. Prof'l Conduct 1.15(4).

25. Proposed Rule 1.5(b)(1) provides that, if a lawyer and client agree in writing, the lawyer may charge a flat or fixed fee for specified legal services to be paid in advance of the rendering of the services. A lawyer who charges such an advance fee does so "at risk" that a refund of all or part of the fee may be required if all or part of the services promised are not provided. In the written agreement with the client, certain information is to be provided to the client regarding the nature of the advance fee being paid and the client's right to a refund if the promised services are not provided. These provisions are intended to ensure that clients are fully apprised of how their funds will be handled and their rights should the promised services not be provided.

26. The proposed rule intends that the provisions of 1.5(b)(1) apply only in those instances where the fee charged is a flat or fixed fee. Where the advance fee is paid with the understanding that it is to be applied against services to be billed at an hourly rate or some other type of billing where the total fee has not yet been fixed, any unearned portion of the advance fee must be held in trust and handled in accordance with the provisions of Rule 1.15.

27. Proposed Rule 1.5(b)(2) is intended to codify the generally accepted practice regarding availability retainers. The key change effectuated by this amendment is that clients must be advised in writing that the fee paid in advance for availability is for availability only and that there will be a separate charge for legal services rendered.

28. Proposed Rule 1.5(b)(3) is intended to accomplish two goals. First, it is intended to prohibit the designation of any advance fee payment as nonrefundable. This is to eliminate the contradiction between the concept of a nonrefundable retainer and the provisions of Rules 1.16(d) and 1.5(a), MRPC, and to prevent clients from being misled as to their right to a refund should the promised services not be provided. Second, the rule is intended to put the burden on the lawyer to promptly take reasonable action to resolve any dispute with the client as to whether the fee has been fully earned in those cases where the lawyer-client relationship has been terminated before the fee has been fully earned.

29. The process contemplated by proposed Rule 1.5(b)(3) is a compromise that permits a lawyer to treat certain advance fee payments as his or her own property when paid, but requires the lawyer to affirmatively take reasonable and prompt action to resolve fee disputes. In other words, instead of informing clients that the funds received in advance are "earned upon receipt," a lawyer would have to advise the client that the funds received in advance would be regarded as the lawyer's property, subject

to a refund if the lawyer does not complete the services. Although some may consider this change merely semantic, it is intended as a middle ground between a flat out requirement that all funds paid in advance of services rendered must be held in trust until they are earned, and the long accepted practice in Minnesota that some advance fees may be considered the lawyer's property upon receipt. This permits the lawyer to utilize the advance flat fee payments on a current basis while providing some protection to the client should the promised services not be provided.

30. The last sentence of Rule 1.5(b)(3) addresses the resolution of disputes between the lawyer and the client over the amount of the fee that has been earned. Initially, language was considered that would have compelled a lawyer to deposit disputed fees into a trust account until the dispute was resolved. That proposal was similar to the existing provision in Rule 1.15(b) that requires a lawyer to continue to hold funds in trust when the client disputes the amount of the lawyer's fee. In many availability or flat fee agreements, however, the client could raise a dispute about the fee many months after the majority of the work had been done. Requiring a lawyer to deposit the full amount of the fee in trust under those circumstances could impose a hardship on the lawyer. Hence, the provision to return disputed funds to the trust account was removed in favor of the current provision, which places an obligation on the lawyer to try to resolve the dispute. A proposal to require lawyers to submit the dispute to binding arbitration was rejected.

31. No part of this discussion is intended to suggest that, in a dispute between a lawyer and client over whether a flat fee was earned, the lawyer must produce records to show the number of hours of work the lawyer completed on the client's matter. Hourly billing is in many cases contrary to the rationale and structure of flat fees; this alternative structure serves both lawyers and clients alike. Lawyers using flat

fees should describe in their retainer agreements how the lawyer will determine when the fee is considered earned.

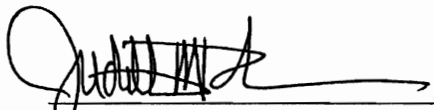
Dated: July 13, 2010.

Respectfully submitted,

MINNESOTA STATE BAR ASSOCIATION

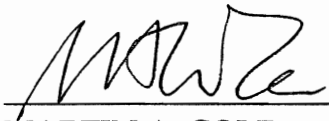
By

TERRANCE W. VOTEL
Its President
Attorney No. 113323
600 Nicollet Mall, Suite 380
Minneapolis, MN 55402
(612) 333-1183



JUDITH RUSH, CHAIR
LAWYERS PROFESSIONAL
RESPONSIBILITY BOARD
Attorney No. 222112
1500 Landmark Towers
345 St. Peter Street
St. Paul, MN 55102-1218
(651) 296-3952

and



MARTIN A. COLE
DIRECTOR OF THE OFFICE OF LAWYERS
PROFESSIONAL RESPONSIBILITY
Attorney No. 148146