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Untangling Attorney Retainers from Creditor Claims

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ARTICLE

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Untangling Attorney Retainers from Creditor Claims

Abstract. Clients will often use a retainer to secure an attorney's representation. But clients in economic distress may have creditors that are eager to access the client's funds in the attorney's hands. Attorneys, clients, courts, and regulators have struggled to understand who has the best claim to such retainer funds. In this Article, we attempt to untangle the most common areas of confusion. We conclude that Article 9 of the Uniform Commercial Code (UCC) offers strong protection for an attorney's interest in client retainers through security interests, even though some courts have misapplied the UCC in this context. Further, we recommend that regulatory bodies create educational programs to help attorneys and courts understand how to apply Article 9 to security interest and also recommend that attorneys help clients understand the benefits and drawbacks of granting a security interest in retainer funds.

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When can a client's creditors reach retainer funds paid to the client's attorney?[1] This question comes up with regularity, as clients in economic distress may be more likely to seek—and to need—legal counsel.[2] The issue can arise at different stages in the litigation. Sometimes it comes up well after an attorney has accepted a retainer from the client when the client's creditors later seek to recover some or all of those funds.[3] Sometimes it emerges after the attorney's client has filed for bankruptcy, with the bankruptcy trustee arguing that some or all of the retainer belongs in the bankruptcy estate.[4] Frequently the question arises even before

1. There is also a separate question of when creditors can attach funds *held by* a client's attorney, as when the attorney holds settlement proceeds for distribution. This is also a vexing problem worthy of future research, but it is outside the scope of this Article. *See* ROBERT P. SCHUWERK & LILLIAN B. HARDWICK, 48 HANDBOOK OF TEXAS LAWYER AND JUDICIAL ETHICS § 6:14 (2021 ed.) ("[T]here is now some question as to whether a non-client has any basis for a *civil action* against a lawyer for failing to pay the non-client a sum due and owing to it out of a client's recovery.") (citing U.S. Bank Nat'l Ass'n v. Sheena, 479 S.W.3d 475 (Tex. App.—Houston [14th Dist.] 2015, no pet.)).

2. *See* Dowling v. Chi. Options Assocs., Inc., 875 N.E.2d 1012, 1022 (Ill. 2007) (explaining creditors' claims "could make it difficult for the client to hire legal counsel").

3. *See* Hadassah v. Schwartz, 966 N.E.2d 298, 299 (Ohio Ct. App. 2011) ("BG&L answered in the garnishment action and acknowledged that it held $150,000 of Schwartz's property in an IOLTA account."); *see also* Jackson Walker LLP v. F.D.I.C., 13 F. Supp. 3d 953, 961 (D. Minn. 2014) (describing the disagreement between the parties over whether the retainer funds were intended to be used for legal fees).

4. *See In re* King, 392 B.R. 62, 66 (Bankr. S.D.N.Y. 2008) (objecting to the use of the retainer to pay the law firm when the estate assets are uncertain and arguing that lesser priority claims should not

representation begins when the attorney tries to craft a retainer agreement that minimizes the risk of leaving retainer funds vulnerable to claims from the client's creditors.

Attorneys, clients, courts, and even regulatory authorities have struggled to articulate and apply a consistent set of rules when faced with creditors' claims to funds held by attorneys. This confusion has caused problems both at the regulatory level and at the individual level. An apparent misunderstanding of the relative priorities led at least one state to change its ethics rules in ways that create a risk of client harm for little, if any, countervailing benefit.[5] A second state has followed the same path through judicial interpretation.[6]

Lawyers who overestimate the risks of accepting security retainers may be unnecessarily reluctant to offer representation to clients facing creditor claims.[7] At the same time, lawyers who undertake representation may be ill-positioned to explain why their right to be paid from client retainers should prevail over the claims of competing creditors.[8] In the worst-case scenario, lawyers may forfeit valid claims to those funds, prompting an outcome unfavorable to both the lawyer and client.[9]

This Article attempts to untangle some of the most common areas of confusion. Part I begins by examining the various types of retainers commonly used and analyzing how these retainer types fit into an attorney's duty to safeguard client property—is the retainer at issue a security retainer, a general retainer, an advance-payment retainer, or an "evergreen"

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be paid before administrative solvency is ensured); *In re* Shafer Bros. Constr. Inc., 525 B.R. 607, 612 (Bankr. N.D. W. Va. 2015) ("MPRT disputes the reasonableness of the compensation sought by [d]ebtor's [c]ounsel and whether [d]ebtor's [c]ounsel may be paid, to the extent the court finds the compensation to be reasonable, from the $20,000 retainer located in Mr. Johnson's client trust account."); *In re* Zukowski, 237 B.R. 194, 198 (Bankr. M.D. Fla. 1998) ("[C]ourts have wrestled with the issue of whether a debtor's attorney has any interest in the earned portion of a retainer . . . .").

5. *See* discussion *infra* Part III.A (discussing a client's risk when New York law requires an attorney to deposit an advance retainer into the attorney's operating account rather than a client's trust account).

6. *See* discussion *infra* Part III.A (permitting the practice of advance-payments in Illinois as well as New York).

7. *See* discussion *infra* Part III.A (identifying a problem where an attorney may not represent a client vulnerable to a creditor's reach).

8. *See* discussion *infra* Part III.B (discouraging a lawyer from preventing a client from terminating representation by charging a non-refundable retainer).

9. *See* discussion *infra* Part III.B (risking a lawyer's complicity in asset concealment through advance-payment retainers).

retainer?[10] The type of retainer makes a difference as to whether the funds belong to the client or the attorney, and thus whether they are properly held in a trust account for the client or placed in the lawyer's own office account where they may be spent or dissipated.

The ownership question is only part of the puzzle however. Part II discusses how Article 9 of the Uniform Commercial Code (UCC) interacts with security retainers. It explains that even when the funds still belong to the client—as with a retainer for security—the attorney will typically have a perfected security interest with priority over most competing claimants.[11] Part II further explores cases where courts failed to recognize the attorney's security interest, exploring how the complexities of Article 9 create difficulties for non-specialist attorneys and judges who struggle to apply the UCC.[12]

Part III discusses how attorney regulatory bodies have compounded these difficulties by expanding "advance-payment" retainers into situations normally covered by security retainers. It argues that Illinois and New York have allowed attorneys to treat unearned payments as earned, bypassing client trust accounts altogether.[13] This practice introduces new risks to clients and creates uncertainty without offering any significantly greater protection than the UCC already provides to security retainers. Part III also explains how the Illinois and New York positions increase the risk that unscrupulous clients will be able to use attorney retainers to improperly conceal assets. Finally, Part IV offers suggestions to help attorneys invoke the protection offered under the UCC and to guide attorney regulatory bodies in adopting rules that protect client funds without impairing attorney interests.

I. TYPES OF RETAINERS

In legal practice, the term "retainer" refers to a sum of money transferred from a client to the lawyer or law firm when hired. Beyond that basic definition, however, the term can have several different meanings depending on the purpose underlying that transaction. This section sets out the most common retainer types and purposes, but these categories are not mutually

10. *See* discussion *infra* Part I (detailing the types of retainers).

11. *See* discussion *infra* Part II.A (discussing elements needed to create a security interest).

12. *See* discussion *infra* Part II.B (describing when a security interest is unsuccessful).

13. *See* discussion *infra* Part III (discussing the practice of regulating retainers).

exclusive. It is common for attorneys to create retainer agreements that include features of more than one category.[14]

A. *The Retainer for Security*

The most common type of retainer serves as security for payment. That is, the client pre-pays some or all the expected cost of the representation. The lawyer, who will commonly be billing by the hour, holds the funds in trust for the client until the work is performed. This procedure allows the lawyer to ensure that the client will be able to pay for the representation, and it reduces the risk of mid-representation payment disputes between lawyer and client.[15] The funds held in trust for the client continue to belong to the client until the lawyer earns them by performing work. When the lawyer's representation terminates—whether through the natural end of the matter or through early termination by either party—the money held in trust must be promptly returned to the client. On the other hand, if the matter becomes more complicated than expected, the lawyer may ask the client for additional funds beyond the initial retainer.[16]

Attorney Mark White offered an example of an agreement establishing a security retainer:

> Client agrees to deposit the sum of $50,000 with the firm, to be billed against on an hourly basis as set out above. This advance deposit will be held in the firm's trust account until such time as it, or a portion of it is earned, at which time it will be made available to the firm's general account. Monthly statements will be sent to the client as provided above. These statements will be paid from the advance deposit thirty days after the date of the statements.

14. *See* Alex B. Long, *Attorney–Client Fee Agreements That Offend Public Policy*, 61 S.C. L. REV. 287, 320 (2009) ("[I]n practice, lawyers often use hybrid retainers, thus making it difficult to draw any meaningful distinction between the two.").

15. Payment security is especially important to attorneys because the ethics rules preclude the attorney from immediately ceasing representation whenever the client fails to pay. *See* MODEL RULES OF PROF'L CONDUCT R. 1.16 (AM. BAR ASS'N 2021) (providing nonpayment of fees can be grounds for withdrawal, but the attorney will still generally need permission from the tribunal); *see also* Lester Brickman & Lawrence A. Cunningham, *Nonrefundable Retainers Revisited*, 72 N.C. L. REV. 1, 34 (1993) ("Permission to withdraw from a criminal case is almost always required by rules of criminal tribunals and is rarely granted.").

16. *Sample Retainer Agreement*, WILLICK LAW GROUP, https://willicklawgroup.com/wp-content/uploads/2012/10/TMC0058.pdf [https://perma.cc/UK36-CQDK].

> At the conclusion of the matter, the balance of the advance deposit will be returned the client.[17]

This language is clear and understandable to the client. The idea of security is implicit in the agreement, and almost certainly understood by both sides. In the example given, the amount of the retainer is likely at a level sufficient to cover the attorney's estimated fee for the representation. The agreement establishes an expectation that that retainer will be sufficient to cover the expected work, and it clarifies the return of any leftover funds to the client at the end.

Even though the idea of security is implicit in White's language, it may be worth more explicitly stating that the purpose of holding the funds is to provide security for payment. A retainer agreement from the Willick Law Group uses language that explicitly references security: "it is intended that the retainer fee deposit will be held and used as a security deposit until the conclusion of the case and [c]lient's payment of all outstanding costs, expenses, and fees for legal services."[18] The explicit use of the word "security" is unlikely to make a difference to the client, who almost certainly understood the purpose of the retainer from the billing structure set out above. Nonetheless, as discussed later, using the term "security" can aid courts looking for easily verifiable documentation of a security interest.[19]

B. *The Engagement Retainer Fee*

A second type of retainer is one used to formalize the attorney–client relationship and to secure availability, sometimes called a "classic" or "general" retainer, though support is growing for calling it an "engagement retainer fee."[20] The "classic" or "general" nomenclature can be somewhat confusing, as it "is really only 'classic' in the sense that it relates to antiquity,"

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17. *See* Mark D. White, *Fee Agreements That Work: Examples & Samples*, *in* STATE BAR OF TEX. 35TH ANN. ADVANCED CIV. TRIAL COURSE 2012 7 (2012), http://www.texasbarcle.com/Materials/Events/11381/145035_01.pdf [https://perma.cc/U9XS-N5T6] (providing an example of an agreement establishing a security retainer).

18. *Sample Retainer Agreement*, *supra* note 16.

19. *See infra* discussion in Part II (positioning "security" as a catch-all phrase that allows courts to verify security interests quickly and effectively).

20. *See* White, *supra* note 17, at 7–8 (describing the engagement retainer as "an amount of money that the client pays you solely for the privilege of having you as his lawyer").

and is not actually common in modern practice.[21] In fact, engagement retainers are much rarer than retainers intended as a security.[22]

The engagement retainer acts almost like an option contract, establishing that the client has hired the lawyer and "thereby prevent[ing] him from acting for his adversary."[23] The engagement retainer "establishes the employment of the attorney by the client" but does not compensate for any actual work performed by the attorney.[24] An engagement retainer is considered earned upon receipt and is to be deposited into the attorney's office account, not into the client trust account. When the attorney performs work for the client, those hours are usually billed separately, as the retainer compensates only for the attorney's availability and not for the work performed.[25]

White also sets out an example of how to reasonably communicate the engagement retainer to the client:

> In addition to paying for the service on an hourly basis . . . the client agrees to pay [the] firm an engagement retainer fee in the amount of $10,000. Such fee is paid in order to secure the firm's immediate availability and readiness to undertake this representation, and in recognition that due to the publicity of this matter, the firm is likely to be prevented from accepting other legal work in this area. The $10,000 engagement retainer fee is not refundable, and client agrees that it is earned by the firm immediately.[26]

This language makes it clear to the client that the fee pays only for establishing an attorney–client relationship and that fees for time expended will be separately billed.

C. *The "Evergreen" Retainer*

An "evergreen" retainer provides partial security to the attorney while still allowing the client to pay for the representation over time rather than all at

21. Milton Williams & Christopher Dioguardi, *Retaining the 'Right' Retainer: Classic, Security or Advance-Payment?*, N.Y. L.J. (2021).

22. *See* Dowling v. Chi. Options Assocs., Inc., 875 N.E.2d 1012, 1021 (Ill. 2007) ("In the vast majority of cases, [the client's interest] will dictate that funds paid to retain a lawyer will be considered a security retainer and placed in a client trust account.").

23. Union Sur. & Guar. Co. v. Tenney, 65 N.E. 688, 690 (Ill. 1902).

24. *Dowling*, 875 N.E.2d at 1017.

25. *See Tenney*, 65 N.E. at 690 (notating a retainer precedes the rendering of services).

26. White, *supra* note 17, at 8.

once.[27] Firms find them useful "when a client can't pay—or would prefer not to pay—a larger single retainer upfront."[28] That is, rather than pay $20,000 upfront, the client might pay only $4,000. As the lawyer does work on the case, however, the client will continue to "replenish" the retainer at regular intervals so that the amount of money held in the retainer never dips below the agreed-upon amount (the retainer stays "evergreen" because there is always a certain baseline of funds in the account). Evergreen retainers may combine monthly billing with a minimum retainer, as in the following example:

> In addition to payment of the monthly statements, we ask that the company wire a retainer in the amount of $10,000 to be held in our trust account and to be billed against. We ask that the trust balance be maintained at the level of $10,000, and our monthly statements will reflect the balance necessary to maintain that amount. Of course, at the conclusion of the litigation, any balance in the trust account will be promptly refunded to the company.[29]

As with a pure retainer for security, the attorney should consider explicitly referring to the purpose of the retainer as providing security for payment. In the case of the evergreen retainer, the minimum trust balance can be called a "minimum security deposit" for clarity.[30]

D. *The Advance-Payment Retainer*

Some states also classify the advance payment of legal fees as a separate type of retainer. The idea of an advance-payment retainer is still somewhat controversial however, and its purpose, limits, and requirements remain somewhat indeterminate.

The advance payment of attorney fees arises most commonly with a flat-fee arrangement. The flat fee offers predictability to the client—they know

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27. *See* Douglas R. Richmond, *Understanding Retainers and Flat Fees*, 34 J. LEGAL PROF. 113, 117 (2009) ("An evergreen retainer is designed to minimize a lawyer's risk of nonpayment if the client's financial condition deteriorates over the course of the representation, or should the client for some other reason decline or be unable to pay the lawyer's fees as they come due.").

28. Teresa Matich, *A Guide to Evergreen Retainers for Law Firms*, CLIO (Aug. 26, 2021), https://www.clio.com/blog/evergreen-retainers-law-firms/ [https://perma.cc/LCK2-85UW].

29. White, *supra* note 17, at 7.

30. *See supra* discussion in Part I.A (discussing the legal ramifications of a "minimum security deposit").

ahead of time what the representation will cost.[31] This works best with cases that are fairly standardized—for example, attorneys defending clients charged with driving while intoxicated often charge flat fees.[32] The attorney knows that some cases will be more complex than average (allowing the client to pay less than they would have with hourly billing), and some cases will resolve more quickly than average (allowing the attorney to earn a higher fee than they would have with hourly billing). With a flat-fee arrangement, the client benefits from the predictability of cost. The lawyer is better able to bear the risk that the representation will be more complex than anticipated because the lawyer can spread that risk over many cases, knowing that the average fee will provide sufficient compensation.

When this flat fee is paid in advance of the representation, it is normally considered to be "nonrefundable" and earned on receipt—meaning that the attorney properly puts the advance payment into the attorney's office account from the beginning and does not need to hold it in the client trust account.[33] This process is not without controversy, however.[34] Difficulties arise when the flat-fee "nonrefundable" payment clashes with the client's right to terminate the attorney's representation.[35] Courts have uniformly held that even "nonrefundable" retainers are, in fact, refundable when the lawyer has not yet done substantial work on the case—to hold otherwise

31. *See, e.g.*, N.Y. Bar Ass'n Comm. on Prof'l Ethics, Op. 1202 (2020) ("A fixed fee is often appropriate in matters frequently performed by the lawyer, where it is possible for the lawyer to accurately estimate the cost of performing the services. It is beneficial to the client since the client knows in advance the cost of the services and is not subject to inefficiencies that may increase the fee in the case of hourly billing.").

32. *How much does a DUI attorney cost?*, THUMBTACK (Aug. 26, 2020), https://www.thumbtack.com/p/dui-lawyer-cost [https://perma.cc/Y3VD-DQBZ].

33. *See* Richmond, *supra* note 27, at 132 ("It is said to be the majority rule that lawyers may, with client consent—typically confirmed in writing—treat flat fees as earned upon receipt and therefore not entrusted."); *see also* Bd. of Prof'l Resp. v. Reguli, 489 S.W.3d 408, 421 (Tenn. 2015) (defining an "advance fee retainer" as one "intended to compensate the lawyer for *all* work to be done on a matter, . . . more commonly known as a 'fixed' or 'flat fee,' and providing that it 'is also earned upon receipt, assuming the lawyer is available to perform the services'"); Dowling v. Chi. Options Assocs., Inc., 875 N.E.2d 1021–22 (Ill. 2007); *In re* Conduct of Balocca, 151 P.3d 154, 160 (Or. 2007); *In re* Connelly, 55 P.3d 756, 761–62 (Ariz. 2002); Alaska Bar Ass'n Comm., Ethics Op. 87–1 (1987); N.C. State Bar, Formal Ethics Op. 4 (1998).

34. *See* ROBERT L. ROSSI, TYPES OF RETAINERS—NONREFUNDABLE RETAINERS § 1:3 (3d ed. 2020) ("The use of nonrefundable retainers or nonrefundable fee advances has become the subject of increasing controversy in recent years.").

35. *See* Steven Lubet, *The Rush to Remedies: Some Conceptual Questions About Nonrefundable Retainers*, 73 N.C. L. REV. 271, 282 (1994) (explaining this issue but cautioning that just because "a lawyer may always be fired does not mean that there should never be economic consequences to the client").

would infringe the client's right to terminate the attorney's representation and would violate the rules of professional conduct, which require that the total fee be "reasonable."[36] Thus, states have made it clear that "a lawyer may still have a duty to refund fees which have been considered property of the attorney and not held in trust."[37] Some courts have gone further and have required attorneys to treat flat fees as earned over time, rather than immediately—meaning attorneys should keep at least part of the flat fee in the client's trust account and communicate to the client at what stages the fee is considered earned.[38]

Attorney Mark White suggests language for how an attorney could communicate an earned-over-time flat fee to the client:

> My fee for this representation described above is $25,000. This is a fixed fee [that] includes an[y] expenses that I may advance, and is not dependent on the course or outcome of the litigation or upon the time I spend on the matter. The fee is due in a lump sum in advance. This money will be held in trust, and withdrawn by me []as earned. It will be considered earned as follows: 10% after initial interviews and case investigation; 40% after discovery, pre-trial motions and hearings; 50% after trial. The full fee will be considered earned upon termination of proceedings by trial or settlement, regardless of whether all proceedings have occurred and regardless of time expended or outcome. If my representation is terminated before completion of the engagement, I will be entitled to the reasonable value of my services, and any

36. *See* Cluck v. Comm'n for Law. Discipline, 214 S.W.3d 736, 740 (Tex. App.—Austin 2007, no pet.) (stating "[a] fee is not earned simply because it is designated as nonrefundable"); *In re* Cooperman, 187 A.D.2d 56, 61 (N.Y. App. Div. 1993) ("By his own admission contained in his affidavit in opposition, the respondent used his retainer agreements to prevent his clients from exercising their right to discharge him."); Tex. Comm. on Prof'l Ethics, Op. 431, 49 Tex. B.J. 1084 (1986).

37. *See In re* Disciplinary Action Against Hoffman, 834 N.W.2d 636, 646 (N.D. 2013) (citing MODEL RULES OF PROF'L CONDUCT R. 1.16 (AM. BAR ASS'N 2011)).

38. *See In re* O'Farrell, 942 N.E.2d 799, 807–08 (Ind. 2011) (providing that "a fee agreement could designate a reasonable part of the initial payment that would be deemed earned by the attorney for opening the case and beginning the representation," but suggesting that "[p]erhaps the entire flat fee could be deemed earned if the client deals unfairly with the attorney or refuses to cooperate with the attorney, and then either fires the attorney or makes continuation of the representation ethically impossible after the attorney expends considerable time and effort on the case"); *Cluck*, 214 S.W.3d at 740 (holding "[a] fee is not earned simply because it is designated as nonrefundable" and requiring that unearned fees—including those designated as nonrefundable—be held in a client trust account until actually earned).

> remaining balance will be refunded. I will notify you when funds are withdrawn from trust and will account for funds remaining in trust.[39]

This language tracks requirements in states, such as Texas, that consider unearned fees as remaining the client's property and held in trust for the client.[40] Other states, however, may allow the entire fee to be immediately placed in the lawyer's operating account even though the fee is still subject to possible reimbursement if the representation is terminated before the attorney has done sufficient work on the case to render the fee reasonably earned.[41]

Advance-payment retainers are controversial when they allow refundable fees to be held outside attorney trust accounts and even more so when they are applied to hourly fees, rather than limited to flat fees, thus allowing unearned hourly payments to be held outside of client trust accounts.[42] The process allows the attorney and client to treat unearned fees as if fully earned, bypassing the client trust account altogether. As legal ethics scholar Douglas Richmond has argued, "making advance[-]payment retainers refundable necessarily transforms them into security retainers . . . ."[43] Nevertheless, at least two large states—Illinois and New York—have permitted this structure, primarily as an attempt to shield the funds from claims by client creditors.[44] Illinois even amended its rules of professional conduct to facilitate such arrangements.[45]

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39. White, *supra* note 17, at 7–8.

40. *Cluck*, 214 S.W.3d at 740 ("Advance fee payments must be held in a trust account until they are earned.").

41. Richmond notes that courts "allowing lawyers to treat flat fees as non-refundable is undesirable" because it "[o]stensibly encourag[es]" lawyers to refuse repayment when they do "little or none of the work for which the fee was paid." Richmond, *supra* note 27, at 132.

42. *Id.* at 138.

43. Richmond, *supra* note 27, at 138.

44. Dowling v. Chi. Options Assocs., Inc., 875 N.E.2d 1012, 1021 (Ill. 2007); N.Y. State Bar Ass'n Comm. on Prof'l Ethics, Op. 1202 (2020); N.Y. State Bar Ass'n Comm. on Ethics, Op. 816 (2007) (allowing for advance-payment retainers and providing that they should be held outside the client trust account, even though they would be refundable to the extent that they were not earned; suggesting that the purpose such a retainer is to avoid "deposit[ing] such a retainer in a client trust account, [where] the funds would remain the property of the client and might be subject to claims of the client's creditors, thereby making it difficult for the client to retain counsel").

45. *See* ILL. RULES OF PROF'L CONDUCT R. 1.15(c) (2021) (providing that "an advance[-]payment retainer shall be deposited in the lawyer's general account or other account belonging to the lawyer," and that "[a]n advance[-]payment retainer may be used only when necessary to accomplish some purpose for the client that cannot be accomplished by using a security retainer."); *see also id.* at R. 1.15 cmt. 3(c) ("An advance[-]payment retainer is a present payment to the lawyer in exchange for

Richmond accurately notes that this treatment of advance-payment retainers is essentially a "sleight of hand" that attempts to re-brand security retainers as pre-paid funds "that need not be held in trust with respect to clients" to avoid "expos[ing] them to clients' creditors."[46] Richmond criticizes the Illinois and New York approach to advance-payment retainers as "needlessly impair[ing] the rights of clients' legitimate creditors."[47] In this Article, we agree with the criticism of these retainers but for a slightly different reason. Advance-payment retainers are unlikely to directly affect the rights of legitimate creditors because security retainers already offer substantial protection against client creditors.[48] In situations where creditors could lawfully reach the attorney retainer, holding those funds in the lawyers' operating account instead of the client trust account will not shield the funds.[49] Thus, the advance-payment retainer, as interpreted by Illinois and New York, fails in its purpose of protecting against creditor claims. At the same time, however, allowing an advance-payment retainer for unearned fees increases other risks—most notably, it makes the retainer vulnerable to dissipation and to claims by the lawyer's own creditors. The advance-payment retainer also risks impairing the rights of legitimate creditors: it makes it easier for unscrupulous clients to conceal assets, and it increases the risks that lawyers will be complicit (either inadvertently or intentionally) in clients' efforts to do so.

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the commitment to provide legal services in the future. Ownership of this retainer passes to the lawyer immediately upon payment; and the retainer may not be deposited into a client trust account because a lawyer may not commingle property of a client with the lawyer's own property. However, any portion of an advance[-]payment retainer that is not earned must be refunded to the client. An advance[-]payment retainer should be used sparingly, only when necessary to accomplish a purpose for the client that cannot be accomplished by using a security retainer. An advance[-]payment retainer agreement must be in a written agreement signed by the client that contains the elements listed in paragraph (c). An advance[-]payment retainer is distinguished from a fixed fee (also described as a 'flat' or 'lump-sum' fee), where the lawyer agrees to provide a specific service (e.g., defense of a criminal charge, a real estate closing, or preparation of a will or trust) for a fixed amount. Unlike an advance[-]payment retainer, a fixed fee is generally not subject to the obligation to refund any portion to the client, although a fixed fee is subject, like all fees, to the requirement of Rule 1.5(a) that a lawyer may not charge or collect an unreasonable fee").

46. Richmond, *supra* note 27, at 138.

47. *Id.*

48. *See* discussion *infra* Part II.A (explaining the protection offered by security retainers).

49. WILLIAM L. NORTON III, 2 NORTON BANKRUPTCY LAW AND PRACTICE § 30:10 (3d ed. 2021) ("By taking a retainer—even though it is considered a security retainer—a professional becomes a secured creditor, and hence has a claim on the retained funds prior to any other administrative claimant.").

II. Security Interests in Attorney Retainers

Funds held in a client trust account, even though still owned by the client, nevertheless maintain some protection from claims by the client's creditors. Both courts and leading bankruptcy authorities agree that an attorney who holds client funds as security for payment generally has a valid security interest in those funds under Article 9 of the UCC.[50] Attorneys who practice outside the commercial law or bankruptcy realms may not realize the protection that Article 9 offers and may not have taken any affirmative steps to comply with the UCC's requirements. Even so, the Code is written broadly enough to apply.

A. *An Article 9 Security Interest*

No particular language or "magic words" are necessary to create a security interest.[51] Article 9 applies to "a transaction, regardless of its form, that creates a [contractual] security interest in personal property[,]" including money.[52] The official comments make clear that Article 9 will apply "regardless of the form of the transaction or the name that parties have given to it."[53] As long as the transaction offers an "interest in personal

50. *See* 3 Collier on Bankruptcy ¶ 328.02 (Richard Levin & Henry J. Sommer eds., 16th ed. 2021) ("With respect to 'secured' retainers, courts generally hold that a professional with such a prepetition retainer is a 'secured creditor' and has a security interest in the retainer . . . by virtue of a possessory interest in cash."); *In re* On-Line Servs. Ltd., 324 B.R. 342, 346–47 (B.A.P. 8th Cir. 2005) ("A security retainer involves the attorney holding the client's money as a pledge—a possessory security interest—and the Uniform Commercial Code expressly allows for a possessory security interest in money."); *In re* North Bay Tractor, Inc., 191 B.R. 186, 187–88 (Bankr. N.D. Cal. 1996) (holding "[t]he attorney's interest in such a retainer is in the nature of a security interest, assuring the attorney of a minimum fee in the case" and stating that requiring the attorney to give up the retainer "would undermine the purpose of retainers . . . ."); *In re* K & R Mining, Inc., 105 B.R. 394, 398 (Bankr. N.D. Ohio 1989) (stating that "the court finds that applicant possesses a security interest in the retainer to secure payment of its attorney's fees and expenses . . . ."); *In re* Burnside Steel Foundry Co., 90 B.R. 942, 944 (Bankr. N.D. Ill. 1988) ("The debtor's attorney who receives a prepetition retainer to insure payment of fees . . . becomes a secured creditor, secured by a possessory security interest in cash. There is nothing theoretically different between the attorney who receives a retainer against future fees and a landlord who takes a cash security deposit to secure the payment of future rents." (citations omitted)).

51. *See, e.g.*, Silver Creek Supply v. Powell, 521 N.E.2d 828, 832 (Ohio Ct. App. 1987) ("The creation of a security interest does not mandate the usage of a form or document so entitled, nor does it require any magical recitation of language to establish the existence of a security interest."); U.C.C. § 1-201(b)(35) (Am. L. Inst. & Unif. L. Comm'n 2020) (defining "security interest" as "an interest in personal property or fixtures which secures payment or performance of an obligation").

52. U.C.C. § 9-109(a).

53. *Id.* § 9-109 cmt. 2.

property" which secures payment or performance of an obligation, it will qualify as a security interest under the UCC.[54]

As long as the attorney and the client agree that the retainer secures payment, it does not matter whether they call it a security interest, and it does not matter whether they intend to invoke the UCC.[55] Under Article 9, the security interest will become enforceable as between the parties when three requirements are met: (1) "value has been given"; (2) the client "has rights in the collateral or the power to transfer rights in the collateral" to the attorney; and (3) the agreement is evidenced either through a signed security agreement or by transferring possession or control of the collateral to the attorney.[56] "Value" is defined broadly, including "any consideration sufficient to support a simple contract."[57]

Two of the three requirements are easily satisfied: the attorney's promise to provide representation counts as value, and the funds handed over as a retainer usually belong to the client, thus satisfying the requirement that the debtor has rights in the collateral.[58] The third requirement is an evidentiary requirement, intended to offer an objective indication of the parties' intent to create a security interest.[59] It can be satisfied by a writing signed by the client—a signed retainer agreement specifying holding funds as security for payment would suffice.[60] But a written agreement is not necessarily required. The evidentiary requirement can also be met through possession or control.[61] As long as the parties orally agree that the funds will secure payment, then the lawyer's possession of the funds, or control of the bank account where the funds are held, will suffice. As a result, when the client hands over funds to secure payment for the attorney's expected future services, the attorney has a security interest in those funds under Article 9.[62] No written agreement is necessary, as long as the parties have agreed

54. *See id.* § 9-109(d) (offering certain exceptions not relevant attorney retainers).

55. *Id.* § 9-109 cmt. 2.

56. *Id.* § 9-203(b); *see also id.* § 9-102(a)(74) (defining "[s]ecurity agreement" as "an agreement that creates or provides for a security interest").

57. *Id.* § 1-204(4).

58. *Id.* § 9-203(b).

59. *Id.* § 9-203 cmt. 3.

60. *See In re* Adv. Imaging Techs., Inc., 306 B.R. 677, 681 (Bankr. W.D. Wash. 2003) ("Under the [e]mployment [a]greement, the Debtor agreed that Gray Cary would hold the retainer funds to secure payment for future services rendered to the Debtor.").

61. *See* U.C.C. § 9-203(b)(3)(B) & (D) (allowing either possession or control to meet the evidentiary requirement for enforceability).

62. *Id.* § 9-203(d).

between themselves that the purpose of the transfer is to secure the payment of fees.

The creation of a security interest is effective as between the debtor and creditor—or, as here, between the client and attorney. For full protection under Article 9, however, the parties need more than just the creation of a valid security interest. Specifically, Article 9 sets out a system of perfection for security interests (that is, a way to communicate the existence of those interests to outside parties) and priority of those interests. Maximum protection comes from having a perfected security interest with priority over competing claimants.

Here again, however, attorneys may have more protection than they realize. The general priority rule under Article 9 for competing security interests is "the first to file or perfect."[63] That is, the first party with a security interest who either perfects that interest or files a financing statement will prevail over later creditors. Most attorneys will perfect their interest without filing a financing statement, and this is not a problem. Under Article 9, a security interest may be perfected by possession of the collateral (and, with cash, possession is the *only* means of perfecting the security interest)[64] or by control of a bank account (called a "deposit account" under the language of Article 9).[65]

The attorney's possession of the retainer (or control over the account holding the retainer)[66] is thus sufficient both to create the underlying security interest and to perfect it. Once the attorney has possession of the cash, the security interest has both attached to the funds and has been perfected by the attorney's possession.[67] This puts the attorney in a good position, as Article 9 gives the holder of a perfected security interest priority over later-acquired security interests.[68] It is possible that the client may

63. *Id.* § 9-322.

64. *Id.* § 9-312(b)(3).

65. *Id.* § 9-314(a); *see also id.* § 9-102(a)(29) (defining "deposit account").

66. *See id.* § 9-104(a) (describing how a secured party may exercise control over a deposit account).

67. *See* Alan J. Wilson, *The Who and What of Possession Under Article 9 of the Uniform Commercial Code*, 14 FLA. ST. U. BUS. REV. 143, 149 (2015) ("With respect to perfection by possession, a secured party's security interest in collateral is perfected at the exact minute the secured party's possession gives notice to other creditors or would give notice if other creditors looked for the collateral.").

68. U.C.C.§ 9-312(b); *see also In re* Shafer Bros. Constr. Inc., 525 B.R. 607, 619 (Bankr. N.D.W. Va. 2015) ("Because Mr. Johnson possessed the $20,000 security retainer in a deposit account that he controlled—his Interest On Lawyer Trust Account ('IOLTA')—he held a perfected security interest in $5,950 thereof to secure the [d]ebtor's payment for services rendered to that point in time.").

have pre-existing secured parties who can claim an interest in the cash as proceeds of an earlier security interest. Even in that case, the attorney is likely protected, as the UCC allows a transferee of funds to take free of the security interests "unless the transferee acts in collusion with the debtor in violating the rights of the secured party."[69]

The most likely competing claimant for attorneys, however, is not another secured creditor—instead, it is what Article 9 calls a "lien creditor."[70] A lien creditor can be one who "has acquired a lien on the property involved by attachment, levy, or the like[,]" "an assignee for benefit of creditors from the time of assignment[,]" or a receiver or bankruptcy trustee.[71] A common example is a judgment creditor—someone who won a court judgment against the client in earlier litigation and later attempts to levy on the client's property.

Under Article 9, the holder of a perfected security interest has priority over someone who later becomes a lien creditor.[72] The relevant date for lien creditor status is the date of the levy, not the date of the underlying debt or judgment.[73] The relevant comparison date for perfection is the day that the attorney took possession or control of the funds.[74] Thus, a client who owes funds to a judgment creditor could pay an attorney retainer, and the attorney would have priority in that retainer as long as the judgment creditor has not yet levied on the funds. If, however, the judgment creditor had managed to levy on the funds before the retainer was paid, then the judgment creditor would have priority in those funds—but in that scenario, the money would not be available to pay the retainer in any case and thus would not have been in the attorney's possession to begin with. The UCC priority scheme offers significant protection to the attorney. The attorney's act of taking possession of the retainer funds puts the attorney in a superior position to the client's creditors, who may later try to levy on those funds.

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69. U.C.C. § 9-332(a) (applying to cash transfers); *Id.* § 9-332(b) (applying to funds transfers from deposit accounts).

70. *Id.* § 9-102(a)(52).

71. *Id.*

72. *Id.* § 9-317(a)(2)(A).

73. *Id.* § 9-102(52)(A).

74. *See id.* § 9-308 ("When Security Interest is . . . Perfected"); *see also id.* § 9-312(b) (providing for perfection by possession of money or by control of a deposit account).

B. *When the Security Interest Fails*

As discussed above, the attorney will typically have a valid Article 9 security interest in funds held to secure payment, and that interest should take priority over creditors' later attempts to levy on client funds. In practice, however, courts have not always recognized that interest. In this section, we explore what went wrong when the security interest failed.

1. *Hadassah v. Schwartz*

One such case arose in Ohio.[75] The law firm of Bieser, Greer & Landis, L.L.P. (BG&L) represented Robert Schwartz, who paid a retainer of $150,000 to the law firm.[76] The firm properly placed the funds in the Interest on Lawyers' Trust Accounts (IOLTA) client trust account.[77] A creditor sought to garnish the funds in the account to satisfy an outstanding restitution order,[78] and the trial court granted the garnishment.[79] On appeal, Schwartz argued that the law firm possessed a security interest in the funds that should take priority over the garnishment action.[80] Under the analysis above, this argument would have merit—but it did not prevail.

There were two reasons why Schwartz lost. The first, and most important, was waiver—Schwartz failed to raise the security-interest argument as a defense to garnishment in the trial court. The second (and related) problem was the court's misunderstanding of Article 9. The court held that a written document was essential to the existence of a security interest: "Secured-transactions principles do not apply in this case, because neither BG&L nor Schwartz produced the representation agreement, and so there is no evidence of a written document creating a security interest in the funds."[81] The court cited earlier Ohio precedent denying a security interest for lack of a written agreement.[82] The cited case, however, dealt with a non-possessory security interest. Non-possessory interests do require

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75. Hadassah v. Schwartz, 966 N.E.2d 298, 301 (Ohio Ct. App. 2011).

76. *Id.* at 299.

77. *Id.*

78. Schwartz, a former attorney himself, was convicted "for mail fraud in connection with his scheme to defraud Hadassah Hospital, a beneficiary of the estate of [his former client] Beverly W. Hersh, of approximately $2,492,469 . . . ." Disciplinary Couns. v. Schwartz, 984 N.E.2d 1050, 1051 (Ohio 2012). Schwartz was ordered to repay the funds. *Hadassah*, 966 N.E.2d at 301.

79. *Hadassah*, 966 N.E.2d at 299.

80. *Id.* at 301.

81. *Id.*

82. *Id.* (citing Silver Creek Supply v. Powell, 521 N.E.2d 828, 832 (Ohio Ct. App. 1987)).

a written security agreement.[83] What the court failed to realize is that possessory interests are different. As noted above, a security interest in property in the secured party's possession does not require a written agreement—possession of the collateral, however, is enough to evidence the existence of the intent to create a security interest.[84]

2. *Jackson Walker LLP v. F.D.I.C.*

Another case involved the law firm Jackson Walker LLP (Jackson Walker).[85] Jackson Walker represented a federally chartered bank, Home Savings of America, that was in financial distress.[86] The bank paid a $100,000 retainer to Jackson Walker. The retainer agreement was an "evergreen" arrangement that required the bank to keep $100,000 in the retainer.[87] As Jackson Walker performed work, it sent monthly invoices to the bank.[88] The bank, for its part, typically paid the invoices as billed, leaving the retainer intact.[89] Once, however, the bank let three of the monthly invoices stack up, and Jackson Walker transferred the funds to cover those invoices from the trust account to its operating account.[90] The bank then replenished the retainer.[91]

The bank ultimately went into receivership and was taken over by the Federal Deposit Insurance Corporation (FDIC).[92] At that time, there were three unpaid invoices amounting to $66,667.57 and there was $100,000 in the retainer account.[93] The FDIC declined to pay the invoices on behalf of the bank and sought the return of the full retainer.[94] Jackson Walker, on the other hand, argued that it had a security interest in the retainer for the

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83. *See Powell*, 521 N.E.2d at 829 (discussing a security interest in crops being grown); U.C.C. § 9-203(b)(3)(A) (AM. L. INST. & UNIF. L. COMM'N 2020).

84. U.C.C. § 9-203(b)(3)(B) is incorporated in Ohio law at OHIO REV. CODE ANN. § 1309.203; Official Comment 4 to U.C.C. § 9-203 notes that the possession and control alternatives "dispense with the requirement of an authenticated security agreement and provide alternative evidentiary tests." U.C.C. § 9-203 cmt. 4.

85. Jackson Walker LLP v. F.D.I.C., 13 F. Supp. 3d 953, 961 (D. Minn. 2014).

86. *Id.* at 954–55.

87. *Id.* at 955.

88. *Id.* at 956.

89. *Id.*

90. *Id.*

91. *Id.*

92. *Id.*

93. *Id.*

94. *Id.*

unpaid—but fully earned—fees.[95] Jackson Walker filed a declaratory judgment in federal district court in Minnesota seeking a declaration that it could keep $66,667.57 from the retainer to compensate for the work completed.[96]

The court acknowledged that a law firm could obtain a security interest in retainer funds but concluded the language in Jackson Walker's retainer agreement was not specific enough to do so.[97] The court explained the retainer agreement provided that Jackson Walker would "normally expect to retain this amount during the course of our engagement," but noted that the agreement also gave the law firm discretion to apply the retainer to the payment of fees and expenses "from time to time" and that the law firm could then "ask that [the retainer] be replenished."[98] The court explicitly disagreed with the FDIC's position "that all security agreements must include words such as 'security' or 'collateral.'"[99] Nevertheless, it concluded that "the language in the [r]etainer [a]greement does not logically reflect the creation of a security interest."[100] The court determined that "[t]he [r]etainer [a]greement does not commit the retainer to Jackson Walker as a means to ensure HSOA's timely payment of invoices; on the contrary, the agreement suggests an alternative method of payment."[101] The effect of the court's holding was to deny the security interest: the court ordered Jackson Walker to return the $100,000 retainer to the FDIC and then submit a claim for the unpaid fees to the receiver as an unsecured creditor.[102]

In so holding, the court made two errors. First, the court looked only at the written documentation of the agreement and ignored extrinsic evidence of the parties' intent.[103] This is problematic because both the text of the UCC and the authorities interpreting it are clear that no written security agreement is necessary when the secured party has possession of the

95. *Id.*
96. *Id.*
97. *Id.* at 961.
98. *Id.*
99. *Id.*
100. *Id.*
101. *Id.*
102. *Id.* at 962. In bankruptcy, unsecured creditors share pro rata in the distribution of assets and are typically lucky to recover even a small fraction of their claim.
103. *See id.* (requiring that the documentation reflect an objective or manifest "intent to form a security interest").

collateral.[104] Again, the court looked to the law of non-possessory security interests and ignored the UCC's more relaxed treatment of possessory security interests. Under the UCC, possession itself satisfies the evidentiary requirement to support a valid security interest. With a possessory security interest, there is no need for an objective indication of intent—it is, instead, the parties' subjective intent that controls.[105] If the parties both possessed the subjective intent to create the security interest, then possession obviated the need for objectively verifiable documentation.[106]

Furthermore, even the court's interpretation of the written agreement seems erroneous. The court is right that the retainer agreement gave Jackson Walker an "an alternative method of payment."[107] But an alternative method of payment is not necessarily inconsistent with a security interest. Instead, that alternative method of payment can itself provide security. Article 9 requires looking into the purpose of the underlying transaction. What reason could Jackson Walker have had to create this alternative method of payment requiring it to hold $100,000 in client funds? The only plausible reason for Jackson Walker to want to hold the funds is to ensure payment. The very purpose of an "evergreen" retainer, after all, is to offer payment security without requiring pre-payment of the full expected fee.[108] Holding funds to secure payment is, at its essence, a security interest, and it is the essence of the transaction, not its form, that matters to Article 9.

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104. *See* WILLIAM D. HAWKLAND ET AL, 8 HAWKLAND UCC SERIES § 9-203:4 ("[N]o formal agreement in record form is required if the attachment and enforceability is based on the secured party's possession of the collateral."); *In re* Fish, 128 B.R. 468, 469 (Bankr. N.D. Okla. 1991) (acknowledging validity of an oral security agreement when the secured party has possession of the collateral); Malek v. Gold Coast Exotic Imports, LLC, 107 N.E.3d 1013, 1018–19 (Ill. App. Ct. 2018) ("Typically the parties' agreement that a security interest attaches to the collateral is evidenced by a written, authenticated security agreement. . . . However, the parties' agreement that a security interest attaches to the collateral may also be evidenced by the secured party's actual possession of the collateral, and such possession likewise operates to put third parties on notice of the secured party's interest in the collateral.").

105. *See* Wilson, *supra* note 67, at 146–47 ("[T]he secured party generally has two objectives: (1) creating a security interest in the collateral to establish the secured party's rights in the collateral; and (2) putting the public on notice that the secured party has a lien against the collateral in order to perfect the secured party's security interest. Possession is one route to satisfy each objective for certain forms of collateral. In the context of possession, the two objectives are often satisfied simultaneously.").

106. *Id.*

107. Jackson Walker LLP v. F.D.I.C., 13 F. Supp. 3d 953, 961 (D. Minn. 2014).

108. *See supra* Part I (detailing the application of an "evergreen" retainer).

Jackson Walker's communications with the bank make the purpose of the transaction clear. The law firm could see that the bank was in danger of receivership, and it asked for a large retainer to avoid the risk of nonpayment.[109] The court somewhat confusingly suggests that Jackson Walker would have protected itself if it had simply charged the retainer before receivership rather than trying to invoice the client.[110] But if Jackson Walker had the right to charge the retainer at all, that right must exist because the client allowed them to hold the funds to secure payment. As scholars of commercial have pointed out, the court's reasoning "seems highly questionable[,]" as "[t]he fact that the agreement contemplated other forms of payment does not imply that the retainer was not security[,]" but rather "bolsters the argument that the retainer was provided to ensure that the client's obligation would be satisfied if the other forms of payment failed."[111]

3. *M.M. v. T.M.*

A third case, from a New York trial court, appeared to fall into the same trap of overlooking the attorney's interest under the UCC.[112] In that case, a divorcing husband had paid a security retainer to an attorney. According to the court, "the wife, seeking to enforce a judgment for unpaid maintenance, sought out an unusual cache of funds: the retainer deposited by her husband with his attorney to cover his legal fees in this proceeding."[113] The wife's counsel served a restraining notice on the attorney and sought a turnover order for the funds. Although the attorney argued that he had a "lien" in the escrowed funds, the opinion made no mention of the UCC and failed to address the potential existence of a security interest under Article 9. As a result, the court held that the funds were still the property of the client and were therefore subject to the wife's claim.[114] Again, the husband's attorney likely would have had priority to

109. *See Jackson Walker LLP*, 13 F. Supp. 3d at 956 (explaining that the retainer was set at $100,000 "because they are at serious risk of FDIC receivership in the 1st quarter").

110. *See id.* at 962 ("The record undisputedly reflects that, despite the easy opportunity, Jackson Walker made no move to draw down on the retainer until well after HSOA entered receivership.").

111. Steve Weise & Stephen L. Sepinuck, *Personal Property Secured Transactions*, 70 BUS. LAW. 1243, 1247 (2015).

112. *See* M.M. v. T.M., 17 N.Y.S.3d 588, 598 (N.Y. 2015) (overlooking the interest of the attorney under the UCC).

113. *Id.* at 593.

114. *Id.*

the funds under Article 9, but, like the attorney in *Hadassah*, appeared to waive the issue.

C. *Why Do Courts Struggle with the Idea of Security Interests in Attorney Retainers?*

Cases like *Hadassah, Jackson Walker*, and *M.M. v. T.M.* demonstrate some difficulties in applying the UCC outside its normal realm. On the one hand, it is easy enough to explain how the courts in those cases misunderstood the requirements of Article 9—mainly by overlooking the possibility of an oral security agreement evidenced by (and perfected by) possession of the client's funds. It is harder, however, to prevent similar misunderstandings from arising in the future.

One thing that is unsurprising is that the courts misunderstanding or mis-applying Article 9 are usually not bankruptcy courts. Article 9 of the UCC offers a cohesive and largely effective system for creating, evidencing, and offering predictable priorities to security interests, but that cohesiveness comes with a price of steep complexity. As a result, Article 9 rewards repeat players. Bankruptcy courts and commercial-transactions attorneys who work with its provisions daily understand the system as a whole and are therefore less likely to make such mistakes. In fact, it is the bankruptcy treatises and the bankruptcy court decisions that have been quickest to recognize attorneys' security interests in the retainers they hold.[115]

Non-specialists, on the other hand, tend to be intimidated by the complexity of Article 9 and more likely to have difficulty with its application. Professor Tim Zinnecker, a commercial-law specialist, suggests that this intimidation begins in law school—he asks (only somewhat facetiously) why "the Article 9 course, more so than others, [has] a tendency to invoke fear, loathing, tremors, twitches, dizziness, shakes, emotional distress, skin rashes, cramps, sleepiness, anxiety, loss of appetite, nausea, uncontrollable weeping, and hair loss?"[116] Zinnecker offers with five explanations: "(i) absence of cases, (ii) terminology, (iii) burying clues in the official

115. *See* 3 COLLIER ON BANKRUPTCY ¶ 328.02 (Richard Levin & Henry J. Sommer eds., 16th ed. 2021) (describing the system of security interests and retainers); *In re* On-Line Services Ltd., 324 B.R. 342, 346 (B.A.P. 8th Cir. 2005) (acknowledging security retainers are available for attorney's fees); *In re* K & R Mining, Inc., 105 B.R. 394, 398 (Bankr. N.D. Ohio 1989) (determining security interest); *In re* Burnside Steel Foundry Co., 90 B.R. 942, 944 (Bankr. N.D. Ill. 1988) (acknowledging retainers can be used to pay attorney's fees).

116. Timothy R. Zinnecker, *Nine Questions for the Article 9 Professor*, 64 ST. LOUIS U. L.J. 311, 347 (2020).

comments, (iv) pitfalls of literalism, and (v) exceptions, exceptions, and more exceptions."[117] But these pitfalls are not just a problem for students trying to learn the material that is (at least for now) still tested on the bar exam.[118] They also create problems for non-specialist lawyers and judges who must apply the law.

Each of the elements that Zinnecker identifies helps make Article 9 somewhat impenetrable to the non-specialist attorney. The terminology involved is specialized, including some words not normally part of everyday English as well as some ordinary English words used in an unexpected way. Reading through the Code can feel like reading a text in a language one is only semi-conversant in.[119] And the exceptions (and the exceptions to the exceptions) can be easy to miss. For example, a signed security agreement is the norm, and substituting possession for such a written agreement is an exception to the typical process, leading courts like the one in *Hadassah* to improperly conclude that a written agreement is required in all cases.[120] The difficulty in tracking exceptions is compounded when key elements to understanding the Code's application (especially cross-references to common exceptions) are found only in the comments.[121] As Professor Zinnecker notes, ignoring the comments can cause a reader "to draw an incorrect or incomplete conclusion, or no conclusion at all."[122]

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117. *Id.*

118. The creators of the Uniform Bar Exam have announced plans to remove "family law, estates and trusts, uniform commercial code and conflicts of law," from the topics tested on the bar, though these areas may still be incorporated into "the context for legal problems or case scenarios." Stephanie Francis Ward, *Big Changes For Bar Exam Suggested By NCBE Testing Task Force*, ABA J. (Jan 4, 2021), https://www.abajournal.com/news/article/big-changes-for-bar-exam-suggested-by-ncbe-testing-task-force [https://perma.cc/23AL-NRZN].

119. A common student misunderstanding is that Article 9's frequent reference to "accounts" includes bank accounts. It does not. In Article 9 terms, an account is a right to payment. U.C.C. § 9-102(2) (AM. L. INST. & UNIF. L. COMM'N 2020). A bank account on the other hand, is called a "deposit account" in Article 9. *Id.* § 9-102(29). The distinction matters, because timely filing a financing statement will typically give a secured creditor priority for a security interest in accounts—but priority for a security interest in deposit accounts requires that the creditor have control of the deposit account. *See id.* § 9-310 (requiring perfection by filing for all types of collateral other than those specifically exempted); *Id.* § 9-312(b) (providing that a security interest in deposit accounts can be perfected only by control); *Id.* § 9-322 (providing the general rule that priority in conflicting security interests will rank according to time of perfection or filing); *see* MARK TWAIN, TALES, SPEECHES, ESSAYS, AND SKETCHES 359–60 (Tom Quirk ed., Penguin Books 1994) (1890) ("[T]he difference between the *almost right* word and the *right* word is a really large matter—'tis the difference between the lightning-bug and the lightning.").

120. *See* discussion *supra* Part II (outlining how a security interest attaches).

121. Zinnecker, *supra* note 107, at 352.

122. *Id.*

In other areas where the law is complicated, the appellate process and subsequent published caselaw help correct errors and bring uniformity to the area. With Article 9, however, there is a comparatively small body of caselaw.[123] In part, this dearth of caselaw comes from the success of the UCC's treatment of security interests. The Code is comprehensive enough and definite enough that those well-steeped in its provisions need not litigate many issues—a factor that again rewards the repeat players in this area of law.[124] The difficulty creates a bit of a paradox, however. That is, Article 9 is clear enough that bankruptcy courts and commercial and bankruptcy practitioners will recognize and give effect to security interests in retainer funds without needing to litigate these issues often enough to develop a large body of caselaw. Without an explanatory body of caselaw to draw on, non-specialized courts and practitioners are more likely to develop a parallel body of cases that mis-applies Article 9. In the next part, we discuss how an unfounded fear of creditors' claims has led some courts to allow lawyers to bypass client trust accounts.

III. REGULATING RETAINERS

As discussed above, non-specialist courts and attorneys have difficulty understanding how Article 9 of the UCC applies to attorneys' fee retainers. This difficulty increases the risks that retainers will erroneously be held to be subject to creditor claims, even when the UCC would have given priority to the lawyer over the competing creditors. Regulatory bodies can compound these problems, however, when they extend this misunderstanding by expanding "advance-payment" retainers into situations normally covered by security retainers. Illinois and New York, the two states at the forefront of this practice, expanded the recognition of advance-payment retainers to protect against creditor claims. In practice, the extension of advance-payment retainers has introduced new risks to clients and created uncertainty without offering significant protection beyond the protection already offered by a security interest.

123. *Id.* at 347–48 (noting other subjects have more caselaw than Article 9).

124. The comprehensiveness of Article 9 also makes the Secured Transactions class different from most law school classes, in that many problems have a probably right or wrong answer. As Professor Zinnecker points out, the Code offers "a collection of well-drafted, cohesive, and elegant provisions (notwithstanding any minor foibles I have raised) that offer bright-line, yes-or-no, clear-cut answers." *Id.* at 354.

A. *Advance-Payment Retainers Offer Little Protection to Attorneys, but Raise Significant Risks for Clients*

The New York and Illinois approach to "advance-payment retainers" both apply what scholar Douglas Richmond has termed "sleight of hand."[125] That is, the states allow the lawyer to hold the funds intended to secure payment in the lawyer's business or personal account rather than in the client trust account.[126] These states allow the lawyer to treat the retainer as "earned up on receipt" even though it may be subject to refund if the contemplated work is not completed. The arrangement is a pre-payment subject to refund—the lawyer has purchased the right to the lawyer's services and will only get money back if the lawyer fails to deliver on those pre-purchased services. Although the advance-payment retainer arose in the context of flat-fee payments (with consequently predictable payments and predictable points at which the funds would be considered fully earned), Illinois and New York both allow advance-payment retainers for hourly fees, where there is no such predictability. That is, the client would be pre-paying for a set number of hours. If the attorney failed to work all of the hours paid for, the client would be entitled to a refund.

In both Illinois and New York, the intent of this expansion was to protect the funds from the client's creditors.[127] Indeed, in Illinois, the rules were expanded to allow advance-payment retainers outside of client trust accounts specifically for fear that without this mechanism, attorneys would be unwilling to represent clients facing significant third-party claims.[128] However, in discussing this perceived vulnerability to creditor claims, both states looked only at the ownership of the funds and failed to consider whether the attorney's security interest would offer sufficient protection. That is, both states looked to ethics law that made clear that funds in the client trust account belonged to the client, and therefore concluded that these client funds would be vulnerable to the claims of the client's creditors,

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125. Richmond, *supra* note 27, at 138.

126. *See* Dowling v. Chi. Options Assocs., Inc., 875 N.E.2d 1012, 1017 (Ill. 2007) (allowing funds to be held in a general account instead of a trust); ILL. RULES PROF'L CONDUCT R. 1.15(c); N.Y. State Bar Ass'n Comm. on Prof'l Ethics, Op. 1202 (2020); N.Y. State Bar Ass'n Comm. on Prof'l Ethics, Op. 816 (2007).

127. *Dowling*, 875 N.E.2d at 1023; N.Y. State Bar Ass'n Comm. on Prof'l Ethics, Op. 816 (2007).

128. *See* ILL. RULES PROF'L CONDUCT R. 1.15(c) (specifying that "[a]n advance[-]payment retainer may be used only when necessary to accomplish some purpose for the client that cannot be accomplished by using a security retainer" and requiring the attorney to state specifically if they would be "unwilling to represent the client without receiving an advance[-]payment retainer").

as in the *Hadassah, Jackson Walker*, and *M.M. v. T.M.* cases. As discussed earlier, however, this perceived vulnerability largely results from a failure to apply the provisions of the UCC. In the ordinary run, even a security retainer should give the attorney priority over later lienholders outside of bankruptcy.

The Illinois and New York approach creates logical paradoxes. For example, attorneys for the later-bankrupt Caesars Entertainment Operating Co. secured a $3 million retainer.[129] They admitted that the size of the retainer was intended as "an insurance policy against nonpayment" but then sought to characterize it as either a "classic" retainer or an "advance-payment" retainer rather than a "security retainer" to protect the funds from other claimants.[130] There was no dispute that the purpose of the retainer was for security, but the attorneys could not call it a security retainer or hold it in a trust account for fear that they would thereby lose their interest in it.

The bankruptcy court in *Caesars Entertainment* upheld the retainer as an "advance payment" under Illinois law.[131] Nonetheless, it seems likely that the attorneys would have been sufficiently protected even if they called it a security retainer. The *Norton Bankruptcy Law and Practice* treatise clarifies that "[b]y taking a retainer—even though it is considered a security retainer—a professional becomes a secured creditor, and hence has a claim on the retained funds prior to any other administrative claimant."[132] A security retainer offers the attorney protection even in bankruptcy.

Furthermore, an advance-payment retainer, even when upheld, does not necessarily insulate the attorney from claims in the bankruptcy process.[133] When the attorney has not provided "reasonably equivalent value" for the retainer, it can be challenged as a fraudulent transfer or voidable transaction:

> The provisions of the Code regarding fraudulent transfer may also be asserted to challenge a prepetition retainer. Under Section 548, for example, a trustee might assert that the debtor did not get reasonably equivalent value for the payment of a retainer, and that the payment was made while the debtor was

129. *In re* Caesars Ent. Operating Co., Inc., 561 B.R. 420, 426–7 (Bankr. N.D. Ill. 2015).

130. *Id.* at 436–37.

131. *Id.* at 438–39.

132. NORTON III, *supra* note 49, § 30:10.

133. 1 BANKRUPTCY DESK GUIDE § 2:65 (2021) ("The deposit of a retainer into an attorney's general operating fund does not insulate it from disgorgement.").

insolvent or the payment caused the debtor to become insolvent, among other causes.[134]

Advance-payment retainers might be subject to slightly less scrutiny in bankruptcy, but the difference is not a huge one. According to one bankruptcy court applying the New York approach permitting advance-payment retainers, the advance-payment retainer would not automatically become the property of the estate, but could still be subject to return if the payment exceeds the reasonable value of the attorney's services.[135] The unearned portion of the security retainer, on the other hand, would automatically become property of the estate—but even so, the Bankruptcy Code would still allow the court to award the retainer funds as compensation to the attorney for ongoing work.[136]

As a result, there seems to be little actual benefit from advance-payment retainers. Outside of bankruptcy, security retainers should sufficiently protect against later-arising creditor liens.[137] And even in bankruptcy, the type of retainer makes only a minor difference. Security retainers that become property of the estate upon bankruptcy filing can still compensate

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134. Eugene R. Wedoff, *Prepetition Retainers in Bankruptcy: Whose Money Is It?*, 1991 ANN. SURV. OF BANKR. L. 6, 6 (1991); *see also* Kenneth L. Kettering, *The Uniform Voidable Transactions Act; or the 2014 Amendments to the Uniform Fraudulent Transfer Act*, 70 BUS. LAW. 777, 807 (2015) (explaining that the Uniform Fraudulent Transactions Act was renamed the Uniform Voidable Transactions Act because its underlying doctrine is "aimed at policing conduct to the prejudice of creditors" and "is in no way limited to debtor behavior that is describable as 'fraudulent' in anything like the modern sense of that word[,]" but is rather "a regulatory tool").

135. *See In re* King, 392 B.R. 62, 71 (Bankr. S.D.N.Y. 2008) ("Funds that are collected as advance retainers do not become property of the estate and are subject to the requirements of § 329 only."); 11 U.S.C. § 329 ("If such compensation exceeds the reasonable value of any such services, the court may cancel any such agreement, or order the return of any such payment, to the extent excessive."); *see also* FED. R. BANKR. P. 2016(b) ("Every attorney for a debtor . . . shall file and transmit to the United States trustee within 14 days after the order for relief . . . the statement required by § 329 of the Code . . . . The statement shall include the particulars of any such sharing or agreement to share by the attorney, but the details of any agreement for the sharing of the compensation with a member or regular associate of the attorney's law firm shall not be required.").

136. *See In re King,* 392 B.R. at 70 ("Since the debtor retains an interest in the retainer, such a retainer is the property of the estate, and is subject to use by counsel upon compliance with §§ 329 and 330."); 11 U.S.C. § 330 (allowing the court to award "reasonable compensation for actual, necessary services rendered by . . . [the] attorney"); *In re* Seek Wilderness, Ltd., 368 B.R. 640, 653 (Bankr. W.D. Mich. 2007).

137. *See* discussion *supra* Part II (describing the benefits of security retainers). Of course, security retainers may still be subject to liens that existed before the funds were handed over to the attorney, but in this regard there is no difference between security retainers and advance-payment retainers.

an attorney with judicial permission—the attorney will not necessarily give up the right to payment, as long as the bankruptcy court agrees that the attorney's future services would benefit the estate. At the same time, even though advance-payment fees do not automatically become property of the estate, they may nonetheless end up there. Whatever equitable right the client had to the refund of unreasonable or unearned fees will become part of the bankruptcy estate, and "[i]f a flat[-]fee [earned-on-receipt] agreement is held to be executory, the trustee may reject it, and the attorney may be required to refund all or a portion of the fees."[138] Finally, if the advance-payment fee is meant to compensate the attorney for any post-petition services, those services must still be approved by the court.[139]

Advance-payment retainers, at least as interpreted by Illinois and New York, therefore do little to change the attorney's position. At the same time, however, they significantly ramp up client risk.[140] As Professor Roy Simon pointed out, New York "actually *requires* a lawyer to deposit advance retainer fees in the lawyer's own account (or the law firm's operating account) unless the lawyer and client have agreed that the lawyer may deposit them in a trust account."[141] Illinois's rule on advance-payment retainers likewise requires lawyers to deposit them into the lawyer's business account rather than the client's trust account.[142]

Once the money is in the lawyer's business account, there is no restriction on the attorney's spending the money. That is why it is especially dangerous that Illinois and New York allow advance-payment retainers to include the pre-payment of fees for work the lawyer has not yet undertaken. In such cases, the client will still have the right to a refund of the unearned portion, but the lawyer may reasonably have spent the funds on office rent, staff, or

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138. WILLIAM L. NORTON III, 9 NORTON BANKRUPTCY LAW AND PRACTICE § 172:18 (3d ed. 2021); *In re King*, 392 B.R. at 69–70 (citing *In re* Rittenhouse, 76 B.R. 610, 611 (Bankr. S.D. Ohio 1987)); *see also In re* Shafer Bros. Constr. Inc., 525 B.R. 607, 619–20 (Bankr. N.D. W.Va. 2015) (finding that the attorneys were entitled to a reasonable amount for their services and allowing them to draw an approved amount from the client's retainer before allowing an administrative claim to any balance remaining).

139. *See In re* ACandS, Inc., 297 B.R. 395, 402 (Bankr. D. Del. 2003) ("Even if Kenesis had been paid a wholly nonrefundable fee prepetition, it was still required to file a retention application and obtain court approval as a condition of providing postpetition services to the estate.").

140. In recognition of this risk, the Illinois rule provides that "[a]n advance[-]payment retainer should be used sparingly, only when necessary to accomplish a purpose for the client that cannot be accomplished by using a security retainer." ILL. RULES PROF'L CONDUCT R. 1.15 cmt 3C.

141. ROY D. SIMON, SIMON'S N.Y. RULES OF PROF'L. CONDUCT § 1.15:4 (2020) (emphasis in original).

142. ILL. RULES PROF'L CONDUCT R. 1.15(c)(2).

other expenses. If so, the lawyer will owe a debt to the client, but that debt will be unsecured—and unsecured debts, of course, are notoriously difficult to collect.[143] With no guarantee of a quick cash refund, the client may find themselves without sufficient funds to hire new counsel. As a result, the client may be unable to fire an attorney when the client has become unhappy with the representation. Of course, this was the very result that New York was trying to prevent when it prohibited nonrefundable fees in *In re Cooperman*.[144] Nevertheless, New York's interpretation of advance-fee retainers risks creating a fee that is nonrefundable in practice, even if refundable in theory.

Perhaps even worse, holding the advance-payment retainer outside the client trust account makes the retainer vulnerable to the lawyer's own creditors.[145] Again, it is anomalous that efforts to protect the funds from the client's creditors might do more harm by making those funds vulnerable to the lawyer's creditors. Nonetheless, lawyers commonly finance their receivables.[146] Lenders with a security interest in the lawyer's accounts will have priority over the client's unsecured claim for a refund of unearned fees, and will keep that priority even if the client later secures a lien.[147] The lawyer's creditors could not, of course, reach funds in the client trust account—that is one of the very purposes for which trust accounts were

143. *See* Brickman & Cunningham, *supra* note 15, at 42 ("Clients often are unable to obtain the return of unearned advance fee payments because their lawyers have either spent the money or otherwise made it unavailable to the client.").

144. *See In re* Cooperman, 633 N.E.2d 1069, 1072 (N.Y. 1994) ("Special nonrefundable retainer fee agreements diminish the core of the fiduciary relationship by substantially altering and economically chilling the client's unbridled prerogative to walk away from the lawyer. To answer that the client can technically still terminate misses the reality of the economic coercion that pervades such matters.").

145. Gregory Dunbar Soule, *Attorney Misappropriation of Clients' Funds: A Study in Professional Responsibility*, 10 U. MICH. J. L. REFORM 415, 416 n.6 (1977) ("Once the clients' funds have been commingled with those of the attorney, there is an increased danger that the clients' money will be used for the attorney's personal expenses or subjected to the claims of his creditors.").

146. *See* Joseph Genovesi, *Factoring Legal Receivables—How This Growing Area of Specialty Lending Helps Attorneys & Their Clients*, ABFJOURNAL (Apr. 15, 2014), https://www.abfjournal.com/articles/factoring-legal-receivables-how-this-growing-area-of-specialty-lending-helps-attorneys-their-clients/ [https://perma.cc/3V4A-2WUZ] ("Factoring legal receivables has become such a popular option for attorneys because of its relative convenience when compared to receiving bank loans or lines of credit. Banks and credit unions will often refuse to advance funds to attorneys and law firms because attorneys frequently have very little physical collateral; legal funding is a viable alternative that exists specifically to advance capital to attorneys."); Me. Prof'l Ethics Comm., Ethics Op. 152 (1995) ("Law Firm Granting Bank Security Interest in Accounts Receivable").

147. U.C.C. § 9-317(2) (AM. L. INST. & UNIF. L. COMM'N 2020); *see supra* Part II.A (noting how priority is determined regarding secured claims).

created.[148] Allowing unearned fees to be held outside the trust account therefore significantly raises the client's risk of loss due to the lawyer's economic insecurity, even when the lawyer has done nothing wrong.[149]

B. *Advance-Payment Retainers Risk Lawyer Complicity in Concealing Assets*

Attorney retainers may offer a tempting vehicle for clients to try to conceal or shelter assets. As discussed above, creditors who try to levy on the security retainer will generally find that their interest is subordinate to the attorney holding those funds to secure payment for their future services.[150] At the same time, however, authorities agree that the client has an absolute right to terminate the attorney's representation at any time and to take back any unearned funds.[151]

Unscrupulous clients may try to exploit the room between these positions, putting money into an attorney retainer when creditors are circling and then withdrawing the funds later when the creditors back off. In one case from Ohio, for example, "[o]ver a three-year period, before and during the divorce proceedings, the client paid the lawyer over $850,000—not for legal services, but to hide the money from her husband."[152] The lawyer placed the money in the client trust account and later wire-transferred it to offshore accounts belonging to the client.[153] The Ohio Supreme Court ultimately disbarred the lawyer for this and other misconduct.[154] Of course, the Ohio example is an egregious one, and the court appeared convinced that the lawyer was intentionally helping the client defraud her husband.[155] But even well-intentioned lawyers can inadvertently become parties to clients' attempts to hide assets.

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148. *See* Lester 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. 647, 667–68 (1989).

149. *Id.*

150. *See supra* Part II (detailing how the position of a secured creditor).

151. *See* Brickman & Cunningham, *supra* note 15, at 18 ("The *Cooperman* court . . . affirmed two longstanding principles of New York law: that a client may terminate a lawyer at any time, with or without cause, and that any attempt by a lawyer to hinder that right (as by charging a nonrefundable retainer fee) violates the Code.").

152. Karen Rubin, *Don't Help Your Client Hide Assets: Clear Case Leads To Lawyer's Disbarment*, THOMPSON HINE (Sept. 8. 2016), https://www.thelawforlawyerstoday.com/2016/09/2790/ [https://perma.cc/WQR3-C7FJ].

153. *Id.*

154. Trumbull Cty. Bar Ass'n v. Roland, 63 N.E.3d 1200, 1205 (Ohio 2016).

155. *See id.* (finding "the misappropriation of client funds and fraudulent or dishonest conduct" warranted permanent disbarment).

Allowing attorneys to place unearned advance-payment retainers into attorneys' private accounts increases the risk that clients' attempts to conceal assets will go unchallenged. One attorney sought an ethics opinion in New York, stating that the client had rebuffed the attorney's attempt to return the unearned portion of a retainer after the conclusion of the representation.[156] "The client asked him to keep the balance in his escrow account, telling the lawyer she 'might need [him] for something else.'"[157] The lawyer wanted to know whether it was ethically permissible to hold onto the funds without any specific plans to provide legal services in the immediate future.[158]

It is somewhat surprising that the authors of the ethics opinion did not question why the client would want to keep funds in the attorney trust account when no immediate legal work was needed. This is a significant oversight, as only three years earlier, a bankruptcy court in the Southern District of New York held that "Attorneys Must Investigate the Source of Funds Received Where A Reasonable Lawyer Would Question the Client's Intent In Paying the Fees."[159] Earlier cases had similarly provided that "[a] lawyer who blindly accepts fees from a client under circumstances that would cause a reasonable lawyer to question the client's intent in paying the fees accepts the fees at his peril," and that a lawyer who fails to inquire into the source of the fee risks being "charged with knowledge of any intent on the part of the transferor to hinder, delay, or defraud."[160]

In spite of this precedent, the opinion author did not advise the attorney to inquire into the client's purpose, but instead assured the attorney that he was "free to agree to that request."[161] The opinion author went even further, however, in reiterating that because New York recognized advance-payment retainers, the lawyer need not even keep the funds in the client's trust account if the client and lawyer agreed to put it in the lawyer's own account:

> At the client's request, the lawyer may retain the unspent portion of the retainer on the conclusion of a matter as an advance[-]payment of fees to be

156. N.Y. State Bar Ass'n Comm. on Prof'l Ethics, Op. 983 (2013).

157. *Id.*

158. *Id.*

159. *In re* Parklex Assocs., Inc., 435 B.R. 195, 211 (Bankr. S.D.N.Y. 2010) (capital letters from original heading removed).

160. Gala Enters., Inc. v. Hewlett Packard Co., 989 F Supp. 525, 532 (S.D.N.Y. 1998).

161. N.Y. State Bar Ass'n Comm. on Prof'l Ethics, Op. 983 (2013).

> used for unspecified future legal services. Such advance[-]payment retainers may be treated either as client-owned funds, to be kept in the lawyer's escrow account, or as lawyer-owned funds, subject to the lawyer's obligation to reimburse the client for any portion ultimately not earned in fees.[162]

The opinion's blessing on the attorney holding the funds without warning the lawyer to inquire into the client's purpose is problematic. After all, this arrangement would not meet the requirement for a security interest; the lawyer would not be holding the funds as security for payment of any contemplated service, and in fact the lawyer had not even agreed to provide further service. Under Article 9, one of the elements to create a security interest is that value must be given; here, however, the funds were to be put in the lawyer's possession without any commitment to extend value in return.[163]

The opinion is even more problematic for suggesting that the funds could be placed in the lawyer's own accounts. This procedure would make the funds nearly untraceable by the client's legitimate creditors. As other scholars have explained, "absent an obligation imposed by law or contract, a lawyer has no obligation to seek out and notify creditors of the lawyer's client of the receipt of funds belonging in whole or in part to the client."[164] When holding client funds in a trust account, lawyers must explicitly account for those funds. And even though the creditors' claims may be subordinate to the lawyer's own security interest, creditors would at least have the possibility of reaching the funds when the representation terminates and the lawyer no longer has an interest in the funds to secure payment. But if the funds are moved into the lawyer's own accounts and treated as the lawyer's own money before any work is done to earn those fees—and before such work is even contemplated—then the risk is even greater. The client interest is at risk if the lawyer spends or dissipates the funds and then cannot return unused funds to the client. And legitimate creditors also run the risk that they might have no way to identify the existence or location of funds belonging to the client—it would be very easy for the client to use the lawyer's services to hide money from creditors.[165]

162. *Id.*

163. U.C.C. § 9-203 (AM. L. INST. & UNIF. L. COMM'N 2020).

164. Schuwerk & Hardwick, *supra* note 1.

165. In an even more troubling twist, the opinion leaves open whether the parties' "attorney–client relationship will continue during that period" while the attorney is holding the fees before undertaking additional work for the client. N.Y. State Bar Ass'n Comm. on Prof'l Ethics, Op. 983. If,

IV. RECOMMENDATIONS

Given the confusion regarding the relative rights between creditors and attorneys in attorney retainers, this is an area where bar associations and attorney regulatory bodies could offer useful guidance. For example, non-bankruptcy judges may benefit from guidance about the application of Article 9 to retainers. Additionally, lawyers need guidance on how to take security interests, as well as how to explain the benefits and drawbacks of such an arrangement to clients. We suggest action in three areas.

A. *States Should Limit Advance-Payment Retainers*

First, Illinois and New York should change their rules to specify that advance-payment retainers are incompatible with hourly billing. Both states expanded their reliance on advance-payment retainers under a mistaken assumption that funds held in traditional Interest on Lawyers' Trust Accounts (IOLTA) or client trust accounts would be vulnerable to claims from the client's creditors. As discussed above, however, the law already sufficiently protects the attorney who takes a possessory security interest in the retainer funds. Thus, there is no reason why unearned funds should not be held in trust. Depending on the jurisdiction, flat fees may be considered to be fully earned upon receipt, and the advance payment of a flat fee may therefore be appropriately held in the attorney's personal or business account. However, when the attorney will be charging by the hour, there is no logical basis to treat pre-paid funds as "earned" before the attorney actually works those hours. Pretending otherwise prevents well-meaning clients from obtaining the protections offered by IOLTA accounts and allows unscrupulous clients to pull their attorneys into asset-hiding schemes. Neither of those risks is worth the illusory protection offered by advance-payment retainers.

B. *Lawyers Should Obtain a Signed Retainer Agreement Explicitly Referencing Security*

Second, even though Article 9 offers lawyers priority over client creditor claims, lawyers may be worried that judges will not understand the complexities of Article 9 and that courts therefore may not uphold a lawyer's priority in retainer funds. This concern is legitimate. As discussed above,

during this period, the funds are considered to belong to the attorney and yet no attorney–client relationship exists, it is hard to imagine what kind of questions a creditor could even ask to uncover the existence of these funds.

courts have struggled to apply the law of security interests to retainer agreements and have mistakenly rules against lawyers who lacked an explicit security agreement signed by the client.[166]

To prevent against later misunderstandings, lawyers may want to take a belt-and-suspenders approach by having the client sign a retainer agreement specifying that the retainer funds are to be held as security for payment of legal fees, and perhaps even referencing "a security interest as the term is used in the Uniform Commercial Code, including Article 9." Under Article 9, such a signed agreement is not necessary either to create or perfect the security interest; possession of the funds is sufficient to do both.[167] Nonetheless, courts unfamiliar with the details of the UCC sometimes expect to see a signed agreement offering objective evidence of a security agreement.[168] It may be easier for the attorney to obtain a signed retainer agreement at the beginning of the representation than it is to later write a brief explaining how possessory security interests are treated differently from non-possessory security interests under Article 9 of the UCC. Having a signed retainer agreement can document the security interest in a way that offers clarity both to courts and to clients.

C. *Regulatory Officials Should Coordinate with Commercial-Law Specialists and Develop Educational Programs*

Third, states should create programs to educate attorneys about the nature of security interests. National coordination in this area would be especially helpful. For example, ABA officials who promulgate the Model Rules of Professional Conduct could work with attorneys at the Uniform Law Commission who publish the UCC. Together, these attorneys could develop common terminology for retainer accounts and could describe how retainers for security fit into the larger scheme of security interests.

Though the belt-and-suspenders approach discussed above should help lawyers in the courtroom, additional guidance may be necessary so that lawyers may clearly articulate to their clients the benefits and drawbacks of granting the lawyer a security interest. Clients should be made aware that their creditors may lose priority in the retainer cash—and they should also be made aware that paying a retainer to defeat those creditors may be regarded as a fraudulent transfer. Adding a shared comment to both the

166. *See supra* Part II.B (explaining when a security interest may fail).

167. *See supra* Part II.A (outlining the elements to create a security interest).

168. *See supra* Part II.B (noting case opinions that have encountered this issue).

Model Rules and to the UCC would make it easier for lawyers, parties, and courts to understand how the law of security interests applies to common retainer agreements. For example, a comment may be appropriate in Model Rule of Professional Conduct 1.5 dealing with fee arrangements. At present, Comment 2 requires the lawyer to give the client "an understanding as to fees and expenses"—this requirement could imply an obligation to explain the effect of the client's grant of a security interest in the retainer.[169] Making this requirement explicit in the comment could better inform and prepare lawyers to fulfill their ethical obligation.

At the state level, regulatory officials should develop annual continuing legal education programs that help disseminate this information to practicing attorneys. Information about security interests in retainers could be added to more general educational programs about handling client funds. Attorneys' management of client funds is "an area of significant client vulnerability and frequent discipline."[170] It would therefore make sense to include these educational programs as part of an overall effort to increase compliance in attorney fund management. Violations of trust fund rules "account for about fourteen percent of all disbarments and about eight percent of all suspensions nationally."[171] Better oversight and education about fund handling is needed to protect client interests, and attorneys may be more motivated to participate in such educational programming when it also includes information that can help lawyers protect their own interests in security retainers.

V. CONCLUSION

It is clear that there is a great deal of confusion about attorneys' rights to retainer funds. When a client's creditor tries to make a claim on funds held by an attorney to secure client payment, both attorneys and courts struggle to understand and articulate the relative rights between the attorney and the client's creditors. Current law protects attorneys' interest in security retainers better than many practitioners or courts realize. Article 9 of the UCC recognizes a valid and perfected security interest when (1) a client delivers possession of funds to an attorney; (2) the parties' subjective intent,

169. MODEL RULES OF PROF'L CONDUCT R. 1.5 cmt. 2 (AM. BAR ASS'N 2021).

170. Cassandra Burke Robertson, *How Should We License Lawyers?,* 89 FORDHAM L. REV. 1295, 1312 (2021).

171. Philip F. Downey, *Attorneys' Trust Accounts: The Bar's Role in the Preservation of Client Property*, 49 OHIO ST. L.J. 275, 276 (1988).

whether or not memorialized in writing, is for the funds to secure payment; and (3) value, broadly defined, has been given to support the transaction—such as the attorney's agreement to provide legal services on behalf of the client.[172]

The complexity of the UCC makes it difficult for non-specialists to understand and apply its provisions. This difficulty has occasionally led both courts and practitioners astray in analyzing the priority of claims in attorneys' retainer funds. Some reported opinions appear clearly at odds with the UCC. And two states—Illinois and New York—have created unnecessarily risky procedures to avoid perceived vulnerability to creditor claims. In light of these problems, this Article recommends that lawyer regulatory bodies take a closer look at the commercial-law aspects of attorney retainers and develop educational outreach programs to attorneys. We further recommend that attorneys draft retainer agreements that explicitly reference the term "security" or "security interest" when the attorney intends to hold client funds as security for payment and that the attorney obtain the client's signature on the retainer agreement. Even though the retainer is typically a possessory security interest under Article 9 of the UCC (for which a written and signed security agreement is not necessary), the existence of a signed agreement may forestall later objections. These explicit agreements may become less important as courts become aware of the interaction between Article 9 and security retainers. Finally, we recommend that lawyers explain to their clients the consequences of a security-interest retainer. Lawyers may be understood to have an ethical obligation to educate their clients as to the effect of such a retainer.

172. *See* discussion *supra* Part II (listing the elements to perfect a security interest).