Living With the Ban on Nonrefundable Retainers: Cooperman's Scope, Meaning and Consequences

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Recommended Citation
Lester Brickman & Lawrence A. Cunningham, Living With the Ban on Nonrefundable Retainers: Cooperman's Scope, Meaning and Consequences, 66 New York State Bar Journal 50 (1994). Available at: https://larc.cardozo.yu.edu/faculty-articles/312

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Living With the Ban on Nonrefundable Retainers: Cooperman's Scope, Meaning and Consequences

By Lester Brickman and Lawrence A. Cunningham

In a case of first impression in the United States, the New York Court of Appeals in Matter of Cooperman earlier this year held that nonrefundable fee agreements between lawyers and clients are unethical. Although these retainers have in the past been most widely used by lawyers practicing criminal, bankruptcy and matrimonial law, the case has important consequences for lawyers in all areas of practice. Because the New York case can be expected to be followed by many other jurisdictions, it also has important consequences for lawyers around the country who have been using nonrefundable retainers.

I. Cooperman's Scope and Meaning

Since the opinion was issued in March, we have been consulted by numerous lawyers, bar groups, clients and others for advice concerning the scope and meaning of the Court of Appeals' ruling and on the practical implications for lawyers having used such devices. These consultations led us to believe that a brief overview of Cooperman's scope and meaning, as well as its practical implications, would be desirable.

Basis of the Decision: Client Discharge Rule

Cooperman follows from the bedrock principle that the attorney-client relationship is fiduciary in nature. The relationship's effectiveness depends on a client having trust and confidence in her lawyer. When a client loses that trust and confidence, the fiduciary basis of the relationship is undermined and its purpose impaired. To protect against this corrosive possibility, it has long been the clear and express policy of most jurisdictions in the United States that a client is entitled to terminate the attorney-client relationship and agreement at any time, for any reason, however arbitrary. The Cooperman Court resoundingly reaffirmed this fundamental principle as the law and policy of New York State.

As a logically necessary corollary to this rule, a client cannot be put in a worse position by exercising her right to terminate the attorney-client agreement. Indeed, as the New York Court of Appeals emphasized in the landmark case of Martin v. Camp, and as the Cooperman Court reemphasized, because imposing a penalty in such circumstances may deter a client from invoking the right to discharge her attorney, when a client discharges her lawyer, the retainer agreement is not breached.

In such a case, the client simply exercises a contract right implied by public policy, and a discharged lawyer's recovery upon termination by his client is determined based on the principles of quantum meruit. As a result, efforts by lawyers to keep more than such an amount, as by charging nonrefundable retainers, are impermissible and unenforceable. Some confusion has stirred, however, with respect to precisely what a nonrefundable retainer is.

3 This trust-based theory of the attorney-client relationship is developed fully in Lester Brickman & Lawrence A. Cunningham, Nonrefundable Retainers: Impermissible Under Fiduciary, Statutory and Contract Law, 57 Fordham L. Rev. 149 (1988).
4 Martin v. Camp, 219 N.Y. 170, 114 N.E. 46 (1916); see also Lester Brickman & Lawrence A. Cunningham, Nonrefundable Retainers Revisited, 72 North Carolina L. Rev. 1, 7 n. 24 (1993) (citing cases from 32 states adopting the client discharge rule from Martin v. Camp and concluding that it has "become the national rule, conquering the jurisdictions with its force of reasoning").
5 Cooperman, 83 N.Y.2d at 472 ("public policy recognizes a client's right to terminate the attorney-client relationship at any time with or without cause") (emphasis in original).
6 See Lester Brickman, Setting the Fee When the Client Discharges a Contingent Fee Attorney, 41 Emory L. Rev. 367 (1992).
7 Martin v. Camp, 219 N.Y. 170, 114 N.E. 46 (1916); Cooperman, 83 N.Y.2d at 472.
Problems of Definition

The Cooperman Court expressly limited its holding to “special nonrefundable retainers,” saying “we intend no effect or disturbance with respect to other types of appropriate and ethical fee agreements.” The Court then announced, without defining its terms, that “[m]inimum fee arrangements and general retainers that provide for fees, not laden with the nonrefundability impediment irrespective of any services, will continue to be valid and not subject in and of themselves to professional discipline.”

Because we have perceived some confusion in interpreting the meaning of these various kinds of fee arrangements, it is important to define each of them and to evaluate their effect upon the client discharge rule and hence their validity.

A special retainer is an agreement between attorney and client in which the client agrees to pay the attorney a specified fee in exchange for specified services to be rendered. The fee may be calculated on an hourly, fixed, percentage or other basis and may be payable either in advance or as billed. Subject to the provisions of DR 2-106 governing the reasonableness of legal fees, these arrangements pose no special ethical problems, and do not impair the client discharge right.

A general retainer—sometimes referred to as the classic retainer—is an agreement between attorney and client in which the client agrees to pay the attorney a fixed sum to the attorney in exchange for the attorney’s promise to be available to perform, at an agreed price, any legal services (which may be of any kind or of a specified kind) that arise during a specified period. Since the general retainer fee is given in exchange for availability, and not for the rendition of legal services, it is a charge separate from fees incurred for services actually rendered. In other words, such fees are “earned when paid” because payment is made for availability. As a result, they also do not impair the client’s right to discharge freely.

The nonrefundable retainer is a subspecies of the special retainer and has nothing in common with the general retainer as defined above. While we have used the term “nonrefundable special retainer” to describe this fee payment, the Cooperman Court used the term “special nonrefundable retainer” to describe the identical device. A nonrefundable special retainer is a fee paid to a lawyer by a client in advance of services to be rendered, and denominated by the lawyer as nonrefundable in the event the client terminates the relationship, even if the work has not been done. Nonrefundable retainers arise only in conjunction with the rendering of specified services for a specified fee, and pursuant to allow a lawyer to keep an advance payment without regard to whether the services contemplated are rendered.

Because a nonrefundable retainer is a fee paid to a lawyer by a client in advance of services to be rendered, once it is paid, a client is no longer free to discharge her lawyer but instead is held hostage to that advance payment—discharging her lawyer costs the client the amount of the advance payment that has not been earned. Hence, nonrefundable retainers—in both design and effect—penalize a client for discharging her lawyer, in contravention of the spirit and the letter of the client discharge rule. Cooperman therefore expressly and emphatically condemns these nonrefundable retainers.

Minimum fee agreements typically provide that a lawyer will work on an hourly or fixed fee basis to complete a particular task. For example, the agreement may provide that, while the task will likely require twenty hours of work, the client will be billed for twenty hours.

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even if it is completed in fewer hours, the fee will still be the twenty hour fee. The agreement may also provide, however, that the fee can be more than the minimum fee, if the task requires more hours or effort than contemplated. This kind of minimum fee also raises no inherent ethical objections. In such a case, the client’s right to discharge the lawyer prior to completion of the service and be liable only in quantum meruit is unimpaired.15

Application of Cooperman

Although the ban announced in Cooperman does not apply to general retainers and minimum fee arrangements of the kind just described,16 it would be a mistake to understand the case to mean that characterizing a particular arrangement as either a general retainer or a minimum fee renders the arrangement ethical and free from scrutiny. While the Court said its ruling applies only to what it called “special nonrefundable retainers” and not to other kinds of fee arrangements, the Court was careful to limit its imprimatur of other kinds of fees to those that do not impair the client discharge right. It said these other kinds of fee arrangements are permissible but only if “not laden with the nonrefundability impediment irrespective of any services.”17

It is this “nonrefundability impediment” that interferes with the client discharge right and renders the nonrefundable retainer unethical and unenforceable per se. Consequently, every fee agreement that has the same effect is also flatly forbidden, no matter what it is called. Rather than investigating the names given to particular agreements, therefore, the test for determining the validity of a retainer agreement must focus on its economic structure. If the arrangement impairs the client discharge right, then it is unenforceable and unethical.

Under this test, for example, an arrangement nominally characterized as a “minimum fee,” but that also purports to allow an attorney to keep an advance payment without regard to whether the services contracted for are rendered, is invalid because it impairs the client discharge right. In effect, it is simply a nonrefundable retainer in disguise—it contains a “nonrefundability impediment.” Minimum fees of this variety are therefore unethical and unenforceable.18

Similarly, a “hybrid” special-general retainer agreement is also impermissible under Cooperman because it too includes a “nonrefundability impediment.” A hybrid is an agreement providing that part or all of a fee denominated as a “general retainer” is to be applied to defray the costs of any services actually performed. A typical version of the hybrid, for example, might call for a $10,000 fee to be paid in advance, with the agreement that any progress is to be charged against that advance. This then would constitute a general retainer “laden with the nonrefundability impediment irrespective of services.”19 A client’s right to discharge would be impaired by such a device because terminating the lawyer before those services were rendered would result in forfeiture of some or all of the advance payment, in violation of Cooperman.

A variant of such a hybrid could be designed by specifying, for example, that $7,000 of the $10,000 advance fee payment is to be a general retainer, given in exchange for availability and not subject to offset, and $3,000 of the advance fee payment is to be a special retainer, given in advance for and charged off against specific services actually rendered. While Cooperman did not expressly address this or other variations on the hybrid, we believe courts following the logic and policy of Cooperman will be led to evaluate their validity by observing a rebuttable presumption that the fee was given for services, and not for availability.20 This is because it can be expected that most clients would not understand or intend to characterize the $7,000 as for availability. In short, lawyers should expect that both the hybrid and all variations on it will receive the same scrutiny as applied to nonrefundable retainers that are clear on their face.

No Waiver of Client Discharge Right

Lawyers should also avoid the temptation to seek a waiver of the client discharge right from clients, because we believe such waivers are also unenforceable. In addition to the threat of undermining the principles that justify the client discharge rule, Cooperman indicates that this right cannot be waived.

The Court observed that under DR 2-110(A)(3) and (B)(4), “an attorney is prohibited from keeping any part of a pre-paid fee that has not been earned because of discharge by the client.”21 It went on to say, in light of that rule, that “it is reasonable to conclude also that an attorney may not negotiate and keep fees such as those at issue here.”22 By expressly prohibiting a lawyer from negotiating a nonrefundable retainer, the Court is saying that even client consent will not insulate such an agreement from scrutiny and rejection. In other words, Cooperman announces that the client discharge right may not be waived, a result that is of course consistent with the treatment of most client rights arising out of the fiduciary nature of the attorney-client relationship.

II. Consequences of Cooperman for Past and Future Fee Agreements

Apart from recognizing the scope of Cooperman, which covers all fee arrangements that impair the client discharge right, it is also important for lawyers having used such devices in the

13 This definition of minimum fees, which we commended to the attention of the Committee to Examine Lawyer Conduct in Matrimonial Actions, is the one that the Appellate Division defined as permissible in its rules prohibiting nonrefundable retainers in matrimonial actions. N.Y. Comp. Codes R. & Regs. tit. 22 § 8-4 (1993).
14 The lower court decision in Cooperman was understood by many to hold that all “nonrefundable retainers,” including general retainers, had been prohibited. See Stephen Gillers, All Non-Refundable Retainers Are Not Created Equal, N.Y.L.J., Feb. 3, 1993. We have previously explained our view that this is not what the Appellate Division held. See Lester Brickman & Lawrence A. Cunningham, Clarification Offered on Lawyers’ Retainers (letter to the Editor), N.Y.L.J., Mar. 1, 1993. It is also not what the Court of Appeals held.
15 Cooperman, 83 N.Y.2d at 476.
16 This “minimum fee” subheading appears in N.Y. State Bar Ass’n, Comm. on Prof. Ethics, Op. 399 (1989), which contains the following linguistic legendarium:
We address in this opinion the ethical propriety of an agreement covering a specific legal matter that calls for an advance payment of a minimum fee that is not refundable to a client if the representation ends before the attorney expends the requisite number of hours that would, at the time charges specified in the retainer agreement, earn the minimum fee.
Id. at 3. This, of course, describes a nonrefundable retainer, with the client attempting to distinguish and legitimate the device by calling it a minimum fee. Both are unethical and unenforceable under Cooperman.
17 Cooperman, 83 N.Y.2d at 476.
19 Cooperman, 83 N.Y.2d at 474-75.
20 Id. at 475 (emphasis added).
past to consider how to deal with the consequences of having done so, and to devise proper means for new fee arrangements now that it is clear that nonrefundable retainers are impermissible.

**Jurisdictional Scope of Cooperman**

The *Cooperman* Court was careful to emphasize that it was declaring the ethical invalidity of nonrefundable retainers in a disciplinary proceeding, rather than in a civil fee dispute between a lawyer and client. The Court qualified its decision as follows:

Since we decide the precise issue in this case in a disciplinary context only, we imply no views with respect to the wider array of factors by which attorneys and clients may have fee dispute controversies resolved. Traditional criteria, including the factor of the actual amount of services rendered, will continue to govern those situations (see, DR 2-106[B]). Thus, while the special nonrefundable retainer agreement will be unenforceable and may subject an attorney to professional discipline, quantum meruit payment for services actually rendered will still be available and appropriate.

It is possible to understand the foregoing excerpt to mean that the *Cooperman* opinion has no application outside the disciplinary context. We believe this view is fundamentally mistaken, however. The Court expressly states that, in addition to subjecting a lawyer to disciplinary action, nonrefundable retainers are unenforceable as a matter of public policy. In civil cases where such nonrefundable retainers are challenged, therefore, the lawyer will have no right to enforce his agreement, but instead may claim only an amount equal to the reasonable value of his services, in quantum meruit. In determining the quantum meruit amount, all the factors set forth in DR 2-106(B), governing the determination of reasonable legal fees, will be relevant.

This interpretation of *Cooperman* was adopted by the Civil Court of the City of New York in *Sarmiento v. Meyer & Greenfield.* It raises important questions concerning the obligations lawyers now have when discharged by clients who have signed nonrefundable retainer agreements.

**Settlement After Discharge**

In *Sarmiento*, a client discharged her lawyer under a nonrefundable retainer agreement and sought a refund. The lawyer refunded 50% of the advance and the client signed a release of the lawyer for any further claims, which the lawyer argued constituted an accord and satisfaction. Thereafter, the *Cooperman* decision was handed down and the client asserted that the accord was invalid. In denying the lawyer’s motion for summary judgment on that claim, the Court decided that the same principles underlying *Cooperman* also applied to determine the legal validity of the purported accord and satisfaction. Because the unenforceable nonrefundable retainer necessarily formed the basis for negotiating the accord, the accord itself was unavoidably infected by that device. In other words, since the accord was entered into before *Cooperman* was decided, the lawyer could credibly have informed the client that the lawyer had a right to keep the retainer. As a result, the accord was tainted by the same ethical problem as the underlying nonrefundable retainer, both of which were therefore unenforceable, and the lawyer was entitled only to collect in quantum meruit.

In light of *Cooperman* and *Sarmiento*, lawyers negotiating settlements of their fees after being discharged under a nonrefundable agreement face a number of additional responsibilities. Any settlements of advance fee payments denominated as nonrefundable and entered into prior to *Cooperman* are inherently suspect for the reasons set forth in *Sarmiento*. Because a lawyer at that time could plausibly have claimed that he was entitled to keep the entire amount of the nonrefundable fee, any settlement under which the client accepted less than the advance net of the reasonable value of the services is unenforceable. Subject to the applicable statute of limitations, therefore, such lawyers are vulnerable to claims by those clients attacking the accord and satisfaction.

With respect to settlements being entered into after *Cooperman*, lawyers should take care to inform the client that she now has a clear right to a return of the entire portion of the advance fee that has not been earned. To obtain maximal assurance that such a settlement will not be subject to later attack, the lawyer should take several steps. First, as noted, he should advise the discharging client that she has the right to a full refund of the advance fee, net of quantum meruit. Second, the lawyer should provide the client with a detailed billing statement supporting the amount he is claiming in quantum meruit. That statement should be prepared with reference to the factors set forth in DR 2-106, concerning the reasonableness of legal fees. Finally, it may be prudent for the lawyer to advise the client that she should consider hiring another lawyer to review the proposed settlement.

**Advance Fees to Protect the Lawyer**

*Cooperman* expressly recognizes the need to balance the interests of lawyers with those of clients, and to protect both from unfair advantage at the hands of the other. In *Cooperman*, this meant protecting the client through the client discharge right and protecting the lawyer by providing relief in quantum meruit even where he has acted impermissibly. Another pair of devices are designed to accomplish a similar balancing of interests between lawyer and client: the advance fee payment and the client trust account.

*Cooperman* has no effect on a lawyer’s right to insist on an advance fee payment from a client at the outset of the representation. This gives the

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23 Id. at 471 (characterizing Jacobson v. Sassower, 66 N.Y.2d 991 (1985), as a "fee dispute case" and referring to *Cooperman* as a "disciplinary matter").
24 *Cooperman*, 83 N.Y.2d at 475 (emphasis added).
26 The client asserted that the lawyer had worked only one hour prior to discharge, although the lawyer denied this.
27 This advice is probably in the discharged lawyer’s interests, moreover, because the fact of discharge does not ipso facto terminate the attorney-client relationship. Consequently, during the settlement negotiations, the discharged lawyer may well continue to owe fiduciary obligations to the client. If the client retains another lawyer to advise her in those negotiations, however, the discharged attorney should be relieved of those duties.
28 *Cooperman*, 83 N.Y.2d at 473.
lawyer assurance that he will be paid for services rendered. However, any such advance fee payment must be deposited into a client trust account pursuant to DR 9-102.29

Under DR 9-102(A), if the client disputes a lawyer’s fee, then the lawyer may not withdraw that part of the fee which is disputed by the client until the dispute is finally resolved. Depositing an advance fee payment into the lawyer’s general office account, rather than to the client trust account, would strip the client of this unwaivable right under DR 9-102(A), just as charging a nonrefundable retainer would strip a client of the unwaivable client discharge right. As a result, a substantial majority of bar associations opining on the matter have declared that advance fees must be deposited to the trust account.30

In connection with many of the kinds of law practices in which nonrefundable retainers have been used in the past, the advance fee payment/trust account approach will protect the interest of the lawyer in assuring compensation for services rendered, while at the same time protecting clients by preserving both the client discharge rule and the fee dispute rule.

As a matter of practice, lawyers obtaining an advance fee should find it desirable at the outset of a representation to prepare a schedule of progress, specifying the steps to be taken that will earn portions of the advance fee, and give a copy of this schedule to the client. In the criminal defense context, for example, a lawyer requiring an advance fee payment of $7,500 could specify that it was for the entire representation and further that after entering an appearance and making a plea, $2,000 would be earned; the next $2,000 after the bail hearing; the next $3,500 after the trial; and so on.

Conclusion

We understand that many lawyers who have read Cooperman lament its lack of crystalline guidance concerning their own past or future fee agreements. While this concern is legitimate, it is simply the natural consequence of any judicial decision resolving a major and previously unsettled issue of vital importance to all lawyers. As Cooperman was the first court in the country to confront directly the ethical problems nonrefundable retainers pose, the lines the Court has drawn inevitably leave indeterminate issues at the margins. Over time these issues will be clarified and resolved, however, as the process is joined by other state supreme courts and law review writers.

We note, moreover, that the Court also took care to express its confidence that the Justices of the Appellate Division, who bear responsibility for applying Cooperman, will “in the highest tradition of their regulatory and adjudicatory roles...exercise their unique disciplinary responsibility with prudence.”31 Accordingly, while we sympathize with lawyers facing the uncertainty left in Cooperman’s wake, we too expect that the Appellate Divisions, as well as the Grievance Committees, will act with discretion and responsibility in distinguishing between retainer agreements that are valid and those which, because they impair the client discharge right, are not.

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30 Id. at 650.
31 Cooperman, 83 N.Y.2d at 476.