

1988

Nonrefundable Retainers: Impermissible Under Fiduciary, Statutory and Contract Law

Lester Brickman

Lawrence A. Cunningham

Follow this and additional works at: <https://ir.lawnet.fordham.edu/flr>



Part of the [Law Commons](#)

Recommended Citation

Lester Brickman and Lawrence A. Cunningham, *Nonrefundable Retainers: Impermissible Under Fiduciary, Statutory and Contract Law*, 57 Fordham L. Rev. 149 (1988).

Available at: <https://ir.lawnet.fordham.edu/flr/vol57/iss2/1>

This Article is brought to you for free and open access by FLASH: The Fordham Law Archive of Scholarship and History. It has been accepted for inclusion in Fordham Law Review by an authorized editor of FLASH: The Fordham Law Archive of Scholarship and History. For more information, please contact tmelnick@law.fordham.edu.

Nonrefundable Retainers: Impermissible Under Fiduciary, Statutory and Contract Law

Cover Page Footnote

Professor of Law, Benjamin N. Cardozo School of Law. B.S. 1961, Carnegie-Mellon University; J.D. 1964, University of Florida; LL.M. 1965, Yale University. Associate, Cravath, Swaine & Moore, New York, New York. B.A. 1985, University of Delaware; J.D. magna cum laude 1988, Benjamin N. Cardozo School of Law.

NONREFUNDABLE RETAINERS: IMPERMISSIBLE UNDER FIDUCIARY, STATUTORY AND CONTRACT LAW

LESTER BRICKMAN*
LAWRENCE A. CUNNINGHAM**

TABLE OF CONTENTS

Introduction	150
I. The Lawyer as Fiduciary	153
A. <i>Client's Right to Discharge</i>	155
B. <i>Codification of Trust</i>	156
C. <i>Exceptions to the Discharge Right</i>	157
D. <i>Historic Development</i>	160
1. Up to <i>Martin v. Camp</i> : Freedom to Discharge	161
2. Up from <i>Martin v. Camp</i> : The Parties' Intentions .	162
3. Proper Role of the Parties' Intentions	163
4. Clever Lawyers and Mum Courts	166
II. Lawyers' Compensation as Unrestrained by Law	170
A. <i>Fee Bill Statutes</i>	171
B. <i>Reform</i>	172
C. <i>Subsequent Statutory Revisions</i>	173
III. Attorney-Client Agreements and Contract Law	176
A. <i>Liquidated Damages</i>	177
B. <i>Judicial Forfeiture</i>	182
C. <i>Mitigation of Damages</i>	188
Conclusion	189

* Professor of Law, Benjamin N. Cardozo School of Law. B.S. 1961, Carnegie-Mellon University; J.D. 1964, University of Florida; LL.M. 1965, Yale University.

** Associate, Cravath, Swaine & Moore, New York, New York. B.A. 1985, University of Delaware; J.D. magna cum laude 1988, Benjamin N. Cardozo School of Law.

INTRODUCTION

This Article examines the legal and ethical validity of nonrefundable retainers,¹ which are being used increasingly by lawyers.² Judicial consideration of nonrefundable retainers has been scant,³ case analysis has been superficial and outcomes inconclusive.⁴ Bar associations have opined both favorably⁵ and unfavorably.⁶ Where nonrefundable retain-

1. A nonrefundable retainer is an agreement between lawyer and client providing for the payment of part or all of the fee in advance of the lawyer's performance. The payment is designated in the retainer agreement as nonrefundable. The dispute regarding the validity of these agreements usually arises when the client terminates the lawyer's employment without just cause before completion of the task and demands return of the unearned part of the advance fee.

2. Nonrefundable retainer agreements are reproduced in lawyers' handbooks and study aids. See, e.g., R. Felder, *Lawyers Practical Handbook to the New Divorce Law 27-29* (1980); J. McRae, *Legal Fees and Representation Agreements 88* (1983) (Monograph Series, ABA Section of Economics of Law Practice); New York Matrimonial Practice 197-98 (PLI 1979); L'Estrange & Tucker, *Fee Agreements*, 27 *Prac. Law.* 11, 23-25 (April 1981). They are commonly used throughout the New York metropolitan area. See *Jacobson v. Sassower*, 113 Misc. 2d 279, 284, 452 N.Y.S.2d 981, 985 (N.Y.C. Civ. Ct. 1982), *aff'd per curiam*, 122 Misc. 2d 863, 474 N.Y.S.2d 167 (App. Term. 1983), *aff'd mem.*, 107 A.D.2d 603, 483 N.Y.S.2d 711, *aff'd mem.*, 66 N.Y.2d 991, 489 N.E.2d 1283, 499 N.Y.S.2d 381 (1985). The authors have been informed by lawyers in other major metropolitan areas that nonrefundable retainer agreements are in common use in domestic relations and criminal law practices and are also in use in corporate practices. The existence of bar association opinions and judicial determinations of their validity also indicates their widespread use. See *infra* notes 5-6 and accompanying text.

3. This is probably explained by the economics of litigation. The authors have been informed by practicing attorneys that nonrefundable retainers in the amount of \$1000 to \$3000 are most common. Since the attorney has usually performed some services before being discharged by the client, the amount being sought by the client will be less than the amount of the advance fee payment. Litigation costs to recover these sums often equal or exceed the amount in contention. Demands for return of advance nonrefundable fee payments most often are referred to arbitration which yields no paper record that can be examined. See generally Millikan, *Arbitration of Attorney-Client Disputes*, 53 L.A.B.J. 270 (1977) (Los Angeles County Bar Association active in arbitration of fee disputes); *The Resolution of Fee Disputes: A Report and Model Bylaws*, Special Comm. on Resolution of Fee Disputes of the A.B.A. Sec. of Bar Activities 4 (1974) (recommending that arbitration committee hear client's fee grievance for merit even when lawyer refuses binding arbitration); Comment, *Arbitration of Attorney Fee Disputes: New Direction for Professional Responsibility*, 5 UCLA-Alaska L. Rev. 309 (1976) (arbitration most effective and efficient method for settling attorney fee disputes).

4. See, e.g., *Federal Sav. & Loan Ins. Corp. v. Angell, Holmes & Lea*, 838 F.2d 395 (9th Cir. 1988) (invalid); *Jersey Land & Dev. Corp. v. United States*, 342 F. Supp. 48 (D.N.J. 1972) (ambiguous); *Baranowski v. State Bar*, 24 Cal. 3d 153, 593 P.2d 613, 154 Cal. Rptr. 752 (1979) (en banc) (ambiguous); *Smith v. Binder*, 20 Mass. App. Ct. 21, 477 N.E.2d 606 (1985) (ambiguous); *Jacobson v. Sassower*, 113 Misc. 2d 279, 452 N.Y.S.2d 981 (N.Y.C. Civ. Ct. 1982) (invalid), *aff'd per curiam*, 122 Misc. 2d 863, 474 N.Y.S.2d 167 (App. Term. 1983), *aff'd mem.*, 107 A.D.2d 603, 483 N.Y.S.2d 711, *aff'd mem.*, 66 N.Y.2d 991, 489 N.E.2d 1283, 499 N.Y.S.2d 381 (1985); *Jacobs v. Holston*, 70 Ohio App. 2d 55, 434 N.E.2d 738 (1980) (ambiguous).

5. See Disciplinary Board of the Hawaii Supreme Court, Formal Op. 29 (1985); Illinois State Bar Ass'n Comm. on Professional Ethics, Op. 722 (1981), *digested in* Law. Man. on Prof. Conduct (ABA/BNA) 801:3007; Maryland State Bar Ass'n Comm. on Ethics, Op. 80-21 (n.d.), *digested in* Law. Man. on Prof. Conduct (ABA/BNA) 801:4301; Oregon Bar Op. 509 (1986), *digested in* Law. Man. on Prof. Conduct (ABA/BNA)

ers have been upheld, it has been without consideration of contract or fiduciary law principles.⁷ As a result, nonrefundable retainers have been categorized as *sui generis* and validated by judicial fiat, thereby escaping scrutiny and definition.

This Article argues that nonrefundable retainers ought not to remain undefined. Rather, they are contractual forfeiture provisions whose ethical and legal validity must be gauged according to well-established legal, fiduciary, and ethical concepts and doctrines.⁸ From these perspectives, most nonrefundable retainers are unethical and illegal. Courts and bar association ethics committees, however, refuse to apply these doctrines to nonrefundable retainers and treat attorney-client employment contracts differently from all other contracts of employment. Consequently, the position of lawyers has been aggrandized in relation to clients.⁹

901:7102; South Carolina Bar Ethics Advisory Comm., Op. 81-15 (1982), *digested in* Law. Man. on Prof. Conduct (ABA/BNA) 801:7903; Texas Bar Op. 391 (1978), *digested in* O. Maru, 1980 Supplement to the Digest of Bar Ass'n Ethics Opinions 12,749 (1982).

6. See ABA Comm. on Professional Ethics, Informal Op. 998 (1967), *reprinted in* II ABA Informal Ethics Opinions 161, 165 (1975); Cleveland Bar Ass'n Op. 84-1 (1984), *digested in* Law. Man. on Prof. Conduct (ABA/BNA) 801:6952; Kansas Bar Ass'n Prof. Ethics Comm. Op. 84-12 (1984); Michigan Bar Op. CI-962 (1983), *digested in* Law. Man. on Prof. Conduct (ABA/BNA) 801:4873; Nassau County Bar Op. 85-5 (1985), *digested in* Law. Man. on Prof. Conduct (ABA/BNA) 801:6208.

7. See sources cited *supra* note 5.

8. These concepts and doctrines include general and special retainers, the right of a client to terminate a retainer agreement without penalty, the excessiveness or reasonableness of a lawyer's fee, judicial forfeiture clauses, liquidated damages and penalties, and mitigation of damages.

9. This is not the only example of lawyers creating special rules to govern their own conduct different from those they have developed to regulate the conduct of others. Consider the rules promulgated by lawyers for the medical and legal system. The malpractice doctrine rule for doctors evaluates conduct in light of the customary practice of physicians in good standing and requires that "there must be a want of ordinary and reasonable care, leading to a bad result." *Pike v. Honsinger*, 155 N.Y. 201, 210, 49 N.E. 760, 762 (1898); see *Mack v. Lydia E. Hall Hosp.*, 121 A.D.2d 431, 503 N.Y.S.2d 131 (1986); *P. Danzon, Medical Malpractice* 139-40 (1985). Conversely, under the malpractice rule for lawyers the client must show that "but for" the lawyer's negligence, the client would have won. See, e.g., *Sage v. Glaze*, No. 60,074 (Kan. Ct. App. Jan. 7, 1988) (LEXIS, States library, Kan file); *Basic Food Indus. v. Grant*, 107 Mich. App. 685, 310 N.W.2d 26 (1981); *Pool v. Burlison*, 736 S.W.2d 485 (Mo. App. 1987); *Katsaris v. Scelsi*, 115 Misc. 2d 115, 453 N.Y.S.2d 994 (Sup. Ct. 1982); *Rorrer v. Cooke*, 69 N.C. App. 305, 317 S.E.2d 34 (1984), *rev'd*, 313 N.C. 338, 329 S.E.2d 355 (1985); *Chocktoot v. Smith*, 280 Ore. 567, 571 P.2d 1255 (1977) (en banc); *R. Mallen & V. Levit, Legal Malpractice* § 583, at 738 (2d ed. 1981 & Supp. 1985). This rule frequently insulates lawyers from liability by placing a formidable, almost unsustainable burden on the client.

Consider the lawyer who fails to file a notice of appeal within the allotted time and whose client is thereby deprived of his right to appeal. The client must show that had the notice been timely filed, he would have won on appeal. Unless the client can show that the court below made a clear and demonstrable error of law that itself led to the client's loss, he has not sustained the burden. See *Hyduke v. Grant*, 351 N.W.2d 675, 678 (Minn. Ct. App. 1984); see also *Nelson v. Appalachian Ins. Co. of Providence*, 399 So. 2d 711, 712 (La. Ct. App. 1981). The comparable case on the medical side is quite different. For instance, if a doctor's inaccurate diagnosis leads to the omission of a specific medical protocol that would have contributed to a 60 percent likelihood of the patient's survival, and the patient dies, the doctor is guilty of malpractice. The patient is compensated for

Part I of this Article examines the fiduciary law principle that gives a client the unfettered right to discharge his attorney without cause and without penalty.¹⁰ The analysis develops a trust-based theory of the attorney-client relationship that leads inexorably to the conclusion that nonrefundable retainers, in most instances, are incompatible with client discharge rights because nonrefundable retainers impose discharge costs

the "loss of chance"—the chance of avoiding some adverse result or achieving some favorable result. Compare *Hicks v. United States*, 368 F.2d 626, 632 (4th Cir. 1966) (doctor is answerable for destroying any chance of survival) and *Jeanes v. Milner*, 428 F.2d 598 (8th Cir. 1970) (adopting reasoning in *Hicks*) and *Servidone Constr. Corp. v. Security Ins. Co.*, 64 N.Y.2d 419, 425, 477 N.E.2d 441, 445, 488 N.Y.S.2d 139, 143 (1985) (insurance company that failed to defend insurer bears burden of proving probable outcome of lawsuit had insured not settled) and *Herskovits v. Group Health Coop.*, 99 Wash. 2d 609, 614, 664 P.2d 474, 476-77 (1973) (evidence of loss of chance to survive due to failure to diagnose sufficient for jury to determine proximate cause) with *Phillips v. Clancy*, 152 Ariz. 415, 418, 733 P.2d 300, 303 (Ct. App. 1986) (objective standard) and *Kallenberg v. Beth Israel Hosp.*, 45 A.D.2d 177, 179-80, 357 N.Y.S. 2d 508, 510-11 (1974) (in medical malpractice action, jury may rely on expert's estimation of chance of survival with proper administration of medication), *aff'd mem.*, 37 N.Y.2d 719, 337 N.E.2d 128, 374 N.Y.S.2d 615 (1975) and *Daugert v. Pappas*, 104 Wash. 2d 254, 256, 263, 704 P.2d 600, 605, 606 (1985) (holding *Herskovits* loss of chance analysis inapplicable to legal malpractice case). But a lawyer in the same circumstances would be exonerated because the client could not show that, had the protocol been applied, the client would have won.

The "but for" standard is so contrary to the usual operating technique of the lawyer that its use in the legal malpractice standard seems disingenuous. Consider the typical case of the client who comes to the lawyer seeking redress for injury to his person or rights. Given the vagaries of courts and juries, the lawyer generally speaks in terms of likelihood, such as, "We have a good chance," never stating, "We will win the case." See generally *D'Amato, Legal Uncertainty*, 71 Calif. L. Rev. 1 (1983) (discussing uncertainty of legal system). But that is exactly what the client must prove to sustain a malpractice claim against a lawyer. See *Maryland Casualty Co. v. Price*, 231 F. 397, 403 (4th Cir. 1916); Note, *The Standard of Proof of Causation in Legal Malpractice Cases*, 63 Cornell L. Rev. 666 (1978); cf. Note, *Medical Malpractice Damage Caps: Navigating the Safe Harbors*, 65 Wash. U.L.Q. 565 (1987) (analyzing legislative responses to increasing medical malpractice litigation and inconsistent judicial results).

Another example of lawyers creating a special rule for themselves is the rule that exempts lawyers from liability to third parties not in privity for negligent misrepresentation, while extending such liability to other professionals such as accountants and doctors. Compare *Kirsch v. Duryea*, 21 Cal. 3d 303, 309, 578 P.2d 935, 939, 146 Cal. Rptr. 218, 222 (1978) (unfair to make attorney pay damages for mere "mistake in choice") and *Friedman v. Dozorc*, 412 Mich. 1, 16, 312 N.W.2d 585, 592 (1981) (attorney owes no duty of care to adverse party in litigation) and *Berry v. Dodson, Nunley & Taylor, P.C.*, 717 S.W.2d 716, 718 (Tex. Civ. App.—San Antonio 1986) (attorney owes no duty of care to those outside attorney-client privilege), *writ granted*, 729 S.W.2d 690 (Tex. 1987) and *Bell v. Manning*, 613 S.W.2d 335, 338 (Tex. Civ. App.—Tyler 1981, writ ref'd n.r.e.) (same) and *Hawkins v. King County*, 24 Wash. App. 338, 344, 602 P.2d 361, 365 (1979) (lawyer generally owes no duty to disclose client information unless aware of client's intent to harm unknowing victim) with *H. Rosenblum, Inc. v. Adler*, 93 N.J. 324, 352, 461 A.2d 138, 153 (1983) (auditor owes duty to all foreseeable recipients of financial statements) and *Armstrong v. Morgan*, 545 S.W.3d 45, 47 (Tex. Civ. App.—Texarkana 1976) (physician owes duty of care not to injure patient during physical examination and to give accurate report) and *Petersen v. State*, 100 Wash. 2d 421, 428, 671 P.2d 230, 237 (1983) (physician owes duty of care to anyone foreseeably injured by patient with drug-related mental problem).

10. See *infra* Part I A-B.

on clients. In addition, the distinction between general and special retainer agreements—which has been seized upon to subject general retainer fees to contract rather than fiduciary law and thereby to legitimate a form of nonrefundable retainers¹¹—is examined and criticized on the ground that both general and special retainers obstruct client freedom to discharge lawyers.¹²

Part II addresses a potentially significant statutory argument against the trust-based theory of the attorney-client relationship.¹³ This argument, founded on a New York statute (“section 474”)¹⁴ that has been adopted by many other states, purports to mandate that attorney-client agreements shall be “unrestrained by law.”¹⁵ This Article challenges that argument by offering a more historically accurate analysis of the statute’s language than the literal, yet erroneous, interpretations that have been rendered. The discussion concludes that section 474’s ostensible proscription of regulation of attorney compensation agreements repeals previous legislative ordinations of attorney-client fee agreements, but does not limit judicial superintendence of the retainer agreement.

Part III proceeds on the basis that the analyses of fiduciary, case, trust and statutory law fall short of invalidating nonrefundable retainers; it therefore examines the validity of nonrefundable retainers from a traditional contract law perspective; specifically, whether they are legitimate liquidated damages clauses or function as unenforceable penalties.¹⁶ The analysis concludes that most nonrefundable retainers function as penalties because the forfeited sum is rarely a reasonable, good faith estimate of damages. Next, the possibility of legitimating the nonrefundable retainer under principles of judicial forfeiture is explored but rejected.¹⁷ Finally, the contract analysis considers the effect on valid nonrefundable retainers of the doctrine of avoidable consequences.¹⁸ The Article concludes that most nonrefundable retainers are legally and ethically impermissible.

I. THE LAWYER AS FIDUCIARY

A lawyer is a fiduciary for his client.¹⁹ While it is commonly said that

11. See *Martin v. Camp*, 219 N.Y. 170, 176, 114 N.E. 46, 48 (1916).

12. See *infra* notes 44-58 and accompanying text.

13. See *infra* Part II.

14. N.Y. Jud. Law § 474 (McKinney 1983) (“section 474”). Although this Article is based chiefly on New York law, its significance is national in scope because the principal New York case, *Martin v. Camp*, 219 N.Y. 170, 114 N.E. 46 (1916) and the apparently conflicting statute, section 474, have been followed or adopted by many other states. See *infra* note 137 and accompanying text.

15. N.Y. Jud. Law § 474 (McKinney 1983).

16. See *infra* notes 174-201 and accompanying text.

17. See *infra* notes 203-45 and accompanying text.

18. See *infra* notes 249-54 and accompanying text.

19. See *Gaffney v. Harmon*, 405 Ill. 273, 277, 90 N.E.2d 785, 788 (1950) (“A fiduciary relationship exists as a matter of law between attorney and client”); C. Wolfram, *Modern Legal Ethics* § 4.1, at 146 (1986) (“the designation of ‘fiduciary,’ . . . surely

fiduciary duties arise when a relationship requires one person to act primarily for another's benefit,²⁰ such a rationale is unacceptably overinclusive. A better view is that lawyers are fiduciaries because the client's retention of an attorney to exercise "professional judgment" on his behalf²¹ necessarily requires the client to repose trust and confidence in the attorney.²² When he exercises that professional judgment, the lawyer

attaches to the [lawyer-client] relationship"). See also H. Drinker, *Legal Ethics* 89-96 (1953) (citing basic fiduciary responsibilities owed by attorney to client such as the ban on commingling of funds, deliberate deception and unnecessary delay); E. Wood, *Fee Contracts of Lawyers* 152 (1936) ("the construction of fee contracts between lawyers and clients does not differ from the construction of contracts between persons who sustain a like fiduciary relation to each other").

The law of fiduciary obligation has been developed over the past 400 years by extending the fiduciary element, which in its earliest form was a part of the law of trusts, to persons not acting as trustees. See D. Waters, *The Constructive Trust, The Case for a New Approach in English Law* 3-4 (1964); Jacobson, *Capturing Fiduciary Obligation: Shepherd's Law of Fiduciaries*, 3 *Cardozo L. Rev.* 519, 524 (1982). The fiduciary obligation of lawyer to client probably derives from the extension of fiduciary law from trustee/beneficiary to principal and agent. Surprisingly little has been written on the subject of fiduciary law, see Jacobson, *supra* at 519, and even less on the origin of the fiduciary nature of the lawyer-client relationship. See Jacobson, *The Private Use of Public Authority: Sovereignty and Associations in the Common Law*, 29 *Buffalo L. Rev.* 599, 616 n.48 (1981). It is likely that, in addition to its derivation from the law of agency, significant contributions have been made by the law of equity. Indeed, early American cases have imposed what we would now call fiduciary obligations by exclusive reliance on equitable principles. See, e.g., *Etzel v. Duncan*, 112 Md. 346, 76 A. 493, 495 (1910); *Whitehead v. Kennedy*, 69 N.Y. 462, 466 (1877); 1 J. Story, *Equity Jurisprudence* § 311, at 298-300. On the transition to fiduciary obligation, see *Etzel*, 112 Md. at 350-51, 76 A. at 495 (court of equity described relation of attorney and client as "quasi fiduciary").

20. See *Riggs Nat'l Bank v. Freeman*, 682 F. Supp. 519, 520 (S.D. Fla. 1988) ("a fiduciary relationship may exist under a variety of circumstances, including cases where there has been a special confidence reposed in one, who in equity and good conscience, is bound to act in good faith and with due regard to the interests of the one reposing the confidence"); *Black's Law Dictionary* 563 (5th ed. 1979) ("A person having duty, created by his undertaking, to act primarily for another's benefit in matters connected with such undertaking."); see also J. Shepherd, *The Law of Fiduciaries* 3-11 (1981) (refusing to define fiduciary on the alternative grounds that the concept is "intrinsically non-rational" and defining it would "rob it of its dynamics and therefore its soul").

21. See *Model Code of Professional Responsibility* EC 5-1, DR 5-105(A) (1982) (hereinafter *Model Code*); *Model Rules of Professional Conduct*, Rule 2.1 (1983) (hereinafter *Model Rules*).

22. See *Williams v. Griffin*, 35 Mich. App. 179, 183, 192 N.W.2d 283, 285 (1971); *In re Wilson*, 81 N.J. 451, 455, 409 A.2d 1153, 1154-55 (1979); *Rosner v. Paley*, 65 N.Y.2d 736, 738, 481 N.E.2d 553, 554, 492 N.Y.S.2d 13, 14 (1985); *White v. Whaley*, 40 How. Pr. 353, 363 (N.Y. Sup. Ct. 1870). A client's trust in his lawyer is regarded as so vital that it forms a theoretical basis for defining the lawyer as fiduciary. See C. Wolfram, *Modern Legal Ethics* § 4.1, at 147 (1986) ("clients have a right to assume that a lawyer who undertakes to listen to them and to render legal assistance can be trusted"). The need for trust is also reflected in the ethical requirement that communications to lawyers be kept confidential, see *Model Code*, *supra* note 21, DR 4-101, *Model Rules*, *supra* note 21, Rule 1.6, and the corresponding evidentiary privilege, see Fried, *The Lawyer as Friend: The Moral Foundations of the Lawyer-Client Relation*, 85 *Yale L.J.* 1060, 1075 (1976) (legal institution "exemplifies . . . the ideal of personal relations of trust and personal care which . . . are good in themselves"); cf. *Hickman v. Taylor*, 329 U.S. 495, 510-11 (1947) (allowing discovery of attorney work-product, which reflects "thoughts" and "mental impressions," would have demoralizing effect on legal profession); *Brock v.*

must advance the client's interests as the client would define them if fully informed.²³ Acting primarily, if not exclusively, in a client's interest requires undivided loyalty²⁴ and zealous devotion.²⁵ To fulfill these fiduciary duties, lawyers must inspire their clients' trust and confidence.²⁶

A. Client's Right to Discharge

When a client loses that essential trust and confidence in his lawyer, the fiduciary basis of the relationship is undermined. As a precaution against this erosive possibility, the client is allowed to terminate the attorney-client relationship and agreement at any time, for any reason, however arbitrary.²⁷ It follows, then, that a client cannot be put in a worse position by exercising the right to terminate the attorney-client agreement. As stated in the leading case, *Martin v. Camp*,²⁸ imposing a

Barnes, 40 Barb. 521 (N.Y. App. Div. 1863) (applying fiduciary theory to attorney acting as agent for his client); *Mobil Oil Corp. v. Rubinfeld*, 72 Misc. 2d 392, 399, 339 N.Y.S.2d 623, 632 (Civ. Ct. 1972) (applying fiduciary theory to franchisees), *aff'd*, 77 Misc. 2d 962, 357 N.Y.S.2d 589 (App. Term. 1974), *rev'd on other grounds*, 48 A.D.2d 428, 370 N.Y.S.2d 943 (1975), *aff'd*, 40 N.Y.2d 936, 358 N.E.2d 882, 390 N.Y.S.2d 57 (1976).

23. See Model Code, *supra* note 21, EC 7-8; Model Rules, *supra* note 21, Rule 1.2(a).

24. See Model Rules, *supra* note 21, Rule 1.7 comment 1; Fried, *supra* note 22, at 1060. See generally Restatement (Second) of Trusts § 170(1) (1959) ("The trustee is under a duty to the beneficiary to administer the trust solely in the interest of the beneficiary."); 2A Scott, *The Law of Trusts* § 170 (4th ed. 1987) (duty of loyalty is most fundamental duty owed by a fiduciary).

25. See Model Code, *supra* note 21, DR 7-101, Canon 7. Other obligations are also present. See, e.g., Model Rules, *supra* note 21, Rule 1.1 (competent legal skill, knowledge and preparation); Model Code, *supra* note 21, DR 6-101(A)(1)-(A)(2) (competence); Model Rules, *supra* note 21, Rule 8.4(c) (candor); Model Code, *supra* note 21, DR 1-102(A)(4), 7-101(A)(3) (candor); Model Rules, *supra* note 21, Rules 1.2-1.4 (candor); Model Code, *supra* note 21, DR 6-101(A)(3) (diligence).

26. As Francis Bacon once stated:

The greatest trust between man and man is the trust of giving counsel. For in other confidences, men commit the parts of life; their lands, their goods, their children, their credit, some particular affair; but to such as they make their counsellors, they commit the whole: by how much the whole they are obligated to all faith and integrity.

F. Bacon, *Of Counsel*, in *The Works of Lord Bacon* 277 (1846), *quoted in Note, Attorneys' Trust Accounts: The Bar's Role in the Preservation of Client Property*, 49 Ohio St. L.J. 275, 275 n.1 (1988); see *Martin v. Camp*, 219 N.Y. 170, 173-74, 114 N.E. 46, 47 (1916) (attorney-client contract different from ordinary employment contracts because of "peculiar relation of trust and confidence").

27. See *In re Dunn*, 205 N.Y. 398, 402, 98 N.E. 914, 915-16 (1912); *Petty v. Field*, 97 A.D.2d 538, 467 N.Y.S.2d 898 (1983), *appeal dismissed*, 61 N.Y.2d 902, 462 N.E.2d 1201, 474 N.Y.S.2d 483 (1984). An attorney-client relationship based upon principles of trust and confidence and the attendant right to discharge is conceptually identical to an option contract. The client has a right to buy the lawyer's services for a price, but whether to exercise that right is completely at his option. Unlike an option contract, however, the client has not given valuable consideration for the option. Instead, the option is his by virtue of public policy.

28. 219 N.Y. 170, 174, 114 N.E. 46, 48 (1916). *Martin* has been adopted by numerous jurisdictions. A list of thirty-four such jurisdictions is set forth in *Note, For a Few Dollars More: Client's Right to Discharge His Attorney Under a Contingent Fee Contract*, 7 Cardozo L. Rev. 913, 919 n.40 (1986).

penalty may deter a client from invoking the right to discharge her attorney. Therefore, when a client discharges his lawyer, the retainer agreement is not breached. Rather, the client simply exercises a contract right implied by public policy.²⁹ In fact, a discharged lawyer's recovery upon termination by his client is limited to quantum meruit.³⁰

B. Codification of Trust

The fiduciary standard of care owed by a lawyer to a client is elaborated and codified in both the Model Code of Professional Responsibility ("Model Code") and in the Model Rules of Professional Conduct ("Model Rules").³¹ For example, both require preserving the confidences and secrets of a client,³² avoiding conflicts of interest,³³ acting competently,³⁴ representing a client zealously,³⁵ and safeguarding client property.³⁶

The Model Code's prohibition against "illegal or clearly excessive" fees,³⁷ and the Model Rules' requirement that "fees be reasonable"³⁸ exemplify significant substitutions of the fiduciary standard for that of the marketplace. Advance nonrefundable fees for a specific legal service may constitute an excessive, unreasonable fee when the client elects to exercise his right to discharge his lawyer before completion of the contemplated service.³⁹ In such a case, a lawyer "cannot rely on the commercial

29. See *Martin v. Camp*, 219 N.Y. at 174, 114 N.E. at 48 ("The discharge of the attorney by his client does not constitute a breach of the contract, because it is a term of such contract, implied from the peculiar relationship which the contract calls into existence, that the client may terminate the contract at any time with or without cause."); see also *Demov, Morris, Levin & Shein v. Glantz*, 53 N.Y.2d 553, 428 N.E.2d 387, 444 N.Y.S.2d 55 (1981).

30. See *In re Ellis*, 193 Misc. 956, 957, 85 N.Y.S.2d 398, 400 (Sup. Ct. 1948) ("If the client exercises his right to discharge the attorney prior to the completion of the services for which the fee agreed upon was to constitute compensation, the attorney is not entitled to the agreed upon compensation but must take instead the reasonable value of his services."), *aff'd*, 275 A.D. 767, 88 N.Y.S.2d 903 (1949).

31. The Model Code and Model Rules are not solely a codification of fiduciary law. Some notable exceptions include the sections dealing with advertising, solicitation, and unauthorized practice of law, which seek to limit competition in the provision of legal services rather than to express a fiduciary standard. See, e.g., Model Code, *supra* note 21, DR 2-101, 2-102, 2-103, 2-104, 2-105, 3-101, 3-102, 3-103; Model Rules, *supra* note 21, Rules 5.5, 7.2, 7.3.

32. See Model Code, *supra* note 21, Canon 4; Model Rules, *supra* note 21, Rule 1.6.

33. See Model Code, *supra* note 21, Canon 5; Model Rules, *supra* note 21, Rules 1.7, 1.8, 1.9, 1.10.

34. See Model Code, *supra* note 21, Canon 6; Model Rules, *supra* note 21, Rule 1.1.

35. See Model Code, *supra* note 21, Canon 7; Model Rules, *supra* note 21, Rules 1.2, 1.3.

36. See Model Code, *supra* note 21, DR 9-102, 2-110(A)(2), 2-110(A)(3); Model Rules, *supra* note 21, Rule 1.15.

37. Model Code, *supra* note 21, DR 2-106(A).

38. Model Rules, *supra* note 21, Rule 1.5(a).

39. A nonrefundable retaining fee may be a violation of Model Code DR 2-106 and to that extent may not be enforced by a court. See, e.g., *In re Kutner*, 78 Ill. 2d 157, 399 N.E.2d 963 (1979); *Jacobs v. Holston*, 70 Ohio App. 2d 55, 434 N.E.2d 738 (1980).

laws to collect a fee that he has not entirely earned, due to his discharge by his client [If he could so rely, then commercial laws would be] in direct conflict with the . . . Code of Professional Responsibility."⁴⁰ Both the Model Code and Model Rules, as codifications of fiduciary law, are premised upon the trust-based theory of the attorney-client relationship, which requires that the client's discharge right displace commercial contract rules.

C. *Exceptions to the Discharge Right*

Martin v. Camp provides two exceptions to the trust-based client discharge rule: change of position and the general retainer. The first provides that when the attorney "has changed his position or incurred expense"⁴¹ in connection with his representation of a client, he may seek contract damages in the event of client breach. Too literal a reading of this exception would consume the rule; too narrow a reading would collapse the exception. The exception therefore should be read to equate "changed position" with a change in the attorney's employment status.⁴² Similarly, "incurred expense" should be limited to expenses not arising in the ordinary course of a particular representation.⁴³ These characterizations coincide roughly with the purported justifications for the second exception to the client discharge rule articulated by the *Martin* court, the general retainer exception.

A general retainer⁴⁴ is an agreement between attorney and client in

40. *Simon v. Metoyer*, 383 So. 2d 1321, 1323-24 (La. Ct. App.), *review denied*, 389 So. 2d 1338 (La. 1980).

41. *Martin v. Camp*, 219 N.Y. 170, 176, 114 N.E. 46, 48 (1916).

42. Thus, for example, a lawyer changes his position when he declines to represent buyer A because seller B promises to retain him, or when he resigns from his partnership after heir C promises to engage him as a full-time legal advisor. *Cf. Jacobson v. Sassower*, 113 Misc. 2d 279, 286, 452 N.Y.S.2d 981, 985-86 (N.Y.C. Civ. Ct. 1982) (rejecting lawyer's claim of reliance on the nonrefundability of the fee at issue), *aff'd per curiam*, 122 Misc. 2d 863, 474 N.Y.S.2d 167 (App. Term. 1983), *aff'd mem.*, 107 A.D.2d 603, 483 N.Y.S.2d 711, *aff'd mem.*, 66 N.Y.2d 991, 489 N.E.2d 1283, 499 N.Y.S.2d 381 (1985).

43. *Cf. I.R.C. § 162(a)* (1986) (business expenses deductible if incurred in "ordinary" course of business).

44. General retainers are to be distinguished from special retainers, which are agreements between attorneys and clients for the performance of specific legal services for a designated fee. *See* 1 S. Speiser, *Attorneys' Fees* §§ 1:17 to :21, at 23-25 (1973). The distinction between a general retainer and a special retainer is often confused. *See McClain, The Strange Concept of the Legal Retaining Fee*, 8 J. Legal Prof. 123 (1983). Notwithstanding this lack of understanding, the general retainer exception is widely followed. *See* California Rules of Professional Conduct 2-111(A)(3) ("A member of the State Bar who withdraws from employment shall refund promptly any part of a fee paid in advance that has not been earned. However, this rule shall not be applicable to a true retainer fee which is paid solely for the purpose of insuring the availability of the attorney for the matter."); Pennsylvania Bar Ass'n Formal Op. 85-120 (undated), *digested in* Law. Man. on Prof. Conduct (ABA/BNA) 901:7301 ("All non-refundable retainer agreements should specify the dollar amount of the retainer and clearly state the time frame in which the agreement will exist."). *But see* *Jacobs v. Holston*, 70 Ohio App. 2d 55, 59, 434 N.E.2d 738, 740 (1980) (even a "nonrefundable retaining fee [given] for accepting the

which the client agrees to pay 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 that arise during a specified period.⁴⁵ It is in form an option agreement.⁴⁶ Since the general retainer fee is given in exchange for availability, it is a charge separate from fees incurred for services actually performed.⁴⁷

The general retainer exception to the discharge rule is based on the theory that⁴⁸ attorneys who accept general retainers make two present sacrifices at the time of agreement. First, they re-allocate their time so that they can stand ready to serve the general retainer client, to the exclusion of other clients.⁴⁹ Second, they give up their right to be retained by persons whose interests conflict with the general retainer client⁵⁰ and thus again forego potential income.⁵¹

These two justifications are not applicable to all general retainer situations. First, attorneys rarely turn down work opportunities because their plates are already full.⁵² Rather they simply pile on more work and jug-

case" may not be enforceable if in violation of DR 2-106's prohibition of charging an "illegal or clearly excessive fee").

45. See *Baranowski v. State Bar*, 24 Cal. 3d 153, 164 n.4, 593 P.2d 613, 618 n.4, 154 Cal. Rptr. 752, 757 n.4 (1979).

46. Here, of course, valuable consideration does pass. See *supra* note 27.

47. The parties may limit the range of legal services to be covered by the general retainer agreement. In addition, the parties can create a hybrid general-special retainer by agreeing that part or all of the general retainer fee be applied to the bill for any services actually performed. See Freund, *Skadden, Arps in 40th Year—A Memoir of 'Flom Machine'*, N.Y.L.J., June 18, 1987, at 1, col. 3.

48. See *supra* note 44.

49. See Pennsylvania Bar Ass'n Formal Op. 85-120 (undated), *digested in* Law. Man. on Prof. Conduct (ABA/BNA) 901:7301.

50. The conflict-of-interest sacrifice is most apparent among lawyers regarded as invaluable experts in particular fields. Clients often retain such specialists to prevent adversaries from doing so. For example, Joseph Flom and his law firm, Skadden, Arps, Slate, Meagher & Flom, have been seen by many as indispensable advisors in contests for corporate control. See Wilson, *Managing for Success at Skadden, Arps*, Int'l Fin. L. Rev. 31 (Nov. 1984); Freund, *supra* note 47. Skadden's general retainer agreements typically provide that the firm will represent the client if it is the target of a hostile takeover, even if the raider is also a retainer client. Thus the firm cannot represent (or bill) raider-clients in takeover efforts against target-clients. See *Kennecott Copper Corp. v. Curtiss-Wright Corp.*, No. 78-1295, slip op. at 6 (S.D.N.Y. April 10, 1978) (mem.); J. Stewart, *The Partners* 255 (1983); *infra* note 55 and accompanying text.

51. See *Blair v. Columbian Fireproofing Co.*, 191 Mass. 333, 77 N.E. 762 (1906); Model Code, *supra* note 21, DR 5-101 (1982). The conflict-of-interest aspect is illustrated by Senator Daniel Webster's refusal to accept clients whose interests were adverse to the Bank of the United States, which he represented on a general retainer basis. See Letter from Daniel Webster to Nicholas Biddle (Dec. 21, 1833), *reprinted in* 2 *The Papers of Daniel Webster*, Legal Papers 320 (1983). The conflict, however, did not deter Senator Webster from demanding that his retainer be "refreshed" while he served in the U.S. Senate and voted on matters involving the Bank. Senator Webster apparently appreciated the potential ramifications of his behavior since he asked Mr. Biddle, the President of the Bank, to burn his letters. See *id.*

52. During the course of evaluating over 100 federally funded Legal Services programs, one of the authors has had occasion to interview more than 800 lawyers in small firm private practice throughout the United States. One common characteristic of virtu-

gle their various undertakings, or in the case of large firms, add more associates as needed. When they do accept a general retainer, they do not set aside time and idly await the moment when their general retainer client demands legal services.⁵³ Even if they did, this time-allocation justification would merely replicate the change-of-position exception to the client discharge rule.⁵⁴ Indeed, in situations where the justification is legitimate, such as where the attorney has changed his position, the change-of-position exception subsumes the general-retainer/time-allocation theory. Accordingly, the time allocation theory does not support a separate general retainer exception to the client discharge rule.

Second, not all general retainer clients will yield conflicts that preclude a lawyer from representing other potential clients. A lawyer practicing in a large metropolitan area who receives a general retainer from a small businessman is not likely to be precluded from representing anyone who might wish his services. Likewise, a lawyer on a general retainer who represents a company that does most or all of its business with government agencies is not likely to have a diminished universe of potential clients.⁵⁵ The foregone representation may be seen as a change-of-position and thus is also subsumed by that broader exception to the client discharge rule.

The general retainer exception to *Martin v. Camp* is further enervated by cases raising other issues in which the justifications would have been valid—such as where a re-allocation of time was made or a conflict-of-interest arose—but the attorney's contractual argument failed nevertheless. For example, contract clauses prohibiting a client from settling a

ally all lawyers interviewed is that they had more work to do than time in which to do it. On the rare occasion when lawyers did turn down or refer work elsewhere, it was outside their area of expertise or not sufficiently remunerative for the effort required. See generally Gordon, *The Independence of Lawyers*, 68 B.U.L. Rev. 1, 60-63 (1988) (lawyers no longer devote portion of time to public service or politics; making money is ultimate goal).

53. Lawyers who accept general retainers may be analogized to banks that have unused lines of credit. A bank does not keep money lying around awaiting its demand by a debtor exercising his credit line. But see *Swindell v. First Nat'l Bank*, 121 Ga. 714, 49 S.E. 673 (1905).

54. The broader and more inclusive change-of-position exception is a particular application of the reliance principle, the now accepted basis for protecting parties who have justifiably and detrimentally relied on promises. See Restatement (Second) of Contracts § 90 (1981).

55. In the case of a specialist committed to a specific client, once the lawyer identifies a potential conflict between two of his clients, he must withdraw from representing both, unless they consent to the dual representation. See Model Code, *supra* note 21, DR 5-105; Model Rules, *supra* note 21, Rule 1.7. Skadden's general retainer agreements, however, typically contain a waiver of the conflict of interest issue that allows the firm to represent the target-client even though his adversary is also a client of the firm. See *Kennecott Copper Corp. v. Curtiss-Wright Corp.*, No. 78-1295, slip op. at 3 (S.D.N.Y. April 10, 1978) (mem.); J. Stewart, *supra* note 51, at 255. Thus, the firm minimizes its conflict of interest losses by accepting fees from at least one client. This provision is arguably unethical. See *Questions About Flom's Retainers*, Am. Law., Feb. 1979, at 14, col. 1.

lawsuit without his lawyer's consent are generally void as against public policy.⁵⁶ The attorney's contract argument yields because a client's right to exercise exclusive control over his property is superior to his lawyer's contractual right to fair compensation. Lawyers are not entitled to contract damages when clients violate the settlement restriction because such clauses are unenforceable.⁵⁷

Enforcement or denial of a lawyer's contractual rights when a client settles a lawsuit without the lawyer's consent is conceptually indistinguishable from enforcement or denial of a lawyer's contractual rights when a client discharges him. Accordingly, voiding the consent-to-settle clause and limiting the lawyer to quantum meruit in the former situation requires perforce voiding a nonrefundable retainer and limiting a lawyer to quantum meruit in the latter.⁵⁸

The facts of many general retainer cases thus do not satisfy the conditions that justify this exception to the client discharge rule. When the conditions are met, the change-of-position exception, as interpreted, sufficiently protects the lawyer's interests. Accordingly, the general retainer exception to the client discharge rule is superfluous.

D. *Historic Development*

The trust-based theory of the attorney-client relationship, as it applies to the nonrefundable retainer, is still nascent. It originated and evolved

56. See *In re Snyder*, 190 N.Y. 66, 82 N.E. 742 (1907); cf. *Andrewes v. Haas*, 214 N.Y. 255, 258, 108 N.E. 423, 424 (1915) (Cardozo, J.) (the law "will not, under the coercion of damages, constrain an unwilling suitor to keep a litigation alive for the profit of its officers"). But see *Gross v. Russo*, 47 A.D.2d 655, 364 N.Y.S.2d 184 (1975) (consent-to-settle provision not void on its face).

57. See *Davis v. Webber*, 66 Ark. 190, 200, 49 S.W. 822, 826 (1899).

58. Additional reasons make the rejection of the nonrefundable retainer more compelling than voiding the consent-to-settle provision. First, as a general policy matter, it is more important under fiduciary standards to protect clients' trust in their lawyers than to ensure their confidence in the success of a lawsuit. See *supra* notes 19-40 and accompanying text. The consent-to-settle provision is invalid because it would impose settlement costs on parties who would otherwise voluntarily choose to settle, forcing clients to negotiate with their lawyers instead of directly with their adversaries. Similarly, the nonrefundable retainer is to be rejected because a client forced to pay for invoking his right to discharge is deterred from exercising that right. See *Martin v. Camp*, 219 N.Y. 170, 174, 114 N.E. 46, 48 (1916). This point is *a fortiori*: it is more objectionable to tax a right based on disappointed trust in a vital relationship than to tax a right based on diminished expectations from a lawsuit. Compare *Hickman v. Taylor*, 329 U.S. 495, 511 (1947) (attorney-client privilege indispensable to proper development of attorney-client relationship) with J. O'Connell, *The Lawsuit Lottery* 3-7 (1979) (lawsuits often become speculative gambles). Another reason for rejecting nonrefundable retainers relates to the purported justifications for the general retainer exception. As noted, only in the most unusual general retainer situation will lawyers have re-allocated their time and only in some cases will the value of actual opportunities forgone because of conflicts of interest be significant. See *supra* notes 48-55 and accompanying text. Conversely, the lawyer acting under a contract with a consent-to-settle clause has in fact re-allocated his time by performing services in connection with the ongoing case. Further, he is much more likely to have declined to represent clients who posed conflicts of interest, because in an active case more issues and interests are implicated.

in New York, and its subsequent development has been grudging and ambiguous. This section traces that development, dividing the history into four "periods," defined as much by doctrine as by historical happenstance.

1. Up to *Martin v. Camp*: Freedom to Discharge

Early pronouncements⁵⁹ treated the attorney as any other contracting party—he was entitled to collect or retain contractual sums by judicial enforcement of his agreements.⁶⁰ This liberality was later curtailed to accommodate the view that lawyers, both as fiduciaries and officers of the court, occupied a special position unlike that held by other contracting parties.⁶¹ The current doctrine arose in the landmark case of *Martin v. Camp*.⁶² The *Martin* court observed that early judicial and statutory principles placed the attorney-client relationship on a contractual footing.⁶³ The court then redefined these positions on the ground that "the peculiar relation of trust and confidence that such a relationship implies injects into the contract certain special and unique features."⁶⁴

Accordingly, the *Martin* court held that clients have an unfettered right to discharge their attorneys at will and that this right requires the corollary that a client cannot be compelled to pay contract damages upon such a dismissal.⁶⁵ As noted, the *Martin* court indicated in dictum that its theory would not apply where an attorney changed his position⁶⁶ or was employed under a general retainer agreement.⁶⁷ The *Martin* court's reticence in expounding the meaning and limits of these potentially self-consuming exceptions may have facilitated the occasional lack of clarity in subsequent decisions.

59. Of course, earliest pronouncements forbade lawyers to sue for fees. *See Adams v. Stevens*, 26 Wend. 451, 452 (N.Y. 1841) ("Blackstone lays it down as the established law of England, that a counselor cannot sustain a suit for his fees.").

60. *See id.* at 456 (rejecting client's argument that attorney's contractual compensation may not exceed amounts designated in fee bill statutes prescribing sums for specified legal services). *Adams* was later described as expressing substantially the view now embodied in N.Y. Jud. L. § 474 that attorney compensation is "governed by agreement, express or implied, which is not restrained by law." *Martin v. Camp*, 219 N.Y. 170, 173, 114 N.E. 46, 47 (1916) (citing predecessor to section 474 (McKinney 1983)); *see infra* Part II (discussing the meaning of section 474).

61. *See, e.g., Matter of Dunn*, 205 N.Y. 398, 402, 98 N.E. 914, 915-16 (1912) (the attorney-client relationship is "so personal and confidential" that it is subject to rules that "would not prevail in the case of ordinary contracts"); *In re Cooper*, 22 N.Y. 67, 83-84 (1860) (evaluating legislature's authority to regulate attorneys in light of the lawyer's position as an officer of the court).

62. 219 N.Y. 170, 114 N.E. 46 (1916).

63. *See id.* at 173, 114 N.E. at 47 (citing *Adams v. Stevens*, 26 Wend. 451, 455 (N.Y. 1841) and the predecessor to N.Y. Jud. Law § 474 (McKinney 1983)).

64. *Id.*

65. *See id.* at 174, 114 N.E. at 48; *supra* notes 27-30, 58 and accompanying text.

66. *See supra* text accompanying notes 41-43.

67. *See supra* text accompanying notes 44-57 (explaining and rejecting this exception).

2. Up from *Martin v. Camp*: The Parties' Intentions

Four years after *Martin*, the New York Court of Appeals began its inquiry into a nonrefundable retainer case by pondering "what was decided by this court in *Martin v. Camp*."⁶⁸ Invoking the *Martin* court's statement that its rule was inapplicable to general retainers, the court in *Greenberg v. Jerome H. Remick & Co.* threatened to limit *Martin* by stating that it "does not extend to a case where it appears by the express terms of the contract or otherwise that a different rule was intended by the parties."⁶⁹ Taken at face value, *Martin* would have been changed from a substantive contract/fiduciary rule into a rebuttable presumption: unless the parties agreed differently, the attorney-client contract was terminable by the client without penalty. All that would have been necessary for such an exception to devour the rule was a form retainer contract providing that the parties intended that the employment relationship was not terminable at will by the client.

It is implausible, however, that the *Greenberg* court, a scant four years later, would dismantle *Martin* so casually. The *Martin* court understood that it was writing a major opinion that created a rule of law in New York that had not before existed and that was contrary to the existing rule in Ohio, California, Indiana, Minnesota, Missouri, Texas, and Illinois.⁷⁰ In rejecting the rule that allowed the attorney to recover fees when the client terminated the relationship without cause, the *Martin* court emphasized that "[t]hese decisions in other jurisdictions are not consistent with the principles which define the nature of the contract under which an attorney is employed, as those principles have been declared by the decisions of this court."⁷¹ Had the *Greenberg* court intended to hold that *Martin* had been written in disappearing ink, it would have provided at least some recognition of the significance of its holding. No such recognition, however, appears in *Greenberg*.⁷²

68. *Greenberg v. Jerome H. Remick & Co.*, 230 N.Y. 70, 72, 129 N.E. 211, 211 (1920).

69. *Id.* at 74, 129 N.E. at 212 (dictum).

70. *See Martin*, 219 N.Y. at 175, 114 N.E. at 48.

71. *Id.*

72. A change in the composition of the court may have contributed to *Greenberg's* loose language that signaled little deference to *Martin*. Four of the seven judges had changed (Chase, Cardozo, Crane, and Elkins had replaced Seabury, Bartlett, Collin, and Cuddleback). Compare *Greenberg v. Jerome H. Remick & Co.*, 230 N.Y. 70, 75, 129 N.E. 211, 212 (1920) (treatment of *Martin v. Camp*) with *Simpson v. Loehmann*, 21 N.Y.2d 305, 314, 234 N.E.2d 669, 674, 287 N.Y.S.2d 633, 640 (1967) (newly-appointed Judge Breitel reluctantly concurring to uphold New York's now infamous and unconstitutional *Seider* doctrine because "[o]nly a major reappraisal by the court, rather than the accident of a change in its composition, would justify the overruling of that precedent."). Another possible reason *Martin* did not get the respect from the *Greenberg* court that it deserved is that the *Martin* opinion was written by Judge Seabury, who resigned to run for governor soon after writing it, and who, during the period in which *Greenberg* was decided, was involved in a contentious series of legal debates with Chief Judge Cardozo and the rest of the court. *See J. Pollard, Mr. Justice Cardozo: A Liberal Mind in Action* 95-99 (1935).

Not only was the *Greenberg* court's apparent appendage to *Martin* overbroad, it was also unnecessary to the *Greenberg* court's analysis and result. Recognizing this, instead of following the command of its all-consuming exception to ask whether the parties intended that a rule other than *Martin v. Camp* apply, the *Greenberg* court retreated to inquire whether a "professional" contract or an "ordinary" contract had arisen.⁷³ The court reasoned that the agreement, which provided for employment of the lawyer as attorney and legal advisor for one year for \$5,200, was an ordinary business agreement because it: (1) did not require the attorney to "conduct a particular suit or proceeding"; (2) was not consummated "in anticipation of expected litigation"; and (3) during its term the client "had [not had] any contentious matter, litigated or otherwise, requiring the advice or services of an attorney at law."⁷⁴

Thus the court essentially determined that the agreement specified a general retainer and therefore met that *Martin v. Camp* exception.⁷⁵ Accordingly, notwithstanding the court's potentially expansive dicta that the parties' intention to displace *Martin* would be valid, it confined its decision to the *Martin* general retainer exception. In fairness to the *Greenberg* court, therefore, we can conclude that it saw the role of the parties' intentions not as determining the validity of the nonrefundable retainer itself, but rather as indicating whether a general or special retainer had arisen.⁷⁶

3. Proper Role of the Parties' Intentions

The intention of the parties analysis, in addition to determining whether a general retainer was intended, has also been used to determine whether a nonrefundable retainer was intended or whether some part of the advance fee had already been earned by the attorney. This subsection focuses on two cases that have used intention of the parties analysis ambiguously, and demonstrates the proper role of such an analysis in determining the impact of nonrefundable retainers and other devices that impose discharge costs on clients.

In *Fellner v. Zuckerberg*,⁷⁷ a client retained a lawyer to handle an an-

73. See *Greenberg*, 230 N.Y. at 75, 129 N.E. at 212.

74. *Id.* at 75, 129 N.E. at 212-13. A general retainer agreement is not a contract for the provision of legal services. Legal services are implicated only if a client exercises the option he has purchased. See *supra* note 27. A breach by the attorney of the general retainer agreement would not produce the same cause of action as would a breach by the attorney providing a legal service to a client. The latter may amount to malpractice while the former is compensable in damages as any other breach of contract. Viewed from that perspective, a general retainer agreement is an "ordinary business agreement." *Greenberg*, 230 N.Y. at 75, 129 N.E. at 212.

75. See *supra* notes 44-50, 67 and accompanying text.

76. Since the distinction in this context between general and special retainers is often superfluous, even this dimension of *Greenberg* does not alter *Martin's* broader policy mandate. See *supra* notes 44-58 and accompanying text.

77. 202 Misc. 122, 109 N.Y.S.2d 50 (City Ct. 1951), *rev'd per curiam*, 202 Misc. 611, 118 N.Y.S.2d 470 (Sup. Ct. 1952).

nulment and paid the entire fee in advance. During the representation, the client reconciled with her spouse and discharged the lawyer. The lawyer had earned some of the advance fee, but the record does not disclose how much.⁷⁸ The lawyer refused to refund anything to the client, basing his resistance on "the law of contracts."⁷⁹ The trial court rejected the lawyer's contention because it fell squarely within the "principle . . . enunciated in the leading case of *Martin v. Camp*."⁸⁰ Since no exception listed in *Martin* existed in this case, the lawyer was limited to quantum meruit.

The intermediate appellate court, in a sixty-four word per curiam opinion without citation to any authority, summarily rejected the trial court's disposition as premature.⁸¹ It then announced that "whether the [client] is entitled to the return of any part of the fee paid . . . depends on the intention of the parties when the payment was made, to be determined from the receipt and all the surrounding circumstances."⁸²

This ambiguous language is subject to several interpretations. The trial court's rejection of the nonrefundable retainer could be interpreted as erroneous because its validity depended on the parties' intentions, which the trial court did not consider. This is implausible, however, because *Martin* offered no such self-engulfing intention-of-the-parties exception,⁸³ and the appellate court did not even cite *Greenberg's* dictum on this point.⁸⁴ If it were permissible simply to employ contractual language such as "the parties intend that *Martin v. Camp* shall not apply and if client terminates, then lawyer is entitled to retain the advance fee paid," the doctrine then would be evanescent. Lawyers would draft and use standard forms with such language and most clients would routinely sign them.⁸⁵ It would be impertinent to ascribe such an intent to either

78. The trial court indicated that the lawyer had unsuccessfully attempted to reconcile the parties and had placed the action on the court calendar. See *Fellner*, 202 Misc. at 123, 109 N.Y.S.2d at 51. The court concluded that the reasonable value of the lawyer's services was \$150, rather than the \$275 advance fee figure. See *id.* at 126, 109 N.Y.S.2d at 54. In light of the appellate court's reversal and remand, these findings and the result may have ignored the intention of the parties as to how much was to be charged for various aspects of the case. See *infra* text accompanying notes 86-88.

79. *Fellner*, 202 Misc. at 124, 109 N.Y.S.2d at 52.

80. *Id.*

81. The judgment was reversed and a new trial ordered. See *Fellner*, 202 Misc. 611, 118 N.Y.S.2d 470 (1952).

82. *Id.* at 612, 118 N.Y.S.2d at 470-71.

83. For example, *Martin* rejected *Adams v. Stevens*, 26 Wend. 451 (N.Y. 1841), which would have focused on the intention of the parties as a matter of contract law. See *supra* note 60 and accompanying text.

84. See *supra* notes 69-76.

85. Such a rule would delegate regulatory power over lawyers to Benders, Blumberg and CCH. Cf. *Jacobson v. Sassower*, 113 Misc. 2d 279, 284, 452 N.Y.S.2d 981, 985 (N.Y.C. Civ. Ct. 1982) (taking judicial notice that forms of retainer agreements such as the one at issue are "reproduced in lawyers' handbooks and study aids"), *aff'd per curiam*, 122 Misc. 2d 863, 474 N.Y.S.2d 167 (App. Term. 1983), *aff'd mem.*, 107 A.D.2d 603, 483 N.Y.S.2d 711, *aff'd mem.*, 66 N.Y.2d 991, 489 N.E.2d 1283, 499 N.Y.S.2d 381 (1985).

New York's Court of Appeals or its Appellate Term.

More plausibly, the *Fellner* court may have concluded that the parties' intentions should be consulted to determine the extent to which the \$275 advance fee had in fact been earned by the attorney.⁸⁶ Since the trial court record was insufficiently developed to enable the intermediate court to answer this question,⁸⁷ it remanded for that purpose. This reading makes sense of the case. Instead of defying the Court of Appeals and flouting *Martin*, the *Fellner* court's "intention of the parties" language was not relevant to the forfeiture issue at all. Rather, that language applied only to determining on remand what portion of the advanced fee had been earned.⁸⁸

*Gross v. Russo*⁸⁹ supports this explanation of *Fellner*. In *Gross*, the parties sought a ruling on the validity of a contingency fee retainer agreement executed after the lawyer had performed substantial services. The agreement provided that if the client discontinued the case without his lawyer's consent, the lawyer's "liquidated damages shall be in the sum of \$25,000."⁹⁰ The trial court began its analysis by stating that retainers that may be construed as unconscionable must be barred,⁹¹ observing that *Martin* stated "the well-established rule that the discharge of an attorney does not subject a client to a breach of contract action."⁹²

The *Gross* trial court then distinguished the *Fellner* reversal on the ground that "[s]ince the entire fee [in *Fellner*] was only \$275, the Appellate Term, in considering the services rendered by the attorney, reversed and remanded the action to determine the 'intention of the parties'"⁹³ Thus, the *Gross* trial court considered the purpose of the *Fellner* remand to determine, according to the parties' intentions, what portion of the fee had been earned. This reading properly left *Martin*, and the other foundations the *Gross* court laid for its opinion, undisturbed.

Although not a nonrefundable retainer case, the agreement in *Gross* merits further analysis both because of its functional equivalence and because it highlights the proper role of the intention of the parties analysis.

86. For example, the attorney could have set out a fee schedule for the various legal events leading to a decree of annulment.

87. See *supra* note 78 and accompanying text.

88. This interpretation of *Fellner* is somewhat unsettling, since the intermediate court failed to state that on remand the lawyer's compensation should be calculated on a quantum meruit basis and not on the basis of the contract specifying the advance payment. Such a quantum meruit evaluation would be based on the reasonable value of the lawyer's services in light of what the parties intended. It would, for instance, account for what the parties considered the lawyer's services to be worth at the time of contract. See *supra* note 86.

89. 76 Misc. 2d 441, 351 N.Y.S.2d 355 (Sup. Ct. 1974), *rev'd*, 47 A.D.2d 655, 364 N.Y.S.2d 184 (1975).

90. *Gross*, 76 Misc. 2d at 441, 351 N.Y.S.2d at 356.

91. See *id.* at 442, 351 N.Y.S.2d at 357.

92. *Id.* at 443, 351 N.Y.S.2d at 358.

93. *Id.*

The *Gross* trial court condemned the "liquidated damages" provision, holding it "as a matter of law unconscionable and violative of public policy" because it would subvert the client's "untrammelled" discharge right.⁹⁴ It found the fact that services were rendered before execution of the agreement to be "counterbalanced" by the lawyer's claim that prospective services were then estimable.⁹⁵ The court reasoned that if the client elected to discharge his lawyer and forego those prospective services, he would be forced to pay for services never received.⁹⁶ Since the provision could thus have an unconscionable application by imposing a penalty on a client in violation of the *Martin v. Camp* right to discharge rule, the court held it was void on its face and set the case down for trial on the quantum meruit basis of the lawyer's claim.

The Appellate Division agreed that the clause contained "unfortunate language" that could be interpreted as a penalty.⁹⁷ However, it found that the language was not fatal because the parties may have intended solely to compensate the lawyer for work that he had already done.⁹⁸ On that basis, the provision was not facially void. Emphasizing the fact that when the "liquidated damages" clause was executed the lawyer had already rendered substantial services, the court held that the clause's validity would depend on the intention of the parties as to the proportionality of services rendered to the \$25,000 fee claimed.⁹⁹

The court thus observed that the \$25,000 could be a discontinuance payment for services already rendered rather than "a substantial penalty for services that were never rendered."¹⁰⁰ The liquidated sum therefore may have been "intended to safeguard the attorney against any 'settlement' which would deprive him of just compensation for services rendered."¹⁰¹ Thus the court prescribed an inquiry into the parties' intentions regarding how much the lawyer had already worked and earned. Like the *Fellner* court, therefore, the *Gross* court did not say that the parties' intentions should dictate the enforceability of their contractual clause, but rather that they might be relevant in determining how much of an agreed-upon fee the lawyer had earned.¹⁰²

4. Clever Lawyers and Mum Courts

While the lawyers in *Fellner* and *Gross* may have lacked familiarity with *Martin* and its exceptions, this was not the case with the attorney in

94. *See id.* at 444, 351 N.Y.S.2d at 359.

95. *See id.*

96. *See id.*

97. *See Gross v. Russo*, 47 A.D.2d 655, 655, 364 N.Y.S.2d 184, 185-86 (1975).

98. *See id.*

99. *See id.*

100. *Id.*

101. *Id.*

102. For a less gracious interpretation of the *Gross* court's description of the "liquidated damages" provision as "unfortunate language," see *infra* notes 190-92 and accompanying text.

Jacobson v. Sassower.¹⁰³ In *Jacobson*, the attorney sought to convert a representation properly denominated as a special retainer into a general retainer¹⁰⁴ and thus to legitimate a forfeiture provision contained in that agreement. In a dramatic example of the delicacy of this problem, the trial court's refusal to endorse the lawyer's effort was affirmed in short-hand opinions by all three courts up New York's appellate ladder.¹⁰⁵

The client in *Jacobson* retained a "well-known, highly regarded matrimonial lawyer" to represent him in a divorce proceeding.¹⁰⁶ The retainer agreement specified compensation at an hourly fee of \$100 to be paid as billed plus a "non-refundable retainer of \$2,500" payable upon commencement of the relationship that would "be credited against . . . charges."¹⁰⁷ After insurmountable friction developed between the attorney and client, the client discharged the lawyer and demanded return of the unearned portion of the \$2,500 advance fee pursuant to the Model Code.¹⁰⁸ The lawyer refused this demand on the ground that the terms of the contract made that \$2,500 nonrefundable.

The trial court disagreed with the lawyer, holding on several alternative grounds that no valid nonrefundable retainer existed and ordering a refund of the unearned portion of the \$2,500 advance fee. Of the court's two principal grounds,¹⁰⁹ the first ground tracks the analysis developed in this Article based on *Martin's* trust-based theory of the attorney-client relationship. The court articulated the *Martin* principles,¹¹⁰ identified the general retainer exception based on *Greenberg*,¹¹¹ and found that the

103. 113 Misc. 2d 279, 452 N.Y.S.2d 981 (N.Y.C. Civ. Ct. 1982), *aff'd per curiam*, 122 Misc. 2d 863, 474 N.Y.S.2d 167 (App. Term. 1983), *aff'd mem.*, 107 A.D.2d 603, 483 N.Y.S.2d 711, *aff'd mem.*, 66 N.Y.2d 991, 489 N.E.2d 1283, 499 N.Y.S.2d 381 (1985).

104. For a discussion of the distinction between special and general retainers, see *supra* notes 44-47 and accompanying text.

105. See *supra* note 103.

106. See *Jacobson*, 113 Misc. 2d at 279, 452 N.Y.S.2d at 982.

107. *Id.* at 280, 452 N.Y.S.2d at 982.

108. See Model Code, *supra* note 21, DR 2-110(B)(4) (lawyer shall withdraw from employment if discharged by his client); *id.*, DR 2-110(A)(3) (withdrawing lawyer shall refund to his client unearned advance fee payments); see also Brickman, *The Advance Fee Payment Dilemma: Should Payments Be Deposited to the Client Trust Account or to the General Office Account?*, 10 Cardozo L. Rev. (forthcoming) (1989) (analyzing these Model Code provisions and DR 9-102).

109. Apart from the court's two holdings discussed in the text, another noteworthy ground of its decision was Model Code DR 2-110(B)(4) and DR 2-110(A)(3). *Jacobson v. Sassower*, 113 Misc. 2d 279, 284, 452 N.Y.S.2d 981, 984 (N.Y.C. Civ. Ct. 1982), *aff'd per curiam*, 122 Misc. 2d 863, 474 N.Y.S.2d 167 (App. Term. 1983), *aff'd mem.*, 107 A.D.2d 603, 483 N.Y.S.2d 711, *aff'd mem.*, 66 N.Y.2d 991, 489 N.E.2d 1283, 499 N.Y.S.2d 381 (1985). If nonrefundable retainers are invalid, then under DR 2-110(A)(3) any unearned portion of an advance fee must be returned to the client. But does DR 2-110(A)(3) substantively state that charging a nonrefundable retainer violates that section? Arguably, "if an attorney is prohibited from keeping any part of a pre-paid fee that has not been earned because of his discharge by his client, he is also prohibited from collecting any part of a fee that he has not earned for that reason." *Simon v. Metoyer*, 383 So. 2d 1321, 1323 (La. App. 1980); see *supra* notes 31-40 and accompanying text.

110. See *supra* notes 62-67 and accompanying text.

111. See *supra* notes 68-76 and accompanying text.

lawyer's effort at establishing a general retainer had failed.¹¹² In sum, the court found "the practice of charging advance 'nonrefundable' fees [to be] a bald attempt to circumvent the rule limiting an attorney's recovery upon discharge to *quantum meruit*."¹¹³

The trial court also grounded its rejection of the nonrefundable retainer in the agreement's ambiguity. Its analysis assumed *arguendo* that the intention of the parties was relevant,¹¹⁴ and found that the agreement would not alert "the average matrimonial client . . . that he was agreeing to a possible forfeiture of his advance payment."¹¹⁵ Further, the contract contained "no explicit language designating the \$2,500 as a 'minimum fee.'"¹¹⁶ Accordingly, the client could not have intended a forfeiture provision since he could not have understood the contract language to describe one.

This alternative holding on ambiguity (or "procedural unconscionability")¹¹⁷ was seized by both the Appellate Division and by the Court of Appeals to affirm the trial court.¹¹⁸ Apart from its misconception of the role of the parties' intentions in evaluating nonrefundable retainers, the principal oddity of this unanimity is that the case presented a rare opportunity for judicial review of a critical attorney-client issue.¹¹⁹ As the trial court's comprehensive opinion indicates, the case presented a wealth of issues for resolution: generally, whether nonrefundable retainers are

112. See *Jacobson v. Sassower*, 113 Misc. 2d 279, 285, 452 N.Y.S.2d 981, 985 (N.Y.C. Civ. Ct. 1982), *aff'd per curiam*, 122 Misc. 2d 863, 474 N.Y.S.2d 167 (App. Term. 1983), *aff'd mem.*, 107 A.D.2d 603, 483 N.Y.S.2d 711, *aff'd mem.*, 66 N.Y.2d 991, 489 N.E.2d 1283, 499 N.Y.S.2d 381 (1985). The court reached this conclusion by observing that an hourly charge was to be offset against the advance payment and that the lawyer was to represent the client "for a period of unspecified duration in connection with a particular legal matter." *Id.* at 283, 452 N.Y.S.2d at 984.

113. *Jacobson*, 113 Misc. 2d at 282, 452 N.Y.S.2d at 983 (citing *Martin v. Camp*, 219 N.Y. 170, 114 N.E. 46 (1916)).

114. See *id.* at 285, 452 N.Y.S.2d at 985 (citing *Fellner v. Zuckerberg*, 202 Misc. 611, 612, 118 N.Y.S.2d 470, 470-71 (App. Term. 1952)); *supra* notes 77-102 and accompanying text (intention of parties relevant to amount of advance fee earned and to whether general retainer was intended, but not to legitimacy of nonrefundable retainer itself).

115. *Jacobson*, 113 Misc. 2d at 285, 452 N.Y.S.2d at 985.

116. *Id.*

117. See *Leff, Unconscionability and the Code—The Emperor's New Clause*, 115 U. Pa. L. Rev. 485, 487 (1967); see also *Henningsen v. Bloomfield Motors*, 32 N.J. 358, 404, 161 A.2d 69, 95 (1960) (failure to call buyer's attention to exculpatory clause).

118. The Appellate Term, the first appellate court to review the trial judge, affirmed substantially on the ground of the trust-based theory of the attorney-client relationship, viewing as "unenforceable any contractual provision which constrains a client from exercising his right to freely discharge his attorney . . . [and that] the larger the amount of the so-called 'nonrefundable' retainer, the more securely is the client held hostage to that payment." *Jacobson v. Sassower*, 122 Misc. 2d 863, 866, 474 N.Y.S.2d 167, 169 (App. Term. 1983), *aff'd mem.*, 107 A.D.2d 603, 483 N.Y.S.2d 711, *aff'd mem.*, 66 N.Y.2d 991, 489 N.E.2d 1283, 499 N.Y.S.2d 381 (1985).

119. The opportunity was rare not because the underlying issues arise infrequently, but because the parties rarely air these grievances in court. *Cf. Jacobson v. Sassower*, 113 Misc. 2d at 284, 452 N.Y.S.2d at 985 ("this retainer agreement is commonly used throughout the New York City metropolitan area").

facially void; whether the general retainer exception¹²⁰ endures; the impact of the Model Code on these rules;¹²¹ the role of the parties' intentions and the meanings of *Fellner*¹²² and *Gross*;¹²³ the relevance of section 474;¹²⁴ and the scope of the change-of-position exception.¹²⁵

It was not a lack of imagination that caused these appellate courts to tunnel their vision to the unexciting and nondispositive issue of procedural unconscionability; on that issue each of the courts took a slightly different position. The Appellate Division, in a brief memorandum opinion, affirmed, finding that the "nonrefundable" retainer agreement [was] ambiguous," and unenforceable, because ambiguity should be construed against the lawyer-drafter.¹²⁶ Then it adopted the *Gross* position, stating that the retainer's enforceability in any case "should depend on a 'full exploration of all the facts and circumstances'" including the parties' intentions and the proportionality of the fees to the services.¹²⁷ Presumably referring to the general retainer and change-of-position exceptions, the court concluded that "[s]uch retainers, while not to be encouraged, are not, in all cases, unenforceable as a matter of law."¹²⁸

The Court of Appeals began its memorandum opinion using the kind of ambiguous language that yielded defeat for the losing attorney: "A client may always discharge his attorney, with or without cause, and in the absence of a contract providing otherwise an attorney discharged without cause is entitled to be compensated in quantum meruit."¹²⁹ It is challenging to discern what the court meant by this "absence of a contract providing otherwise" phrase, especially because it then cited *Martin*. The only logical and honest reading of the full sentence is to accept the "contract providing otherwise" phrase as an imprecise reference to *Martin*'s general retainer and change-of-position exceptions. If the court intended anything broader it would have cited *Greenberg v. Jerome H. Remick & Co.*,¹³⁰ in addition to or instead of *Martin*, which it pointedly did not do. *Greenberg* can much more easily be fitted for the proposition that the parties' contractually expressed intentions are important. Equally telling is the court's omission of any reference to the Appellate

120. See *supra* notes 44-58 and accompanying text.

121. See *supra* notes 108-09.

122. See *supra* notes 77-88 and accompanying text.

123. See *supra* notes 89-102 and accompanying text.

124. N.Y. Jud. Law § 474 (McKinney 1983); see *infra* Part II.

125. See *supra* notes 41-43 and accompanying text.

126. See *Jacobson v. Sassower*, 107 A.D.2d 603, 603, 483 N.Y.S.2d 711, 711, *aff'd mem.*, 66 N.Y.2d 991, 489 N.E.2d 1283, 499 N.Y.S.2d 381 (1985).

127. See *id.* at 603, 483 N.Y.S.2d at 712 (dictum) (citing *Gross v. Russo*, 47 A.D.2d 655, 655, 364 N.Y.S.2d 184, 186 (1975)); *supra* notes 81-102 and accompanying text (intention of parties relevant to amount of advance fee earned but not to legitimacy of the nonrefundable retainer itself).

128. *Jacobson*, 107 A.D.2d at 603, 483 N.Y.S.2d at 712.

129. *Jacobson*, 66 N.Y.2d at 993, 489 N.E.2d at 1284, 499 N.Y.S.2d at 382 (citing *Martin v. Camp*, 219 N.Y. 170, 114 N.E. 46 (1916)).

130. 230 N.Y. 70, 129 N.E. 211 (1920).

Division's citation to *Gross v. Russo*¹³¹ for the proposition that the intention of the parties should control. These citation omissions make the court's perpetuation of ambiguity particularly inexplicable.¹³²

In any case, the court declared the nonrefundable retainer unenforceable because it suffered from procedural unconscionability—"it did not state clearly that . . . [it] was intended to be a minimum fee and that the entire sum would be forfeited" upon termination.¹³³ The court placed the burden on the lawyer, indicating that she "was required to establish that [the client] understood that those were the terms of the agreement and she failed to do so."¹³⁴ The court concluded its opinion with this final ambiguity: "In view of this disposition, it is not necessary to reach [the client's] further contention that nonrefundable retainer agreements are against public policy and, therefore, void."¹³⁵

The *Jacobson* court thus neither undermined nor reaffirmed *Martin*. Rather, it enigmatically left *Martin* intact, *Greenberg* a remotely potential detractor, and the client with the right to void a nonrefundable retainer clause.

II. LAWYERS' COMPENSATION AS UNRESTRAINED BY LAW

Arguably, nonrefundable retainers could be justified pursuant to section 474 of New York's Judicial Code,¹³⁶ which has been adopted in substantially similar form in many states.¹³⁷ Section 474 provides that attorney compensation is "governed by agreement, express or implied, which is not restrained by law."¹³⁸ Read literally, the statute appears to mean that if a lawyer contracts for a nonrefundable retainer, he is entitled to have it enforced. Literal interpretation of the statutory language, however, is inconsistent with judicial doctrine treating the attorney-client contract as an aspect of fiduciary law.¹³⁹ This Part discusses section

131. 76 Misc. 2d 441, 351 N.Y.S.2d 355 (Sup. Ct. 1974), *rev'd*, 47 A.D.2d 655, 364 N.Y.S.2d 184 (1975).

132. *See supra* note 119.

133. *Jacobson*, 66 N.Y.2d at 993, 489 N.E.2d at 1284, 499 N.Y.S.2d at 382.

134. *Id.*; *Henningsen v. Bloomfield Motors, Inc.*, 32 N.J. 358, 403-04, 161 A.2d 69, 94-95 (1960).

135. *Jacobson*, 66 N.Y.2d at 994, 489 N.E.2d at 1284-85, 499 N.Y.S.2d at 382.

136. N.Y. Jud. Law § 474 (McKinney 1983).

137. *See, e.g.*, Cal. Civ. Proc. Code § 1021 (West 1980 & Supp. 1988); Idaho Code § 3-205 (1979); Minn. Stat. § 549.01 (1988); Mo. Rev. Stat. § 484.130 (1959); Mont. Code Ann. § 37-61-420 (1987); N.D. Cent. Code § 28-26-01 (1974 & Supp. 1987); S.D. Codified Laws Ann. § 15-17-6 (1984); Utah Code Ann. § 78-51-41 (1987); Va. Code § 3201 (1890) (discussed in *Thomas v. Turner's Administrator*, 87 Va. 1, 5, 12 S.E. 149, 153 (1890)); Wash. Rev. Code § 4.84.010 (1988). One court specifically recognized the origin of its state's statute: "Section 1 of this [Missouri] statute is an exact copy of section 66 [the precursor to § 474] of the New York Code . . ." *Curtis v. Met. St. Ry.*, 118 Mo. App. 341, 349, 94 S.W. 762, 764 (1906); *see also* C. Wolfram, *supra* note 19, § 9.1, at 496-97 n.4 ("[S]tatutes . . . found in several states . . . declare that the measure of a lawyer's compensation is to be fixed by the client-lawyer agreement.").

138. N.Y. Jud. Law § 474 (McKinney 1983); *see supra* note 14.

139. *See supra* Part I A-B. Moreover, the adoption of the Model Code of Professional

474's legislative history and its later interpretations. It offers a more historically accurate depiction of the statute's meaning and function that is not inhibited by a literal interpretation and that reconciles judicial treatment of the statutory language. Accordingly, this Part rejects the contract-based theory of attorney-client relationships in favor of the trust-based theory developed in Part I.

A. *Fee Bill Statutes*

The first effort to regulate attorneys' fees in New York occurred in 1658 when Peter Stuyvesant proclaimed a prohibition against lawyers charging excessive fees.¹⁴⁰ That fee bill specified that lawyers would be entitled to specified amounts as payment for performing defined tasks. Through 1813, fee bills prescribed the total compensation to which a lawyer would be entitled, including both the attorney-client contract rates ("fees") and the litigation costs recoverable by the winning party ("costs").¹⁴¹ Thus, the fee statutes purported to declare that the specified recoverable costs were the full measure of the lawyer's compensation.¹⁴²

Thereafter, fee bills began to blur the distinction between fees and costs,¹⁴³ and courts began to allow lawyers to recover fees based on agreements even where the agreed upon fee exceeded the prescribed costs.¹⁴⁴ Post-1823 fee bills¹⁴⁵ did not seek to control what courts could allow as recoverable costs, but to prescribe what an attorney could charge his client. Those fee bills stated, for example, that a lawyer could charge two dollars for "[p]erusing and amending interrogatories" and one dollar for "[d]rawing a demurrer or joinder in demurrer."¹⁴⁶ Lawyer income thus became a function of court filings and "the prominence and practice of a lawyer was judged by the number of writs he sued out, or to

Responsibility by the Appellate Divisions of New York's court system, and by other states, would have been precluded since several sections regulate the inception of the attorney-client relationship and the fees to be charged. *See, e.g.*, Model Code, *supra* note 21, DR 2-103, 2-104, 2-106, 2-110(A)(3), 5-101, 5-104, 6-101, 9-102.

140. *See* 1 C. Lincoln, *The Constitutional History of New York* 458 (1906).

141. *See* 1813 N.Y. Laws ch. 83 ("no officer . . . shall exact, demand or ask, or be allowed [any fee greater than prescribed]").

142. *See* *Davenport v. Ludlow*, 4 How. Pr. 337, 338 (N.Y. Sup. Ct. 1850) (referring to function of fee bills prior to repeal).

143. 3 N.Y. Rev. Stat. (1829) ("For the following services . . . the following fees shall be allowed."); *see also* *In re Bleakley*, 5 Paige Ch. 311 (N.Y. Ch. 1835).

144. This practice may have been more widespread than many thought. *See* *Adams v. Stevens*, 23 Wend. 57 (N.Y. 1840), *aff'd*, 26 Wend. 448 (N.Y. 1841) (historically, lawyers' fees have been allowed to exceed recoverable costs); *Adams*, 26 Wend. at 458 (quoting Chancellor Kent as believing in 1828 that "no Fee-Bill ever did or ever can remunerate the solicitor or counsel for one half their services. A great part of that burden always falls on their own clients."). These views were later described as expressing substantially the same view as section 474 of New York's Judicial Code. *See* *Martin v. Camp*, 219 N.Y. 170, 173, 114 N.E. 46, 47 (1916).

145. *See, e.g.*, 1840 N.Y. Laws ch. 386; 1829 N.Y. Rev. Stat. tit. III, ch. 10.

146. 1840 N.Y. Laws ch. 386.

which he appeared."¹⁴⁷

B. Reform

In the mid-nineteenth century, David Dudley Field and other reformers were engaged by the state of New York to address the unnecessary procedural complexities that resulted from the dual system of equity and law, which often denied meritorious claimants victory by archaic insistence on obsolete formalism.¹⁴⁸ The reform movement culminated in New York's 1846 constitution, which, in turn, led to the Field Code of 1848.¹⁴⁹ Part of the reform effort focused on attorney compensation and began by rejecting two principles that undergirded the fee bill statutes through 1848. First, Field criticized the fact that compensation depended on "the number or length of proceedings."¹⁵⁰ The fee bills were unacceptable because they encouraged "multiplication of the processes" and fees were "not proportioned to the real labor performed."¹⁵¹ Second, the reformers rejected "the right of the state, to interfere between citizens . . . [or] to make bargains for the people or to regulate prices."¹⁵² Field and his colleagues took the position that lawyers are not public officers, but rather act "for private purposes, and on behalf of private persons."¹⁵³ Hence, state regulation of lawyers' fees was considered an unwarranted intrusion.¹⁵⁴

Field agreed with one purpose of the existing attorney compensation system: to require the losing party to pay the winning party's fees.¹⁵⁵ That traditional rule on attorneys' fees, now known as the "English rule,"¹⁵⁶ had been evaporating because the fees an attorney charged his client frequently exceeded considerably the costs the winner recovered from his adversary. Judicial determination that lawyers had the right to enter into enforceable attorney-client agreements permitted this gap to grow, and where agreements were not enforced, the awarding of quantum meruit instead of the statutory "costs" further widened the gulf.¹⁵⁷ As recoverable costs became an increasingly smaller proportion of fees

147. H. Scott, *The Courts of the State of New York* 217-18 (1909); see 1 A. Chester, *Legal and Judicial History of New York* 73-74 (1911) (purpose of the fee bill ordinance was to prevent common practice of notaries overcharging clients).

148. See J. Hazard, *Civil Procedure* § 1.6, at 17-18 (3d ed. 1985).

149. See First Report of the Commissioners on Practice and Pleadings, *New York Code of Procedure* 204, Title X (1848) (hereinafter First Report of the Commissioners).

150. *Id.* at 205.

151. *Id.*

152. *Id.* at 204.

153. *Id.* at 205.

154. *But see In re Cooper*, 22 N.Y. 67, 84 (1860) (lawyers are officers of the court and subject to judicial supervision); 6 W. Holdsworth, *A History of English Law* 434-35 (1927) (In English history, lawyers were officers of the court and were regulated by statute and court order.); C. Wolfram, *supra* note 19, at 17-19 (same).

155. See First Report of the Commissioners, *supra* note 149, at 206.

156. See Leubsdorf, *Toward a History of the American Rule*, 47 *Law & Contemp. Probs.* 9, 12-13 (1984).

157. See *id.* at 16.

charged, the “American rule” emerged, requiring that each party pay his own attorneys’ fees.¹⁵⁸ Field sought to limit this trend toward the American rule and to restore the English rule through a statutory scheme of indemnity under which prevailing parties could recover legal expenses from their adversaries.

Field’s strategy to eliminate multiplicative proceedings and to minimize state involvement while retaining the English rule was to abolish the fee bill system and to treat lawyers just like other professionals: “to enforce the contracts made by [them]”¹⁵⁹ and, in addition, to require by statute that losing parties pay the winners’ fees. The statute that Field drafted to achieve his objectives provided:

Section 258. All statutes establishing or regulating the costs or fees of attorneys, solicitors and counsel in civil actions, and all existing rules and provisions of law, restricting or controlling the right of a party to agree with an attorney, solicitor or counsel, for his compensation, are repealed; and hereafter the measure of such compensation shall be left to the agreement, express or implied, of the parties. But there may be allowed to the prevailing party, upon the judgment, certain sums by way of indemnity, for his expenses in the action; which allowances are in this act termed costs.¹⁶⁰

This statute consists of three parts. The first part, up to the first semicolon, was a reaction to the excessive and frivolous pleadings that the fee bills generated. It repealed all prior fee bills. The second part, the remainder of the first sentence, redundantly provided that attorney fees were no longer governed by statute, but rather by contract law. The third part, the second sentence, was a response to the transformation from the English to the American rule and the vast differences between costs and fees. It stated that section 258 was to govern costs recoverable by the prevailing litigant from his adversary. This simple analysis has been complicated by subsequent revisions of the statute.

C. *Subsequent Statutory Revisions*

The 1851 Code of Procedure contained identical language to section 258 on all three points.¹⁶¹ However, in 1876, the statute was revised.¹⁶² The first part of section 258 was deleted because the fee bills had already been repealed in 1848. The second part, although it was superfluous when originally enacted, was retained, and to it was added the language “unrestrained by law.” That language was simply a reference to and a

158. *See id.*

159. First Report of the Commissioners, *supra* note 149, at 206 (“[R]elations between the client and the lawyer [must be] left free so that they may make whatever contract they please.”).

160. 1848 N.Y. Laws § 258.

161. 1851 N.Y. Code of Procedure § 303.

162. *See* 1876 N.Y. Code of Remedial Justice § 66, at 13.

replacement for the deleted words of repeal.¹⁶³ Thus, the New York Code of Remedial Justice in 1876 set forth the language that appears today,¹⁶⁴ declaring only that "compensation of an attorney . . . is governed by agreement, express or implied, which is not restrained by law."¹⁶⁵

These subsequent re-adoptions of section 258 of the Field Code were technically improper because the repeal no longer stated anything substantive.¹⁶⁶ Nevertheless, the progeny of section 258 erroneously has

163. The third part, regarding costs, was also deleted, presumably because the American rule had by then become enshrined in practice. *See id.* It is ironic that Field's attempt to restore the primacy of the English rule should have led to its demise.

164. *See* N.Y. Jud. Law § 474 (McKinney 1983) (attorney compensation is "governed by agreement, express or implied, which is not restrained by law"). The same language appeared in all statutory revisions between 1899 and today: 1899 Laws of New York ch. 61, § 66; 1909 Laws of New York ch. 35; 1912 Laws of New York ch. 229, § 474; 1947 Laws of New York ch. 366, § 474; 1962 Laws of New York ch. 310, § 231.

165. N.Y. Jud. Law § 474 (McKinney 1983).

166. This lack of substance was recognized by one court:

Plaintiff puts much reliance upon [what is now § 474 of the Judiciary Law], which provides that an attorney's compensation is governed by agreement, "which is not restrained by law," which he understands to include a prohibition against its supervision in equity. But that this language . . . was not intended to vary the meaning of the old Field Code of Procedure is shown by the revisers' own declaration. In Appendix B to their report, containing a list of the sections in which the law is amended, they omit [what is now § 474], thus relegating it to the class of redrafts "whose sole object is to conform the syntax of the terms used to those of other portions of the bill, to prune down redundant expressions, or otherwise to attain greater simplicity and clearness without material change of the meanings." . . . The present words "which is not restrained by law" replace a provision of the [Field] Code . . . § 258 . . . which repealed all then existing statutes regulating attorney's fees, together with "all existing rules and provisions of law restricting or controlling the right of a party to agree with an attorney . . . for his compensation" . . . and the object of the codifiers was to give the attorney the same right of contract "as in respect to every other professional person." (Report of the Code Commissioners, 1848, pp. 204-205). The jurisdiction of equity over persons in confidential relations stood untouched.

Ransom v. Ransom, 70 Misc. 30, 38-39, 127 N.Y.S. 1027, 1033-34 (Sup. Ct. 1910), *rev'd on other grounds*, 147 A.D. 835, 133 N.Y.S. 173 (1911). In *Ransom*, the lower court reduced the attorney's contingent fee from one third to 7.5 percent because the attorney had misrepresented the risk involved in the litigation. The appellate court reversed, upholding the fee. As for the lower court's analysis of section 258 of the Field Code, the appellate court vigorously attacked a straw man. It held that the lower court's view would render it useless for an attorney to enter a contract fixing his fee because it would always be subject to revision by a court or jury. *See Ransom*, 147 A.D. at 849, 133 N.Y.S. at 183. This reasoning vastly overstates the import of the fiduciary standard. The lower court's analysis of the legislative history, quoted above, is accurate.

The appellate court nevertheless went on to say that

it cannot be said, even in view of the plain phraseology of the Code section, that the court is without power to inquire into the good faith of an agreement between attorney and client But . . . their agreement should not be set aside unless fraud has been perpetrated, undue influence exerted, material facts affecting the subject-matter misrepresented, suppressed, or advantage taken of a position of confidence and trust to obtain an unconscionable advantage over the party.

Id. at 848, 133 N.Y.S. at 182. This is a position midway between the fiduciary and the

been accepted as a new feature of the legal landscape,¹⁶⁷ instead of being recognized, after the first adoption, as a nonfeature.

As noted, section 258 repealed statutory interference with the pricing of lawyer-client agreements.¹⁶⁸ Field's admonition on this point (contained in the first sentence of section 258, following the semi-colon) was obviously precatory, but was intended to influence future legislatures not to revive fee bills. Of course, later legislatures *could* do so no matter what the statute said because the restraint is not part of the state's constitution. In the end, Field's drafting was successful because revisors retained that precatory expression of legislative restraint.

What the Code and its successors did not say, however, was that the judiciary's role in supervising attorney-client agreements was to be diminished or altered in any way.¹⁶⁹ To the contrary, by employing the language "express or implied," the statute necessarily contemplated obligations being created by judicial doctrine in the absence of an express promise to pay.¹⁷⁰ Moreover, the word "law" in the phrase "unrestrained by law" obviously referred only to statutory law. Indeed, section 474 and its counterparts in other states generally are not perceived as restricting the scope of judicial review of attorney-client contracts,¹⁷¹ es-

contract standard and belies the court's statutory analysis. If the statute is to be read literally, then how can an attorney's fee contract be undone because of a breach of trust and confidence unless such a fiduciary obligation exists? The practical effect of the appellate court's opinion is to reverse the burden of proof placed on the attorney by the lower court to prove that the fee contract was made in good faith and to place the burden on the client to show a lack of good faith. *But see* Committee on Legal Ethics v. Tatterson, 352 S.E.2d 107, 113 (W. Va. 1986) ("The burden of proof is upon the attorney to show the reasonableness and fairness of the contract for the attorney's fee.").

167. *See, e.g.*, Morton v. Forsee, 249 Mo. 409, 427, 155 S.W. 765, 770, 772 (1913); *In Re Fitzsimons*, 174 N.Y. 15, 23, 66 N.E. 554, 557 (1903); Fischer-Hansen v. Brooklyn Heights R.R., 173 N.Y. 492, 497, 66 N.E. 395, 396 (1903); Ransom v. Cutting, 112 A.D. 150, 152, 98 N.Y.S. 282, 284 (1906), *aff'd*, 188 N.Y. 447, 81 N.E. 324 (1907); Werner v. Knowlton, 107 A.D. 158, 161, 94 N.Y.S. 1054, 1057 (1905); Friedman v. Mindlin, 91 Misc. 473, 477, 155 N.Y.S. 295, 298 (N.Y.C. City Ct. 1915). A more correct analysis of the impact of section 258, though not of its historical derivation, is set out in Gair v. Peck, 6 N.Y.2d 97, 124, 160 N.E.2d 43, 59, 188 N.Y.S.2d 491, 512 (1959) (Froessel, J., dissenting), *cert. denied*, 361 U.S. 374 (1960).

168. *See* First Report of the Commissioners, *supra* note 149, at 204 (state has no right "to make bargains for the people or to regulate prices"); *see also* Martin v. Camp, 219 N.Y. 170, 173, 114 N.E. 46, 47 (1916) ("Notwithstanding the fact that the employment of an attorney by a client is governed by the contract which the parties make, the peculiar relation of trust and confidence that such a relationship implies injects into the contract certain special and unique features.").

169. *See* Barry v. Whitney, 3 Sand. Ch. 696, 698 (N.Y. Ch. 1851) ("Before the [Field] code, the court had the general power of examining into [attorney-client] bargains . . . to see that they were not unreasonable or oppressive, and the power has not been taken away.").

170. For example, the court could determine that an implied-in-fact contract arose where a client, absent an express agreement, actually requested services but then refused to pay because he had not so promised. *See* Lampleigh v. Brathwait, 80 Eng. Rep. 255 (C.P. 1615); 1 A. Corbin, Corbin on Contracts § 19, at 44-50 (1963); 1 S. Williston, Contracts § 3A, at 12-15 (3d ed. 1957).

171. *See, e.g.*, Eriksson v. Boyum, 150 Minn. 192, 184 N.W. 961 (1921); Beals v. Wag-

pecially not of contingent fee contracts.¹⁷² Hence, the statute does not erect a regime of free contractual bargaining between attorney and client insulated from judicial review or fiduciary standards. Having spent itself in the fee bill repeal, section 474 survives, devoid of all substantive content, to discourage legislative intervention into a fee bargaining process still tempered by judicial superintendence. As properly analyzed in this Article, section 474 is a mere shadow of history awaiting a statutory revision to delete it from the current codes.

III. ATTORNEY-CLIENT AGREEMENTS AND CONTRACT LAW

The analysis in Part I of this Article established the proposition that nonrefundable retainers are incompatible with trust-based client discharge rights. Part II rejected the argument that section 474 and its analogues in other states require that attorney-client relationships be governed by commercial contract rules. This Part assumes *arguendo* that the arguments in Parts I and II have failed, and that the contract theory of the attorney-client relationship prevails over the trust-based theory. Fiduciary principles are thus laid aside, trust is ignored, and nonrefundable retainers are considered from a traditional contract perspective.¹⁷³ Even from this contract perspective, however, the nonrefundable retainer fails to pass muster.

Parties to a contract are permitted to include clauses in their agreements that supplant judicially determined remedies for breach.¹⁷⁴ Thus

ener, 47 Minn. 489, 50 N.W. 535 (1891); *Coleman v. Sisson*, 71 Mont. 435, 230 P. 582 (1924); *Haight v. Moore*, 5 Jones & S. 161 (N.Y. Sup. Ct. 1874); *Barry v. Whitney & Tucker*, 3 Sand. 696 (N.Y. Ch. Ct. 1851); *Moran v. Simpson*, 42 N.D. 575, 173 N.W. 769 (1919); *Egan v. Burnight*, 34 S.D. 473, 149 N.W. 176 (1914); *Ashton v. Skeen*, 85 Utah 489, 39 P.2d 1073 (1935). In *Ransom v. Ransom*, 70 Misc. 30, 41, 127 N.Y.S. 1027, 1035 (N.Y. Sup. Ct. 1910), *rev'd*, 147 A.D. 835, 133 N.Y.S. 173 (1911) (discussed *supra* note 166), the court again hit the nail on the head: "Upon reviewing all the authorities [regarding the effect of section 258 of the Field Code,] I do not find any that diminish the force of the ancient rules of chancery affecting contracts between persons in confidential relations." See also *Karlin v. Culklin*, 248 N.Y. 465, 477, 162 N.E. 487, 492 (1928); *Martin v. Camp*, 219 N.Y. 170, 173, 114 N.E. 46, 47 (1916); *Gross v. Russo*, 76 Misc. 2d 441, 442, 351 N.Y.S.2d 355, 357 (Sup. Ct. 1974), *rev'd*, 47 A.D.2d 655, 364 N.Y.S.2d 184 (1975); *Albert v. Munter*, 136 Wash. 164, 176, 239 P. 210, 214 (1925).

172. See, e.g., *Gair v. Peck*, 6 N.Y.2d 97, 106, 160 N.E.2d 43, 48, 188 N.Y.S.2d 491, 497 ("Notwithstanding section 474, . . . few propositions are better established than that our courts do retain this power of supervision" of contingent fee agreements), *modified*, 6 N.Y.2d 983, 161 N.E.2d 736, 191 N.Y.S.2d 951 (1959), *cert. denied*, 361 U.S. 374 (1960); *Rooney v. Second Ave. R.R.*, 18 N.Y. 368, 369 (1858) ("There is no less reason for the exercise of [judicial] power [over attorneys and clients] now than before adoption of the Code.").

173. This position could be defended by accepting a broad "intention of the parties" construction, see *supra* notes 77-102 and accompanying text; by an expansive reading of the exceptions noted in *Martin v. Camp*, see *supra* notes 41-58 and accompanying text; or from breathing life into section 474, which actually lived only for a nanosecond. See *supra* Part II.

174. See Restatement (Second) of Contracts § 356(1) (1981) (liquidated damages and penalties clause).

they may specify a sum or other consideration in their contract that the breaching party will pay and/or the non-breaching party will retain upon breach. If the clause minimizes contract risk, cost or uncertainty, or discourages inefficient breaches, policy applauds the provision.¹⁷⁵ But if the clause imposes costs on otherwise efficient breaches—if it has an *in terrorem*¹⁷⁶ effect—it is rejected because it violates the compensation principle of contract remedies,¹⁷⁷ which prohibits punitive damages. The compensation principle seeks instead to put the aggrieved party in as good a position as if the breaching party had fully performed.¹⁷⁸ Alternatively, in the case of restitution, the attempt is to restore the status quo ante.¹⁷⁹ As will be discussed in the next section, liquidated damages clauses and a specialized form of them called take-or-pay contracts¹⁸⁰ fall in the first category and are upheld by policy; penalties fall in the second category, and are rejected because of their *in terrorem* effect.

A. Liquidated Damages

To be enforceable as a liquidated damages provision, a clause that sets an amount to be paid in the event of breach must meet two conditions.¹⁸¹ First, the sum must be a reasonable estimate of damages from breach, and second, the amount of loss upon breach must be unascertainable or difficult to prove.¹⁸² Clauses that fail the liquidated damages test are characterized as unenforceable penalties.¹⁸³

To be valid under a liquidated damages analysis, a nonrefundable re-

175. See *Wassenaar v. Panos*, 111 Wis. 2d 518, 528, 331 N.W.2d 357, 362 (1983); Goetz & Scott, *Liquidated Damages, Penalties and the Just Compensation Principle: Some Notes on an Enforcement Model and a Theory of Efficient Breach*, 77 Colum. L. Rev. 554, 558 (1977).

176. If the cost of breach is set considerably higher than both the value of the breach to the breaching party and the loss to the nonbreaching party, then breach obviously will be substantially precluded. Indeed, contract performance would then be exacted by strong economic compulsion. The penalty would be more akin to punitive sanctions for a tortious breach of duty than to the compensatory model of contract remedies.

177. See A. Farnsworth, *Contracts* § 12.18, at 896 (1982); Restatement (Second) of Contracts, ch. 16 introductory note, at 100 (1981).

178. See U.C.C. § 1-106(1) (1987); G. Gilmore, *The Death of Contract* 14-17 (1974); Goetz & Scott, *supra* note 175, at 558.

179. See D. Dobbs, *Remedies*, 792-93 (1984).

180. See *infra* notes 197-200 and accompanying text.

181. This is a rather shorthand way of stating the doctrine, but it is sufficient for analyzing the nonrefundable retainer. See Goetz & Scott, *supra* note 175, at 554 n.3 (“The rationale for designating a particular liquidated damages provision a penalty has as many formulations as there are treatments of the doctrine.”).

182. See *Truck Rent-A-Center, Inc. v. Puritan Farms 2nd, Inc.*, 41 N.Y.2d 420, 425, 361 N.E.2d 1015, 1018, 393 N.Y.S.2d 365, 369 (1977); Restatement (Second) of Contracts § 356 (1981).

183. See *Northwest Collectors, Inc. v. Enders*, 74 Wash. 2d 585, 594, 446 P.2d 200, 206 (1968) (“A provision in a contract which bears no reasonable relation to actual damages will be construed as a penalty.”); 5 A. Corbin on Contracts § 1058, at 337 (1963) (“When the provision is one that will be enforced by the court, the amount specified therein is called liquidated damages. In cases where enforcement is denied, it is said that the parties have provided for a penalty or a forfeiture.”).

tainer has to be intended as an estimate of damages, with the lawyer and client negotiating the designated amount based on an assessment of the likely consequences to the lawyer should the client terminate the relationship. The estimate also must be reasonable, or intentionally compensatory. The lawyer also has to be able to demonstrate that his damages upon breach would be difficult if not impossible to determine.¹⁸⁴

The typical nonrefundable retainer clause fails to satisfy the reasonable estimate condition for two reasons. First, the nonrefundable retainer entitles the lawyer to compensation without regard to mitigation obligations.¹⁸⁵ Such an effect constitutes a penalty rather than a liquidation of damages because it calls for an amount exceeding the lawyer's compensatory expectations.¹⁸⁶ Second, the typical nonrefundable retainer, set at commencement of employment, is not designed to compensate the lawyer for losses in the event of a breach by the client, but rather to secure payment of the lawyer's fee.¹⁸⁷ Thus the typical nonrefundable retainer

184. *Compare* Pacheco v. Scoblionko, 532 A.2d 1036, 1039 (Me. 1987) (burden of proving validity of liquidated damages provision is on its proponent even if the other party is in breach) *with* Vines v. Orchard Hills, Inc., 181 Conn. 501, 511, 435 A.2d 1022, 1028 (1980) (burden is on party challenging liquidated damages provision even if that party is in breach) *and* Wassenaar v. Panos, 111 Wis. 2d 518, 526, 331 N.W.2d 357, 361 (1983) (employer who terminates contract has burden of showing stipulated damages provision was unenforceable).

185. *See* Truck Rent-A-Center, Inc. v. Puritan Farms 2nd, Inc., 41 N.Y.2d 420, 421, 361 N.E.2d 1015, 1016, 393 N.Y.S.2d 365, 367 (1977) (liquidated damages provision in truck lease valid because defined as balance due less 50 percent, representing parties' estimate of truck's re-rental value); Northwest Collectors, Inc. v. Enders, 74 Wash. 2d 585, 594, 446 P.2d 200, 206 (1968) (acceleration clause in equipment lease invalid because full contract amount was due without regard to actual damages sustained, i.e., without providing for mitigation); *cf.* Wassenaar v. Panos, 111 Wis. 2d 518, 542-43, 331 N.W.2d 357, 369 (1983) (valid liquidated damages clause moots mitigation obligations).

186. *Cf.* Wassenaar v. Panos, 111 Wis. 2d 518, 331 N.W.2d 357 (1983) (upholding clause as liquidated damages provision entitling hotel manager/employee to recover full contract amount upon his termination even though no mitigation was specified). The clause in *Wassenaar* was enforceable because the parties negotiated with concern for the employee's job security and could have anticipated, and were therefore permitted to agree on, the employee's consequential damages upon terminating: injury to reputation, loss of career development, emotional distress, and other "anticipated elements," such as "salary lost while out of work, expenses of finding a new job, [and] lower salary on the new job." *Id.* at 536-37, 331 N.W.2d at 365-66. A lawyer-employee is unable to rely on these circumstances to waive his mitigation obligations through a nonrefundable retainer because his consequential damages, if any, are different. Nonrefundable retainers are not prompted by concern for job security. A lawyer's reputation generally is unsullied because no one, other than the law firm, knows or is concerned about the client's termination. In addition, because the lawyer has many clients at once, she, unlike the hotel employee who has but one employer, has greater mitigation opportunities.

187. *See* N.Y. State Bar Ass'n Op. 570, at 4 (1985) ("We are also mindful that the very reason that many lawyers require advance fee payments in the first place is so that they will not be subject to a client's refusal to pay for legal services after they are rendered."). When a deposit is given as security for payment of a contract debt, moreover, the non-breaching party may keep that part representing damages but must return the rest. *See* Peirson v. Lloyds First Mortgage Co., 260 N.Y. 214, 222, 183 N.E. 368, 370 (1932); Bellefonte Borough Auth. v. Gateway Equip. & Supply Co., 442 Pa. 492, 497, 277 A.2d 347, 349-50 (1971). Likewise, since nonrefundable retainers are often required as security

is an *in terrorem* device discouraging client termination rather than a good faith estimate of the net losses the lawyer will sustain upon client breach.¹⁸⁸

The second condition—difficulty of proving losses—depends on the nature of the representation. Unless unusual litigation or negotiation is a component of the representation, lawyers are usually able to estimate the time required to perform legal tasks. The second condition of valid liquidated damages clauses is therefore generally unmet.

An analysis of *Gross v. Russo*¹⁸⁹ under contract principles illustrates the failure of nonrefundable retainers from this perspective. In *Gross*, the agreement called for “liquidated damages” of \$25,000 if the client breached.¹⁹⁰ The appellate court, which upheld the provision and which apparently wished to legitimate the nonrefundable retainer, described this characterization as “unfortunate language”; presumably it perceived that the clause not only failed the two-pronged liquidated damages test but also was patently a penalty.¹⁹¹ The *Gross* retainer thus not only violated *Martin*’s fiduciary principles by imposing a “penalty,” it also failed from a contract perspective by imposing a “substantial penalty.” The clause could not be sustained as “liquidated damages”; thus it appears that it was sustained by fiat.¹⁹²

In assessing whether a nonrefundable retainer is a valid liquidated damages clause or an invalid penalty, the parties’ sophistication might be relevant.¹⁹³ Thus, despite “deep hostility” to penalty clauses, a persistent question is “whether a modern court should refuse to enforce a penalty clause where the signator [sic] is a substantial corporation, well able to

for payment of a fee, the lawyer may retain only that portion of the nonrefundable retainer representing actual damages in quantum meruit and must return the rest to the client.

188. See *supra* note 176.

189. 47 A.D.2d 655, 364 N.Y.S.2d 184 (1975). See *supra* notes 93-103 and accompanying text.

190. See *Gross*, 47 A.D.2d at 655, 364 N.Y.S.2d at 185-86.

191. The lower court observed that \$25,000 would have been payable for the lawyer’s pre-agreement services plus the estimable prospective services at the time of the agreement, and concluded that termination before the prospective services were rendered would impose a substantial penalty on the client. See *Gross v. Russo*, 76 Misc. 2d 441, 444, 351 N.Y.S.2d 355, 359 (Sup. Ct. 1974), *rev’d*, 47 A.D.2d 655, 364 N.Y.S.2d 184 (1975). Since that termination occurred, such a substantial penalty actually resulted. Although the determination that the \$25,000 caused a substantial penalty spoke from the *Martin* perspective of imposing discharge costs on clients, see *supra* notes 28-30 and accompanying text, it strongly implies that it was also a penalty in the contract sense because a penalty violates *Martin* even if it is insubstantial. Of course, the two “penalties” do not have identical meanings.

192. See *supra* notes 89-102 and accompanying text.

193. Cf. *Truck Rent-A-Center, Inc. v. Puritan Farms 2nd, Inc.*, 41 N.Y.2d 420, 426-27, 361 N.E.2d 1015, 1019-20, 393 N.Y.S.2d 365, 370-71 (1977) (attaching no significance to use of printed form because “[t]here is no indication of any disparity of bargaining power or of unconscionability”).

avoid improvident commitments."¹⁹⁴ For example, a Wall Street law firm advising a Fortune 500 company with inside general counsel may rightly expect its nonrefundable retainer to be enforced as liquidated damages.¹⁹⁵ Many attorney-client agreements, however, involve an unsophisticated, uncounseled client, unable to evaluate the proposed fee agreement. That inability further counsels against enforcing nonrefundable retainers.¹⁹⁶

A specialized form of liquidated damages is the take-or-pay clause, which literally obligates a buyer to accept goods or services or pay for them anyway.¹⁹⁷ The legal validity of such clauses is determined by applying liquidated damages criteria tailored to the factual contexts in which take-or-pay clauses are typically sought to be applied. For instance, take-or-pay clauses are applied where the supplier makes a substantial investment in order to supply the buyer; in exchange, the buyer agrees to a long term commitment to buy specified quantities that will amortize the supplier's investment.¹⁹⁸ The device serves to apportion risk where transactional uncertainty is particularly high and is enforceable as long as that allocation is reasonable in relation to the risk and to the corresponding reliance of the parties.¹⁹⁹ Take-or-pay clauses thus are

194. *Lake River Corp. v. Carborundum Co.*, 769 F.2d 1284, 1288-89 (7th Cir. 1985) (Posner, J.).

195. *Cf. Brobeck, Phleger & Harrison v. Telex Corp.*, 602 F.2d 866, 875 (9th Cir.) (minimum contingent fee of \$1 million not unconscionable when multi-million dollar corporation of superior bargaining strength sought best possible counsel), *cert. denied*, 444 U.S. 981 (1979).

196. *Cf. Schenk v. Hill, Lent & Troesch*, N.Y.L.J., July 11, 1988, at 30, col. 3 (N.Y. Sup. Ct.) (client's consent alone is insufficient proof of full understanding of legal rights); *Cooper & Keys v. Bell*, 127 Tenn. 142, 150, 153 S.W. 844, 846-47 (1913) (contract unenforceable unless attorney can show client understood meaning and effect of written attorney-client contract); *Committee on Legal Ethics v. Tatterson*, 352 S.E. 2d 107, 113 (W. Va. 1986) (even with client consent, an attorney's fee is "clearly excessive" if grossly disproportionate to amount of work required).

197. The only judicial discussion of the confluence of take-or-pay and liquidated damages analysis appears in *Lake River Corp. v. Carborundum Co.*, 769 F.2d 1284, 1292 (7th Cir. 1985) (Posner, J.) ("If . . . a supplier's fixed costs were a very large fraction of his total costs, a take-or-pay clause might well be a reasonable liquidation of damages.")

For discussion of take-or-pay contracts, see *International Minerals & Chem. Corp. v. Llano, Inc.*, 770 F.2d 879 (10th Cir. 1985), *cert. denied*, 475 U.S. 1015 (1986); *National Fuel Gas Distrib. Corp. v. Pennsylvania Public Util. Comm'n*, 76 Pa. Commw. 102, 464 A.2d 546 (1983); *Pierce, State Regulation of Natural Gas in a Federally Deregulated Market: The Tragedy of the Commons Revisited*, 73 Cornell L. Rev. 15, 18-20 (1987).

198. Contracts for the sale of natural gas are the paradigm case. They often contain take-or-pay clauses under which the buyer must accept a specified minimum amount of gas over a designated period at a formulated price or pay that price in any case. See *International Minerals*, 770 F.2d at 879; *National Fuel Gas Distrib. Corp.*, 76 Pa. Commw. at 106-07, 464 A.2d at 549; *Pierce*, *supra* note 197, at 18-20.

For an analysis of take-or-pay contracts from a national energy policy perspective, see Comment, *Take-Or-Pay: The D.C. Circuit Forces the FERC's Hand*, 23 Land & Water L. Rev. 149 (1988); Comment, *Take-Or-Pay Provisions: Major Problems for the Natural Gas Industry*, 18 St. Mary's L.J. 251 (1986).

199. *Cf. National Telecanvass Assoc. v. Smith*, 98 A.D.2d 796, 470 N.Y.S.2d 22 (1983) (liquidated damages clause in telecanvassing contract disproportionate to plain-

valid as a species of liquidated damages if damages are difficult to prove or are unascertainable because of transactional uncertainty due to, for instance, market volatility or regulatory changes.²⁰⁰

An examination of the specialized risk factors in these contracts leads to the conclusion that, in liquidated damages terms, take-or-pay clauses are valid if the amount is reasonable in relation to the risk and reliance at the time of contract and if losses are difficult to ascertain given inordinate fluctuations in transactional variables.²⁰¹

Nonrefundable retainers functionally may be seen as a type of take-or-pay clause because the client agrees to take designated legal services at the nonrefundable retainer price or to pay that price in any case. The lawyer, however, faces no risk equivalent to the natural gas supplier or other risk-assuming provider. There is no danger of not recovering fixed start-up costs of representation because the lawyer has none, and market demand for legal services is not volatile. Accordingly, the arguments that sustain take-or-pay clauses as valid liquidated damages provisions in long term supply contexts do not apply in the lawyer-client context to sustain the nonrefundable retainers.²⁰² Before concluding that contract

tiff's probable loss, and therefore deemed unenforceable as a penalty). Although the term "take-or-pay" was not used, the parties in *Smith* attempted a kind of take-or-pay provision, specifying that a political campaign committee would pay for a minimum of 500,000 telephone canvassing calls whether they were made or not. Given that the canvassing company's principal was an avowed expert in conducting massive political telecanvassing such as the one agreed to, the company apparently incurred no substantial start-up costs in connection with the aborted campaign. *See id.* at 798, 470 N.Y.S.2d at 24-25. Hence, the clause was an unenforceable penalty because there was no reasonable relation between it and the probable loss. *See id.* at 797-98, 470 N.Y.S.2d at 24.

200. *Cf. id.* at 798, 470 N.Y.S.2d at 24-25 (clause also unenforceable because it did not appear that actual damages would be difficult to prove or estimate).

201. In natural gas sales contracts, for instance, the supplier requires the take-or-pay clause to cover two risks. First, it is necessary to protect performance outlays where the supplier's fixed costs of performance are a large percentage of total costs. *See Lake River Corp. v. Carborundum Co.*, 769 F.2d 1284, 1292 (7th Cir. 1985) (Posner, J.). Second, it is required to insulate the supplier from the risk of sharply declining market demand. *See Universal Resources Corp. v. Panhandle E. Pipe Line*, 813 F.2d 77, 80 (5th Cir. 1987). Negotiations center on actual and expected market and regulatory conditions and the supplier often uses the contract as security to develop and finance expansion of productive capacity needed to perform. *See Pierce, supra* note 197, at 18-20. The take-or-pay provision is legitimate when it minimizes contract risk by apportioning it and the supplier requires and relies on his customer's promise to take the specified contract amount. *See Universal Resources Corp.*, 813 F.2d at 80. *Lake River* concerned a sell-or-pay clause, a functional equivalent of the take-or-pay clause. The clause was held invalid because the initial investment needed for performance was less than 20 percent of the amount agreed to as damages in case of breach, the investment was fully usable to service other customers, and the net recovery in case of breach exceeded by a factor of four the profit that would have been made had there been full performance. *See Lake River Corp. v. Carborundum Co.*, 769 F.2d 1284, 1289-92 (7th Cir. 1985) (Posner, J.).

202. Even if the trust-based theory yields to contract analysis and if the liquidated damages test is met, other fiduciary principles remain. For example, the typical client is ill-equipped to evaluate a lawyer's proffer that X dollars is a reasonable estimate of losses due to client breach. Instead, he must rely on the lawyer's representation, which may be reasonable from a contract but not from a fiduciary perspective. Since the fiduciary is

law almost always invalidates nonrefundable retainers, however, the conceptually distinct problem of judicial forfeiture must be addressed.

B. *Judicial Forfeiture*

Judicial forfeiture occurs by judicial invocation of the common law rule prohibiting a breaching party from recovering in restitution upon his breach.²⁰³ It is to be distinguished from the contractual forfeiture provision—a type of liquidated damages clause in which a down payment is designated as the liquidated sum. Such a clause literally provides that upon breach a non-breaching party may retain consideration previously provided by a breaching party.²⁰⁴ A nonrefundable retainer is a form of contractual forfeiture because it provides that, if the client breaches, he forfeits the advance fee, which the lawyer is to retain as liquidated damages. Its status as liquidated damages or penalty would be superfluous, however, if judicial forfeitures were permitted—the breaching client would not be able to raise the issue or to regain that part of his advance payment exceeding the lawyer's damages. Accordingly, it is both appropriate and necessary to consider the current status of the judicial forfeiture rule.

The ancient common law is said uniformly to have denied the breaching party's right to restitution.²⁰⁵ The centuries-old debate over the propriety of this rule²⁰⁶ has obscured the fact that it probably never

under a duty to disclose all material facts, *see* SEC v. Capital Gains Research Bureau, 375 U.S. 180, 194 (1963); Klein v. First Edina Nat'l Bank, 293 Minn. 418, 421, 196 N.W.2d 619, 622 (1972), and must deal fairly with his client, *see* Gordon v. Bialystoker Center, 45 N.Y.2d 692, 698, 385 N.E.2d 285, 288, 412 N.Y.S.2d 593, 597 (1978), meeting the contract standard may still fall short of meeting the fiduciary standard.

203. *See* J. Calamari & J. Perillo, *The Law of Contracts* § 15-1, at 647 (3d ed. 1987); A. Farnsworth, *supra* note 177, § 8.14, at 600. Note that such a forfeiture penalizes additional performance because the amount forfeited increases with partial performance. *See* Corbin, *The Right of a Defaulting Vendee to the Restitution of Installments Paid*, 40 Yale L.J. 1013 (1931).

204. The judicially imposed forfeiture rule is the conceptual diametric of the liquidated damages/penalty rule. The former, emphasizing "freedom of contract," allows for damages that are not compensatory; the latter, emphasizing "social control," permits the provision of determined damages clauses only if they are compensatory. The organizing principle of the first and second editions of the Contracts casebook by Professors Friedrich Kessler, Malcom Sharp, and Grant Gilmore was the tension between "free volition" or "freedom of contract" and "social control." *See* F. Kessler & G. Gilmore, *Contracts: Cases and Materials Teacher's Manual* (1971) (hereinafter Kessler I) (unpublished) (available in the files of the *Fordham Law Review*). *Compare* F. Kessler, G. Gilmore & A. Kronman, *Contracts Cases and Materials 1-17* (3d ed. 1986) (hereinafter Kessler III) (contractual liability understood through the competing theories of freedom versus fairness and autonomy versus social responsibility) *with* F. Kessler & G. Gilmore, *Contracts Cases and Materials 1-38* (2d ed. 1970) (hereinafter Kessler II) (transactions are influenced by the tensions between free bargaining and social control). This Article does not treat this conceptual tension, which has yet to be considered in depth in the literature.

205. *See* Kessler III, *supra* note 204, at 1058-59.

206. *See, e.g.,* Perillo, *Restitution in the Second Restatement of Contracts*, 81 Colum. L. Rev. 37, 50 (1981).

commanded the unanimous consent habitually claimed for it.²⁰⁷ In fact, no more than twenty states ever reported opinions embracing the judicial forfeiture rule.²⁰⁸ On the other hand, the rule has been rejected in reported opinions by twenty-two states,²⁰⁹ including many initial supporters, and three federal circuit courts.²¹⁰ Confusion has stirred over which is the majority and which is the minority position.²¹¹ A plausible explanation for the confusion²¹² is that the "common law rule" was taken to

207. See 5A A. Corbin, *supra* note 183, § 1122, at 3 (common law rule is a broad statement unsupported by actual case law).

208. See *Tomboy Gold & Copper v. Marks*, 185 Cal. 336, 197 P. 94 (1921); *Thach v. Durham*, 120 Colo. 253, 208 P.2d 1159 (1949); *Foss-Hughes Co. v. Norman*, 32 Del. 108, 119 A. 854 (Super. Ct. 1923); *Beatty v. Flannery*, 49 So. 2d 81 (Fla. 1950); *Wheeler v. Mather*, 56 Ill. 241 (1870); *Stevens v. Brown*, 60 Iowa 403, 14 N.W. 735 (1883); *Gibbons v. Hayden*, 3 Kan. App. 38, 44 P. 445 (1896); *Stark v. Parker*, 19 Mass. (1 Pick.) 267 (1824); *Miller v. Snedeker*, 257 Minn. 204, 101 N.W.2d 213 (1960); *Ellinghouse v. Hansen Packing Co.*, 66 Mont. 444, 213 P. 1087 (1923); *Lexington Mill & Elevator Co. v. Neuens*, 42 Neb. 649, 60 N.W. 893 (1894); *Katz v. Katz*, 134 N.J.L. 303, 47 A.2d 423 (1946); *Dunken v. Guess*, 40 N.M. 156, 56 P.2d 1123 (1936); *Smith v. Brady*, 17 N.Y. 173 (1858); *Brannock v. Fletcher*, 271 N.C. 65, 155 S.E.2d 532 (1967); *Pfeiffer v. Norman*, 22 N.D. 168, 133 N.W. 97 (1911); *Livesley v. Strauss*, 104 Or. 356, 206 P. 850 (1922); *Atlantic City Tire & Rubber Corp. v. Southwark Foundry & Mach. Co.*, 289 Pa. 569, 137 A. 807 (1927); *Engstrom v. Bushnell*, 20 Utah 2d 250, 436 P.2d 806 (1968); *Neis v. O'Brien*, 12 Wash. 358, 41 P. 59 (1895).

209. See *Nordin Constr. Co. v. City of Nome*, 489 P.2d 455 (Alaska 1971); *Freedman v. Rector*, 37 Cal. 2d 16, 230 P.2d 629 (1951); *Leoffler v. Wilcox*, 132 Colo. 449, 289 P.2d 902 (1955); *Vines v. Orchard Hills, Inc.*, 181 Conn. 501, 435 A.2d 1022 (1980); *Haas v. Crisp Realty Co.*, 65 So. 2d 765 (Fla. 1953); *Boyce Constr. Co. v. Valencia Community College*, 414 So. 2d 634 (Fla. Dist. Ct. App. 1982); *Nelson v. Hazel*, 91 Idaho 850, 433 P.2d 120 (1967); *Nichols v. Knowles*, 87 Idaho 550, 394 P.2d 630 (1964); *McLendon v. Safe Realty Corp.*, 401 N.E.2d 80 (Ind. Ct. App. 1980); *Washington v. Claassen*, 218 Kan. 577, 545 P.2d 387 (1976); *Woodliff v. Al Parker Sec. Co.*, 233 Mich. 154, 206 N.W. 499 (1925); *Maxe v. Grindmeyer*, 379 So. 2d 297 (Miss. 1980); *Kitchen v. Mori*, 84 Nev. 181, 437 P.2d 865 (1968); *Humphrey v. Sagouspe*, 50 Nev. 157, 254 P. 1074 (1927); *R.J. Berke & Co. v. J. P. Griffin, Inc.*, 116 N.H. 760, 367 A.2d 583, (1976); *Comerata v. Chaumont, Inc.*, 52 N.J. Super. 299, 145 A.2d 471 (1958); *Kulseth v. Rotenberger*, 320 N.W.2d 920 (N.D. 1982); *Kirkland v. Archbold*, 113 N.E.2d 496 (Ohio Ct. App. 1953); *Massey v. Love*, 478 P.2d 948 (Okla. 1971); *Golden v. Golden*, 273 Or. 506, 541 P.2d 1397 (1975); *Lancellotti v. Thomas*, 341 Pa. Super. 1, 491 A.2d 117 (1985); *DeLeon v. Aldrete*, 398 S.W.2d 160 (Tex. Civ. App.—San Antonio 1965, writ ref'd n.r.e.); *Perkins v. Spencer*, 121 Utah 468, 243 P.2d 446 (1952); *Mallory v. City of Olympia*, 83 Wash. 499, 145 P. 627 (1915); *Schwartz v. Syver*, 264 Wis. 526, 59 N.W.2d 489 (1953), *overruled*, 19 Wis. 2d 597, 120 N.W.2d 679 (1963); *Schneider v. Allis-Chalmers Mfg. Co.*, 196 Wis. 56, 219 N.W. 370 (1928).

210. See *American Sur. Co. v. United States*, 368 F.2d 475 (9th Cir. 1966); *Hook v. Bomar*, 320 F.2d 536 (5th Cir. 1963); *Amtorg Trading Corp. v. Miehle Printing Press & Mfg. Co.*, 206 F.2d 103 (2d Cir. 1953).

211. See *J. Calamari & J. Perillo, supra* note 203, § 11.22, at 477 (restitution for the breaching party has met "fairly wide acceptance" but "the majority of jurisdictions appear to adhere to the general principle that a defaulting party has no remedy notwithstanding the degree of hardship and forfeiture he may suffer."); 1 G. Palmer, *Law of Restitution* § 5.13, at 651-52 (1978) (rule of *Britton v. Turner*, 6 N.H. 481 (1834), allowing restitution, still "a minority position" but nothing is certain); 12 S. Williston, *Contracts* § 1473, at 222-24 n.3 (3d ed. 1957) (cases allowing recovery constitute the weight of authority).

212. An alternative explanation for the confusion is that instead of one rule covering

mean "embraced by fifty states" so that converting it from the majority rule to the minority rule meant waiting until twenty-six states had rejected it. But since many states have never decided the problem, the denominator is less than fifty and the necessary numerator for conversion is less than twenty-six.²¹³ To avoid perpetuating or claiming to resolve the confusion, this Article adopts the following taxonomy: judicial forfeiture is the old rule, restitution is the modern rule.²¹⁴

Under the modern rule, an employee who breaches a one-year term contract after ten months is entitled to recover in quantum meruit,²¹⁵ but not on the contract itself.²¹⁶ The old rule would have denied recovery to the breaching employee; he would have forfeited the value of his ten months of labor.²¹⁷ Among the leading cases espousing this forfeiture principle was *Smith v. Brady*,²¹⁸ where a plurality of New York's Court of Appeals denied recovery to a builder who did not meet exacting contract specifications because the owner did not get what he bargained for.²¹⁹ The result under the old rule in *Smith* was not particularly harsh because progress payments had been made throughout the contract term and the builder had been denied only the final payment.²²⁰ Nevertheless, Judge Comstock unwittingly supplied generations of contracts scholars with fertile debating ground by condemning and penalizing breaching parties.

In later cases, courts scrutinized and rejected the rule when its harshness became evident.²²¹ New York has been at the forefront of a losing

all contracts there are four, one each for sales of goods, construction contracts, employment agreements, and installment land sales. See D. Dobbs, *supra* note 179, §§ 12.7-12.26, at 832-935. Because this Article avoids using the slippery categories of majority and minority, it is able to abstract above these four subsidiary rules to generalize about the parent rule.

213. Further, forty-nine states have adopted some version of Article 2 of the U.C.C., see White & Summers, Uniform Commercial Code § 1, at 1 (3d ed. 1988), so that in the sale of goods context, all states except Louisiana allow the breaching party to recover in restitution. See U.C.C. § 2-718(2) (1987).

214. See *Maxton Builders, Inc. v. Lo Galbo*, 68 N.Y.2d 373, 502 N.E.2d 184, 509 N.Y.S.2d 507 (1986) (using this taxonomy). See *infra* text accompanying notes 225-40. This trend reflects the broader transformation in contract doctrine away from rigid 19th century rules toward a flexible analysis epitomized by the shift from impossibility to impracticability. See A. Farnsworth, *supra* note 177, § 8.14, at 600 ("In recent years, courts have tended to grant restitution to the party in breach.").

215. Of course, such problems are not common today because employment contracts are typically payable at least monthly.

216. The employee therefore would not be automatically entitled to recover 10/12 of the contract, although that would be the limit. See *Britton v. Turner*, 6 N.H. 481 (1834) (New Hampshire was ahead of its time).

217. See *Stark v. Parker*, 19 Mass. (2 Pick.) 267, 274-75 (1824).

218. 17 N.Y. 173 (1858) (Comstock, J.) (plurality opinion).

219. See *id.* at 186-87.

220. See *id.* at 174.

221. See *Vines v. Orchard Hills, Inc.*, 181 Conn. 501, 505, 435 A.2d 1022, 1026 (1980) (Peters, J.) (citing five early cases barring recovery and thirteen more recent cases allowing claims in restitution).

battle to preserve the old judicial forfeiture rule.²²² But even in New York, as elsewhere, courts have recognized the rule's potential unfairness and have attempted to minimize its harsh results by employing such escape outlets as waiver, divisibility, and "equity."²²³ For many years New York courts "obediently went through the two-way stretch" under which they would cite the forfeiture rule and then the waiver exception, an oblique approach that "has enjoyed at most a literary existence."²²⁴

New York's most recent pronouncements evince a Cardozo-esque transformation to the modern rule—an exposition characterized by resounding affirmation masking dramatic change.²²⁵ In *Maxton Builders, Inc. v. Lo Galbo*,²²⁶ a seller of real estate retained a 10 percent deposit, which the breaching buyer sought to recover.²²⁷ The New York Court of Appeals was asked to "reexamine the rule of *Lawrence v. Miller*, . . . which permits a vendor on a real estate contract to retain the down payment when the purchaser willfully defaults."²²⁸

The court acknowledged criticism that the old rule—which it characterized as the "parent rule," denying recovery in many factual contexts, including construction, employment, installment land sales contracts and sales of goods²²⁹—is "out of harmony with the general principle that actual damages is the proper measure of recovery for a breach of con-

222. See *Maxton Builders, Inc. v. Lo Galbo*, 68 N.Y.2d 373, 502 N.E.2d 184, 509 N.Y.S.2d 507 (1986); 32 *Beechwood Corp. v. Fisher*, 19 N.Y.2d 1008, 228 N.E.2d 823, 281 N.Y.S.2d 843 (1967); *Lawrence v. Miller*, 86 N.Y. 131 (1881); *infra* text accompanying notes 225-40.

223. See *Glovsky v. Holly Point Estates, Inc.*, 354 Mass. 94, 236 N.E.2d 202 (1968) (equity required restoring real property down payment to plaintiff); *Housing Authority v. Warrick*, 100 N.J. Super. 256, 241 A.2d 655 (1968) (forfeiture of land installment payments without warning was unconscionable; contract not literally enforced); *Jacob & Youngs, Inc. v. Kent*, 230 N.Y. 239, 129 N.E. 889 (1921) (substantial performance doctrine invoked to produce equitable result); *Avery v. Willson*, 81 N.Y. 341 (1880) (facts justified waiver of complete performance before liability arose); *Ruiz v. Crespi*, 46 A.D.2d 44, 360 N.Y.S.2d 917 (1974) (equity supported plaintiff's recovery of real estate down payment); *Gerder Services, Inc. v. Johnson*, 109 Misc. 2d 216, 439 N.Y.S.2d 794 (Sup. Ct. 1981) (land sales contract providing for absolute forfeiture was inequitable and unenforceable); *Brannock v. Fletcher*, 271 N.C. 65, 155 S.E.2d 532 (1967) (in equity, vendee may recover down payment less reasonable rental value in event of vendor's breach); *Malmberg v. Baugh*, 62 Utah 331, 218 P. 975 (1923) (in forfeiture, equitable principles prevent enforcement of rule granting damages in excess of just compensation).

224. *Kessler III*, *supra* note 204, at 1038-39.

225. Judge Clark's prophecy may at last have been realized. See *Amtorg Trading Corp. v. Miehle Printing Press & Mfg. Co.*, 206 F.2d 103, 105-07 (2d Cir. 1953) (chronicling the trend in the law of contracts advocating that a contracting party in default should be able to recover "the amount of actual benefit conferred on the opposing party," and speculating that the New York Court of Appeals "might well give some effect" to this trend); *cf.* *J. Calamari & J. Perillo*, *supra* note 203, § 11-22, at 477 n.69 (noting that anticipated change in New York law has not occurred).

226. 68 N.Y.2d 373, 502 N.E.2d 184, 509 N.Y.S.2d 507 (1986).

227. The sales contract did not contain a forfeiture provision, which would have become relevant given the court's circumvention of the old rule.

228. *Maxton Builders*, 68 N.Y.2d at 376, 502 N.E.2d at 185, 509 N.Y.S.2d at 508.

229. See *id.* at 379, 502 N.E.2d at 187, 509 N.Y.S.2d at 510.

tract.”²³⁰ The court further observed that the “modern rule” allows “a party in default to recover for part performance to the extent of the net benefit conferred.”²³¹ The court sympathized with this position, applauding the modern rule as having “much to commend it,”²³² and indicated that even New York had widely rejected the parent rule: “In most areas of the law the Legislature and the courts, have now adopted rules generally permitting a party in default to recover for part performance to the extent of the net benefit conferred.”²³³ In addition, the court could have added that even before these express declarations, much of *Smith v. Brady*,²³⁴ New York’s version of the parent rule, had been eviscerated under the oblique “two-way stretch” method.²³⁵ The court then stated that, notwithstanding the eclipse of the parent rule in “most” cases, a subsidiary forfeiture rule endured in most jurisdictions for real estate sales contracts, “especially where the down payment does not exceed 10 percent of the contract price.”²³⁶ It thus appears that the judicial forfeiture rule is dead in New York in all but real estate down payment cases. Even there, however, rather than embracing the old rule as written in *Lawrence v. Miller*²³⁷ and categorically foreclosing a breaching party’s recovery, the court prescribed a modified analysis:

That analysis begins by considering whether the agreement expressly provides that the seller could retain [the down payment] upon default. If it did, the provision would probably be upheld as a valid liquidated damages clause in view of the recognized difficulty of estimating actual damages and the general acceptance of the traditional 10% down payment as a reasonable amount.²³⁸

However, “[i]f the contract itself is deemed to pose no bar,”²³⁹ for instance, if it does not contain a liquidated damages clause entitling the seller to retain the down payment, then the buyer could recover at least some of his down payment. He can do so, however, only if he meets the

230. *Id.* at 378, 502 N.E.2d at 186, 509 N.Y.S.2d at 509.

231. *Id.* at 380, 502 N.E.2d at 187-88, 509 N.Y.S.2d at 511.

232. *Id.* at 381, 502 N.E.2d at 188, 509 N.Y.S.2d at 510-11.

233. *Id.* at 380, 502 N.E.2d at 188, 509 N.Y.S.2d at 511 (citing Amtorg Trading Corp. v. Miehle Printing Press & Mfg. Co., 206 F.2d 103 (2d Cir. 1953)); see *Jacob & Youngs, Inc. v. Kent*, 230 N.Y. 239, 129 N.E. 889 (1921); U.C.C. § 2-718 (1987).

234. 17 N.Y. 173 (1858).

235. See *supra* note 221 and accompanying text.

236. *Maxton Builders, Inc. v. Lo Galbo*, 68 N.Y.2d 373, 380, 502 N.E.2d 184, 188, 509 N.Y.S.2d 507, 511 (1986). But see *Lancellotti v. Thomas*, 341 Pa. Super. 1, 9, 491 A.2d 117, 121 (1985) (“the common law rule is no longer intact even with respect to land sales contracts”).

237. 86 N.Y. 131 (1881).

238. *Maxton*, 68 N.Y.2d at 382, 502 N.E.2d at 189, 509 N.Y.S.2d at 512. The court also observed that the Restatement (Second) of Contracts adopts the “modern rule,” but recognizes an exception for liquidated damages. See *id.* at 380, 502 N.E.2d at 187, 509 N.Y.S.2d at 510; cf. *Freedman v. Rector*, 37 Cal. 2d 16, 230 P.2d 629 (1951) (11 percent real estate down payment liquidated damages clause presumptively valid if reasonable in amount, but invalid if damages easily ascertainable).

239. *Maxton*, 68 N.Y.2d at 382, 502 N.E.2d at 189, 509 N.Y.S.2d at 512.

burden of showing that the down payment exceeded actual damages, which is a heavy burden when the down payment is 10 percent or less.²⁴⁰

Under this subtle transformation of New York's evaporating judicial forfeiture rule, then, the buyer will rarely, if ever, be able to recover his down payment where it is 10 percent or less of the purchase price; *Lawrence* therefore still reigns. When the down payment exceeds 10 percent, however, and there is no liquidated damages clause, the buyer can seek return of that part exceeding actual damages²⁴¹ and *Lawrence* is dethroned. When it exceeds 10 percent and the agreement contains a liquidated damages clause, the buyer will be able to seek the same return under an alternate liquidated damages analysis. The difference in the buyer's arguments caused by the presence or absence of the liquidated damages clause is principally temporal. With the clause, reasonableness of damages is analyzed from the perspective of prospective damages as of the contract's making. Without the clause, reasonableness—that is, whether the sum to be forfeited exceeds actual damages—is determined as of the time of breach.²⁴² This modified analysis, which the court called “a change in the law,” “will provide a forum” for the parties to “dispute their differences,”²⁴³ rather than foreclosing that opportunity under the now interred judicial forfeiture rule.²⁴⁴

To summarize, if the judicial forfeiture rule still reigned, it would deny the breaching client the right to sue in restitution for the return of that part of his advance fee payment that exceeded actual damages. The question of the validity of nonrefundable retainers could not then be reached. Moreover, since the modern rule firmly rejects the judicial forfeiture principle, nonrefundable retainers cannot be sustained under the

240. See *id.* at 382, 502 N.E.2d at 189, 509 N.Y.S.2d at 512.

241. Since the down payment is given as security, the buyer will be able to recover any amount that would impose a penalty (i.e., any amount exceeding the seller's damages). See 5 A. Corbin, *supra* note 183, § 1074, at 415-16 (“A penalty will not be enforced merely because it is in the form of a deposit.”).

242. In either case, there appears to be no issue that the damages would be difficult to prove or unascertainable.

243. *Maxton*, 68 N.Y.2d at 382, 502 N.E.2d at 189, 509 N.Y.S.2d at 512.

244. The *Maxton* court may have intended a broader residual category of cases to endure suffering judicial forfeiture—it said “most” cases require allowing restitution but added that forfeiture still applies for 10 percent real estate down payments. See *supra* text accompanying note 228. The most likely candidate for inclusion in such a residual camp would be the service contract, which has not yet been expressly excluded from New York's old rule. Even indulging the conceivable assumption, however, that the Court of Appeals intended a broader category, without offering examples of what it might include, nonrefundable retainers would not belong there. The *Maxton* court indicated that “[e]xcept in cases where there is a real risk of overreaching, there should be no need for the courts to relieve the parties of the consequences [e.g., a forfeiture] of their contract.” *Maxton*, 68 N.Y.2d at 382, 502 N.E.2d at 189, 509 N.Y.S.2d at 512. It is hard to think of a relationship in which the potential for overreaching is greater than where a client with an actual or potential legal problem seeks counsel from a loyal advisor. See *Bradner v. Vasquez*, 43 Cal. 2d 147, 151, 272 P.2d 11, 13 (1954); *Robinson v. Sharp*, 201 Ill. 86, 90, 66 N.E. 299, 301 (1903); *Wunschel Law Firm v. Clabaugh*, 291 N.W.2d 331, 336 (Iowa 1980).

now dishonored common law judicial forfeiture rule that prohibited the breaching party from recovering in restitution. Even New York, one of the last holdouts, has drastically curtailed the rule's applicability to a narrow class of real estate down payment contracts.²⁴⁵ As a matter of contract law, therefore, the nonrefundable retainer frequently is invalid: it usually constitutes a penalty rather than a liquidated damages provision; it does not meet the specialized requirements of take-or-pay contracts; and it is not protected by the judicial forfeiture rule.

Nonetheless, one can conceive of circumstances, however unusual, in which a nonrefundable retainer may be valid. For example, if a lawyer is offered a substantial special retainer, payable in advance and nonrefundable, inducing him to leave his firm to represent a client in a protracted matter and the client breaches, the lawyer could retain that sum under all theories considered: first, under the trust-based theory, the nonrefundable retainer is valid because of the lawyer's change of position;²⁴⁶ second, under a contract analysis, the nonrefundable retainer is a valid liquidated damages clause since it satisfies both the compensatory and unascertainability requirements;²⁴⁷ and third, again under contract analysis, it is a valid take-or-pay clause because of the heavy up-front expense of abandoning regular law firm income in reliance upon the client's long-term commitment.²⁴⁸

C. *Mitigation of Damages*

In the rare case when a nonrefundable retainer is a valid liquidated damages clause, the avoidable consequences doctrine is implicated upon breach. This doctrine requires an attorney to make reasonable efforts to mitigate damages.²⁴⁹ Like other employees, an attorney is not entitled to "liv[e] in voluntary idleness" upon discharge but must seek alternative employment.²⁵⁰ Damages are reduced by the amount the lawyer earned or could have earned doing comparable work.²⁵¹ The extent to which mitigation reduces damages depends on the injured lawyer's elasticity of capacity—the extent to which the lawyer's practice can accommodate additional services for new or additional clients.

If elasticity is infinite, then a lawyer is equivalent to the lost volume seller of commercial law, whose damages are the lost profits from the broken contract not offset by the profits on the resale of the item in question. This is because he would have benefited from two sales instead of

245. See *Maxton Builders, Inc. v. Lo Galbo*, 68 N.Y.2d 373, 380, 502 N.E.2d 184, 188, 509 N.Y.S.2d 507, 511 (1986).

246. See *supra* notes 41-43 and accompanying text.

247. See *supra* notes 182-84 and accompanying text.

248. See *supra* notes 197-200.

249. See Restatement (Second) of Contracts § 350 (1981).

250. See *Howard v. Daly*, 61 N.Y. 362, 374 (1875).

251. See, e.g., *Gross v. Lamb*, 1 Ohio App. 3d 1, 3-4, 437 N.E.2d 309, 312 (1980) (such work must be of a similar kind in a similar place).

one but for the breach.²⁵² Whether an attorney has a capacity that is both liberated and idled by the breach, therefore requiring him to mitigate, is a question of fact. But since most attorneys keep their plates full,²⁵³ they often will be unable to satisfy the conditions of the lost volume seller; they will rarely have high elasticities of capacity.²⁵⁴

The most likely candidate for the lost volume lawyer category would be the large law firm that routinely recruits new associates; that minority of firms can plausibly argue that they can render services without limitation and thus avoid the obligation to mitigate damages. In all cases, the client's liability upon breach would be determined by reducing the lawyer's contract damages, usually based on expectancy, by his avoidable damages, based on comparable alternatives. In the lost volume case, this mitigation obligation will be zero. Unless a lawyer is able to show lost volume and difficulty in ascertaining damages, however, then the extent of his duty to mitigate is considered in determining the reasonableness of the sum fixed as a liquidated damages clause. The lawyer thus cannot use liquidated damages provisions to insulate himself from the obligation to mitigate.

However, the same considerations that yield zero mitigation also limit if not preclude nonrefundable retainers from being good faith estimates of damages. Thus, in the case of the law firm equivalent to the lost volume seller, damages for breach would be limited to the profits lost as a consequence of the breach. Lost profits would be measured as lost revenue less the cost that would have been incurred for hiring associates to undertake the work. Accordingly, even if mitigation is zero, damages are less than the amount of the price for the service. Therefore, for a nonrefundable retainer to be a reasonable estimate of damages, it would have to be conceived as a lost profit rather than a lost revenue.

CONCLUSION

This Article invoked venerable doctrines to analyze nonrefundable retainers charged by lawyers. Such provisions have proven to be contractual forfeiture clauses that, as part of an attorney-client agreement, must be subject to special scrutiny.

Because lawyers are fiduciaries of their clients, the law has granted clients the right to discharge their attorneys at any time for any reason. A corollary of this rule requires that no penalty be imposed on clients who exercise this right to discharge. Since nonrefundable retainers im-

252. See *Neri v. Retail Marine Corp.*, 30 N.Y.2d 393, 400, 285 N.E.2d 311, 314, 334 N.Y.S.2d 165, 170 (1972); U.C.C. § 2-708(2) (1987); *White & Summers*, *supra* note 213, § 7-9, at 314-15.

253. See *supra* text accompanying note 52.

254. Cf. Restatement (Second) of Contracts § 347 comment f (1981) (because entrepreneurs tend to "operate at optimum capacity . . . it is possible that an additional transaction would not have been profitable and that the injured party would not have chosen to expand his business by undertaking it had there been no breach").

pose such penalties, they are to be condemned as inconsistent with the trust-based quality of the unfettered discharge right.

The argument that the lawyer has a statutory right to bargain freely is based on erroneous statutory revision, and is, in any case, inconsistent with fiduciary law from which we draw the trust-based theory of the attorney-client relationship. Nevertheless, even assuming that attorneys should be entitled to bargain freely with their clients without the constraints of fiduciary law, nonrefundable retainers are generally unenforceable. Instead of constituting liquidated damages clauses, they typically function as unenforceable penalties. Accordingly, this increasingly prevalent and potentially oppressive clause must be eliminated from the standard form retainer agreements that currently are in widespread use.²⁵⁵

It would be the pinnacle of irony, moreover, to allow nonrefundable retainers in the teeth of fiduciary law when virtually all jurisdictions have determined that, in the arms-length commercial law sale-of-goods context, forfeitures shall be limited to 20 percent of the value of total performance to a limit of \$500.²⁵⁶ Validating the nonrefundable retainer, despite contract and fiduciary law, would create another special rule for lawyers.²⁵⁷ Such a rule would of course be lucrative, but would it be professionally responsible?²⁵⁸

255. See *supra* note 2.

256. See U.C.C. § 2-718(2) (1987); see also *Maxton Builders, Inc. v. Lo Galbo*, 68 N.Y.2d 373, 381, 502 N.E.2d 184, 188, 509 N.Y.S.2d 507, 511 (1986).

257. See *supra* note 9.

258. "The profession has a responsibility to assure that its regulations are conceived in the public interest and not in furtherance of parochial or self-interested concerns of the bar." Model Rules, *supra* note 22, Preamble.