

KENTUCKY BAR ASSOCIATION

Ethics Opinion KBA E-426

Issued: March 23, 2007

OPINION

Subject: The use of credit cards¹ for payment of earned attorney fees, non-refundable retainers, and advances.

Question I: May a lawyer accept credit card payment for both earned fees and non-refundable retainers? If so, must the payment be deposited in the lawyer's office account?

Answer: Yes

Question II: May a lawyer accept credit card payment for advances on either attorney fees or costs and expenses? If so, where must the lawyer deposit the funds?

Answer: See discussion below.

Question III: May the lawyer pass the credit card service charges on to the client?

Answer: See discussion below.

References: KBA E-172(1977); ABA Formal Op. 338(1974); KBA E-380 (1995); Kentucky Bar Ass'n v. Bubenzer, 145 S.W.3d 842 (Ky. 2004); Clendenin v. Kentucky Bar Ass'n, 114 S.W.3d 858 (Ky. 2003); SCR 3.130 (1.4); (1.5), (1.15), (1.16) and (7.05); Geoffrey C. Hazard, Jr., and W. William Hodes, The Law of Lawyering, sec. 19.4 (2002 Supplement); Or. Eth. Op.2003-172, WL 22397286 (2003); N.C. Bar Op. 247 (1997); S.C.Op. 98-08 (1998).

Introduction

In 1977, this Committee issued KBA E-172 authorizing Kentucky lawyers to accept credit cards in payment of legal services. The opinion affirmed the position of the ABA, as reflected in Formal Opinion 338 (1974).² These older opinions assumed that the credit card payments were

¹ Although this opinion focuses on the use of credit cards, many of the same principles apply to debit cards and other electronic transactions.

² Both KBA E-172 (1977) and ABA Formal Opinion 338 (1974) expressed various concerns about improper advertising and solicitation under the rules that were in effect at that time. In 2000, the ABA withdrew Formal Opinion 338, and three other opinions relating to the use of credit cards, because the adoption of the ABA Model Rules of Professional Conduct rendered the guidelines relative to advertising and solicitation contained in those opinions inapplicable. ABA Formal Op. 00-419 (2000).

for services that had already been performed by the lawyer. Today's questions involve an extension of earlier practices and ask whether credit cards may be used to pay non-refundable retainers and advances on fees and expenses that have not been earned or incurred by the lawyer. In addition, there are issues as to what type of account credit card payments are to be deposited in and whether the lawyer can charge the client for bank service charges incurred in connection with the use of a credit card.

It should be noted that many of these issues are not unique to credit card transactions and may be equally relevant when payments are made by check or other electric transfer. Nevertheless, consumers, including consumers of professional services, increasingly rely upon the use of credit cards to pay for those services. The purpose of this opinion is to address some of the general ethical issues that may arise in conjunction with the use of credit cards. It is not the objective of this opinion to discuss the intricacies of the lawyer's contract with the credit card company, nor to dictate the precise details of how those arrangements should be structured.

I. Credit Card Payment for Earned Attorney Fees and Non-refundable Retainers

KBA E-172 (1977) states that a lawyer may accept credit cards as a method of payment for services that have been performed – earned fees. Once a lawyer has earned a fee, he or she is entitled to payment. If a credit card is used to pay the fee, the funds belong to the lawyer and should be deposited to the lawyer's office account.

On the issue of non-refundable retainers, KBA E-380 (1995), provides that a lawyer may charge a client a reasonable "non-refundable" retainer in order to secure the lawyer's services. In that opinion, the Committee noted that the term "retainer" has come to have several meanings and it emphasized that it was talking about the "true" retainer to secure the lawyer's services, not an "advance" on fees and expenses. The opinion states that a true retainer can only be designated "non-refundable" if the lawyer complies with the detailed requirements set forth in the opinion.³ KBA E-380 further states that "the lawyer who receives a retainer has earned the fee by promising to be available for future work, and the funds so received need not be put in a trust account." This is true despite the fact that the opinion recognizes that there may be cases where the lawyer may be obligated to return "some portion of the 'non-refundable' fee retainer upon termination of the representation, depending upon all the circumstances; that is, the 'reasonableness' of the fee."

The Committee is unaware of any rule of professional conduct that would prohibit the use of a credit card for the payment of a non-refundable retainer and, like the earned fee, the funds should

³ KBA E-380 (1995) provides as follows:

Accordingly, we find that in order for a non-refundable fee retainer to be valid the arrangement must meet the following criteria:

1. The arrangement must be fully explained to the client, orally, and in a written fee agreement that is signed by the client;
2. The arrangement must specify the dollar amount of the retainer, and its application of the scope of the representation, and/or the time frame in which the agreement will exist; and
3. The total fee to be charged must be "reasonable."

A "retainer" that does not meet these requirements will be treated as an advance and must be deposited in the client trust account. In the event the lawyer is terminated, the unearned portion of the advance must be returned to the client. *See, Kentucky Bar Ass'n v. Bubenzer*, 145 S.W.3d 842 (Ky. 2004); *Clendenin v. Kentucky Bar Ass'n*, 114 S.W.3d 858 (Ky. 2003).

be deposited in the lawyer's office account. See SCR 3.130 (1.15) prohibiting the commingling of lawyer and client funds.

II. Credit Card Payment for Advances on Attorney Fees, Costs and Expenses

In some areas of practice, it is common for a lawyer to require a client to pay an "advance," before the lawyer commences work on the client's behalf. An advance serves as a fund from which the lawyer may withdraw fees as they are earned, and costs and expenses as incurred. Although there is nothing ethically impermissible about requiring such an advance, the lawyer must comply with the applicable rules of professional conduct. Specifically, the lawyer must have a clear understanding with the client about the purpose of the advance and may withdraw funds only upon proper authorization. These obligations arise from the duty to communicate with the client under SCR 3.130(1.4), the duty to protect and account for client property under SCR 3.130(1.15), as well as the lawyer's duties upon termination of the representation under SCR 3.130(1.16(d)).

Question II asks whether a lawyer may accept credit card payment for advances. As previously noted, KBA E-172 only addressed the use of credit cards in conjunction with "legal services performed" – earned fees – and it did not consider the use of credit cards for advances to cover unearned fees and expenses.

The Committee is of the view that there is nothing inherently unethical about charging an advance to a credit card, as long as the advance meets the requirements of reasonableness imposed by Rule 1.5 and the lawyer complies with the rules on handling client property contained in Rule 1.15. Unlike earned fees and non-refundable retainers described in Questions I, advances serve as security for future charges and, until earned, the funds belong to the client. As a result, the lawyer has a special responsibility to safeguard advances. The lawyer's fiduciary responsibilities are outlined in SCR 3.130(1.15), and include the duty to segregate client funds in a trust account and to keep complete records. *See generally*, Geoffrey C. Hazard, Jr., and W. William Hodes, *The Law of Lawyering*, sec. 19.4 (2002 Supplement).

The duty to segregate client funds has a number of implications for lawyers who accept credit cards. As noted above, credit card proceeds for advances must be deposited in a trust account. There are number of ways in which a lawyer might deal with his or her "merchant account."⁴ One solution is for the lawyer to have two merchant accounts, one would be a business account and the other would be a trust account. The lawyer would have to exercise care to distinguish between various types of charges so that funds were credited to the proper account. See Or. Eth. Op.2003-172, WL 22397286 (2003). The other alternative is to establish a trust account into which all credit card funds flow and if some portion of the deposited funds belongs to the lawyer, it should be withdrawn. See Or.Eth. Op., *supra*, (stating that if the bank insists on a single account, it should be a trust account) and N.C. Bar Op. 247 (1997) (stating that if the bank will only deposit funds into a single account, all payments should be deposited into a trust account and funds belonging to the lawyer should be withdrawn). The current rules recognize that there are some occasions where the lawyer's trust account will, for a period, contain funds belonging to both the lawyer and the client. This may be unavoidable, as where settlement check is issued in a contingent fee case. In any case, where the lawyer has a right to funds in the trust account, it is critical that the lawyer maintain accurate records, monitor the account scrupulously, and comply with the applicable requirements of SCR 3.130(1.15).

⁴ As used here, the term "merchant account" is the account in which the credit card proceeds are deposited.

The more difficult issue relates to what are known as a “charge-back.” If credit card proceeds are deposited in a trust account and the client disputes the charge, the disputed amount will be charged back – withdrawn from the trust account. If the lawyer has disbursed the credit card proceeds prior to the charge-back, then the charge-back will be against other clients’ funds. The same is true with a check that is dishonored. Any arrangement that compromises the integrity of the trust account violates SCR 3.130(1.15). A lawyer could avoid the ethical implications of a charge-back by delaying disbursements until after the time a charge-back could occur. Alternatively, the lawyer might negotiate an agreement with the bank whereby any charge-back would be made against the lawyer’s business account, rather than the trust account to which the funds were deposited. It is not the function of the Committee to explore all of the options that might be available for avoiding charge-backs against trust accounts. We merely caution lawyers that any arrangement that could result in charge-back against another client’s funds in a trust account is strictly prohibited.

III. Service Charges

Like a merchant who accepts credit cards in payment of goods, a lawyer who accepts credit cards will be charged a transactional fee by the financial institution processing the charge. The question is whether the lawyer can pass these transactional costs on to the client, assuming that such a practice does not violate the contract with the financial institution or any other law.

A number of ethics committees in other jurisdictions have considered this issue and concluded that lawyers may pass reasonable transactional costs of credit card use on to clients if the client agrees to such a charge. *See, e.g.*, Or. Eth. Op. 2003-172; N.C. Bar Op. 247; S.C.Op. 98-08 (1998). SCR 3.130(1.5) provides that “the basis or rate of the fee should be communicated to the client, preferably in writing, before or within a reasonable time after commencing the representation.” Because the practice of passing service charges on to the client deviates so dramatically from the commonly accepted practice in the commercial world, lawyers have an unusually high burden in making sure the client fully understands the consequences of electing to use a credit card. The client must be advised that he or she will be responsible for an amount in excess of the billed charge if a credit card is used and what the additional charge will be, as well as any other information that may be necessary to adequately inform the client of the nature of the payment arrangement.⁵ Moreover, although the current rules do not require that such communications be in writing, it is the Committee’s view that, especially where an additional charge is added for credit card use, both clients and lawyers will be best served if the agreement is in writing.

Conclusion

Consumers rely heavily upon the use of credit cards and other forms of electronic payment and the Kentucky Rules of Professional Conduct authorize lawyers to accept credit cards for the payment of fees. See SCR 3.130(7.05) and KBA E-172(1977). As the use of credit cards and other forms of electronic payment become more common, lawyers will need to be increasing cautious in structuring these arrangements to ensure compliance with all of their ethical obligations, particularly those relating to client communication, segregation of client funds and accounting.

⁵ If the client is entitled to a refund, it should be processed in such a way so as to return the applicable transactional fee charged, if any.

Note to Reader

This ethics opinion has been formally adopted by the Board of Governors of the Kentucky Bar Association under the provisions of Kentucky Supreme Court Rule 3.530. Note that the Rule provides: "Both informal and formal opinions shall be advisory only; however, no attorney shall be disciplined for any professional act performed by that attorney in compliance with an informal opinion furnished by the Ethics Committee member pursuant to such attorney's written request, provided that the written request clearly, fairly, accurately and completely states such attorney's contemplated professional act."