OTHER PEOPLE'S MONEY: A LAWYER'S OBLIGATION TO SAFEGUARD PROPERTY BELONGING TO OTHERS

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All lawyers know that it is wrong to convert client funds. And most understand the importance of managing clients' funds to avoid commingling those funds with their own. Although proper recordkeeping will not prevent theft by lawyers, and a dishonest lawyer will find a way to take the money regardless of what recordkeeping obligations they may have, these rare, but scandalous cases, illustrate why the rules exist and why Disciplinary Counsel may be strictly enforcing these rules.

Lawyers must keep good records to trace the path of funds into their accounts and out of their accounts so that defalcations can be detected, and so that lawyers do not inadvertently co-mingle funds or lose track of funds. Moreover, an effective recordkeeping system will allow an attorney to monitor the conduct of employees and to prevent or detect fraud by them. Most ethics rules on handling client's funds derive from ABA Model Rule 1.15. Be aware, however, that the rules in each state vary somewhat and you need to be familiar with the rules in your state. This article points out some of the variations that exist.

The core provisions of Model Rule 1.15, adopted by most states, require that funds belonging to clients or third parties that are entrusted to a lawyer be placed in a separate trust account to avoid commingling those funds with the lawyer's own money. Like the model rule, most states' rules describe what kinds of fees must be held in a client trust account. Most require that a lawyer is required to "promptly deliver to the client or third person any funds or other property that the client or third person is entitled to receive and, upon request by the client or third person, shall promptly render a full accounting regarding such property." Most also require that lawyers maintain specific kinds of records related to the handling of such funds and that such records are kept for a certain number of years. Beyond these standard provisions, states' ethics rules greatly diverge.

Commingling occurs when a lawyer holds his or her own funds in the same account that is holding client or third party funds. Commingling is, itself, a violation of the ethics rules and may subject a lawyer to discipline. Importantly, this commingling is almost always a disciplinary offense even if none of the other person's money is stolen.
It is not always clear, however, whether certain funds belong to the lawyer or to their clients. For example, some fees are earned by the lawyer as soon as they are paid, such as a non-refundable flat fee, assuming this fee arrangement is allowed by local rules. Other fees are merely advances on fees that the lawyer will earn as he or she works on the matter.

Some states, like Pennsylvania, Connecticut and Michigan, address this issue by specifying that no funds belonging to the lawyer shall be deposited in a client trust account, except for funds reasonably sufficient to pay account charges imposed by the bank, or funds belonging in part to a client and in part presently or potentially to the lawyer, such as advanced legal fees and expenses.[1] A lawyer may properly withdraw these funds from a client trust account only as fees and expenses are earned, unless the right to receive the funds is disputed by the client, in which event the disputed portion shall not be withdrawn until the dispute is finally resolved.[2]

Ethics rules also frequently address how client funds may be withdrawn. Rhode Island, Colorado and Massachusetts prohibit withdrawals from client trust accounts except to a named payee; payments in or to cash are forbidden.[3] Because these rules prevent lawyers from disbursing money in cash form, it is inappropriate and in violation of the rules for lawyers to have ATM cards on their clients' trust accounts.[4] Moreover, in New York and Rhode Island, the only person who can withdraw money from a trust account is an attorney admitted to practice law in that jurisdiction.[5]
Additionally, some states have imposed a regulatory system of sorts designating which financial institutions in the state may maintain trust accounts. In those jurisdictions, like Colorado, Rhode Island, and the District of Columbia, a lawyer may only set up trust accounts in approved financial institutions that have agreed in writing, to timely notify the bar overseers of any trust account checks that have been dishonored for insufficient funds, or that would otherwise have been dishonored, but for overdraft protection.[6] In Colorado and Rhode Island, the lawyer further impliedly agrees to indemnify and hold harmless the designated financial institution for its compliance with the reporting and production requirements.

In order to protect clients and others who give funds to a lawyer for safekeeping, many states impose rules on how client trust account records are to be maintained. Some states mandate that lawyers retain contemporaneous records of each

trust account transaction necessary to document a transaction.[7] Lawyers commonly use one general ledger for all transfers for all clients. But some states require more. One such state is Massachusetts, which requires that lawyers maintain a separate record for each client for whom trust funds are received that documents each receipt and disbursement, the identity of the matter for which funds were deposited or disbursed, including a subsidiary ledger for each client matter that documents each receipt and disbursement of the funds of the client with respect to such matter.[8] The Massachusetts rule prohibits lawyers from disbursing funds from the trust account that would create a negative balance with respect to any individual client and requires lawyers to reconcile each trust account no less frequently than every 60 days.[9] California and Ohio similarly require that separate records are maintained for each client on whose behalf funds are held.[10] But the rule in each of those states mandates that lawyers perform and retain reconciliations on each trust account on a monthly basis.[11]

While rules requiring lawyers to separately track in one ledger or sub-account all financial transactions as to each client and transaction are seemingly in the minority, practical considerations warrant maintaining trust accounts in this manner. Certainly, maintaining records in this manner will require additional bookkeeping at the front end. But doing so will make it easier for lawyers and their staff to determine where the problem lies if there is some type of discrepancy in the trust account later on.

States' ethics rules likewise vary widely on the types of records that must be kept. Some states, like West Virginia, still follow the model rule and simply require that, lawyers maintain "complete records" of client trust accounts.[12] Other states' rules are more specific as to what records must be maintained and how they must be kept.
One variation is that all transaction records provided by a bank must be maintained for each trust account, including periodic bank statements, deposit slips, and cancelled checks. Massachusetts and Pennsylvania, for example, insist that records be maintained electronically, so long as, images are readily obtainable and capable of being reproduced in hard copy. To be compliant, however, electronic records must be backed up regularly on an appropriate or separate storage device.[13]

Ohio, Rhode Island and New York each require that all retainer and compensation agreements be maintained, whereas Colorado further obliges lawyers to maintain copies of all written communications with clients setting forth the basis or the rate charged.[14] The majority of these states also require that copies of all bills and disbursement statements sent to clients be kept.[15]

Interestingly, New York's bookkeeping requirements set forth in DR 9-102(D), apply not only to trust accounts but to other operating accounts maintained by a law firm. The exacting standards in New York demand that lawyers maintain all checkbooks, bank statements, prenumbered canceled checks and duplicate deposit slips for all trust accounts and operating accounts, but may be read to require that, originals of these records are also maintained.[16] Notably, lawyers who fail to maintain all of the records and documents specified in DR 9-102(D) are deemed to violate the rule and are subject to disciplinary proceedings, even if they do not commingle or misappropriate client funds.[17]

States' ethics rules on safekeeping client property also greatly differ on whether funds must be kept in interest-bearing accounts, referred to as "IOLTA" accounts, short for "interest on lawyer's trust accounts." Although Rhode Island's Rule 1.15 (f) is written with mandatory language ("law firms shall . . . deposit clients' funds . . . in one or more interest bearing trust accounts . . ."), Rule 1.15(h) makes it clear that lawyers can opt out of the IOLTA rules by notifying the clerk of the Rhode Island Supreme Court in writing during the month of January in each year. If such notice is provided, a lawyer may place client funds in an interest-bearing account and pay the interest to the client.
States like Rhode Island, West Virginia and Michigan that do not impose IOLTA requirements, typically imbue attorneys with a great deal of discretion as to whether funds should be deposited in an IOLTA or a non-IOLTA account. Such states generally require that, IOLTA accounts be utilized for client funds received that are either "nominal in amount" or that are more than "nominal in amount" but which are only being held by the lawyer for a "short period of time, " with the lawyer making this determination.[18]

Michigan's rule similarly requires that, lawyers consider other factors to determine whether to utilize an IOLTA account such as, the amount of interest the funds would earn during the period that they are expected to be deposited, the cost of establishing the IOLTA account and the ability to calculate and pay income to clients.[19] Although the decision to utilize an IOLTA account rests with the lawyer in these jurisdictions, the lawyer's good-faith determination in this regard does not necessarily amount to an ethical violation.[20] The same cannot be said for states mandating that lawyers strictly comply with mandatory IOLTA rules.

Read the requirements of the ethics rules applicable in your jurisdiction. Knowing what your state requires, as well as, adopting practices and procedures designed to assure compliance, is essential to avoiding legal malpractice or other civil liability and disciplinary actions.

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1. See Pennsylvania Rules of Prof. Conduct, Rule 1.15(h)&(i), 42 Pa. C.S.A.; Connecticut Rules of Prof. Conduct, Rule 1.15 (c)&(d); Michigan Rules of Prof. Conduct, Rule 1.15 (f)&(g).
2. See Pa. Rule 1.15 (f)&(i); Conn. Rule 1.15 (d)&(e); Mich. Rule 1.15 (c) &(g).
3. See Rhode Island Rules of Prof. Conduct, Rule 1.19(c) (withdrawals must be made by check or, with prior written approval of the payee, by bank transfer); Colorado Rules of Prof. Conduct, Rule 1.15(i)(1)&(3); Massachusetts Rules of Prof. Conduct, Rule 1.15(e)(3).
4. See generally id.
5. See New York Rules of Prof. Conduct, DR 9-102(E); R.I. Rule 1.19(c). See also Colo. Rules of Prof. Conduct, Rule 1.15(i)(2) (trust account withdrawals and transfers may only be made by a lawyer admitted to practice in Colorado or by a person supervised by such a lawyer).
6. See Colo. Rules of Prof. Conduct, Rule 1.15(e)(3); District of Columbia Rules of Prof. Conduct, Rule 1.19(b); R.I. Supreme Court Rules, Article IV, Rule 2.

7. See e.g. Mass. Rule 1.15(f)(1)F.
8. Id. at 1.15(f)(1)C.
9. Id. at 1.15(f)(1)E.
10. See California Rule 4-100(C)(1)(a); Ohio Rules of Prof. Conduct, Rule 1.15(a)(2).
11. See California Rule 4-100(C)(1)(d); Ohio Rule 1.15(a)(5).
12. See West Virginia Rule of Prof. Conduct, 1.15(a). See also Mich. Rule 1.15(b)(2).
13. See Mass. Rule 1.15(f)(1)G; Penn. Rule 1.15(c)(3).
14. See Ohio Rules of Prof. Conduct, Rule 1.15(a)(1); R.I., Rule 1.19(a)(5); New York, DR 9-102(D)(3); Colo., Rule 1.15 (j)(3).
15. See R.I., Rule 1.19(a)(5); DR 9-102(D)(5); Colo. Rule 1.15(j)(5).
16. See N.Y. State Bar Op. 680 (1996).
17. N.Y. DR 9-102(J).
18. See e.g. R.I. Rule 1.15(f); W.V. Rule 1.15(d).
19. Mich. Rule 1.15(e).
20. Id. at 1.15(j). See also W.V. Rule 1.15(e).

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