Handling Client Funds

The Lawyer's Fiduciary Responsibility and the Administrator's Role

BY ED POLL

Every lawyer-client relationship begins (or should begin) with a written engagement agreement that includes how and when the lawyer will be paid. As a general rule, most engagement agreements stipulate that the client's payment for work that *has been* performed is to be deposited into a lawyer's general account, and payment for work that *will be* performed is generally to be deposited into a client's trust account.

Managing and accounting for client funds held in trust is a lawyer's personal responsibility. Although several good computer software programs exist to assist with trust accounting, including QuickBooks by Intuit, the lawyer who receives clients' trust funds bears the responsibility of accounting for every penny. In an accounting sense, these funds are a liability of the law practice to the client, must be kept in an entirely separate account, and cannot be commingled with any other law firm funds.

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DISCIPLINARY RULES

The American Bar Association's Model Code of Professional Responsibility specifically addresses the issue of trust accounts and commingling of funds. Disciplinary Rule DR 9-102, "Preserving Identity of Funds and Property of a Client," states

A. All funds of clients paid to a lawyer or law firm, other than advances for costs and expenses, shall be deposited in one or more identifiable bank accounts maintained in the state in which the law office is situated and no funds belonging to the lawyer or law firm shall be deposited therein except as follows:

1. Funds reasonably sufficient to pay bank charges may be deposited therein.

2. Funds belonging in part to a client and in part presently or potentially to the lawyer or law firm must be deposited therein, but the portion belonging to the lawyer or law firm may be withdrawn when due unless the right of the lawyer or law firm to receive it is disputed by the client, in which event the disputed portion shall not be withdrawn until the dispute is finally resolved.

The conclusion to be drawn from this requirement is that money earned by a lawyer for provision of services belongs to the lawyer and must be removed from the client's trust account when earned. This must be done immediately (unless jurisdictional rules state otherwise), with the earned money being placed in the lawyer's general account.

FIDUCIARY RESPONSIBILITY

When a lawyer is entitled to make the transfer, the lawyer *must* make the transfer or be guilty of commingling personal and client funds. The lawyer is a fiduciary who must keep accurate accounting records of such transfers under every U.S. state's rules of professional conduct.

Some lawyers are fortunate enough to have practices that can afford to engage staff members who manage the "back office" functions, thereby allowing the lawyer to focus on delivering quality legal services. It then falls on the principal administrator or other firm business professional to address the lawyer's fiduciary responsibilities. It behooves the administrator to know the appropriate trust account regulations of the jurisdiction, including both the Bar's and banking association's requirements.

Notwithstanding this role, however, the lawyer cannot escape responsibility for the administrator's actions. As noted in other contexts, "ignorance of the law" is not excuse. One case comes to mind: A practitioner had been delivering quality legal services for more than 50 years. Nevertheless, because of the inappropriate actions of his "trusted staff person," he was disbarred. Relying on staff to handle the process is no excuse.

Each law office must answer a fundamental question: When you first receive funds, into which account should they be placed – the trust account or the general account? The rules of conduct seem quite clear. If the funds are provided on retainer, then they are for a task that is not completed and the hours are not yet earned. That means the money goes into the client trust account. If the funds have been earned when you receive them, then they should go into the general account.

ACCOUNTING CONCERNS

Ethical issues can arise in very active personal injury or debt collection law practices, family law practices, and in large firm real estate practices, among others. The trust accounts often become so large that the lawyer's recordkeeping becomes flawed and develops errors. These may be understandable human errors, but the net result is that the funds' recordkeeping is not clear and accurate. This can happen in many ways: Lien holders fail to cash checks written against the account, funds subject to a lawyer-client dispute remain long after the controversy is forgotten, funds are held back for a triggering event that never takes place, or a departed staff member has made an incomplete or erroneous record of trust monies that the lawyer can no longer decipher.

Contingencies such as this, and such as bank failure, again serve as no excuse. When dealing with fiduciary matters, every U.S. state imposes a fiduciary duty to properly account for clients' funds to prevent misappropriation or negligence. Failure to provide accurate accounting records on a State Bar inquiry means very bad news for the lawyer. If an accounting issue does arise, one expensive approach is to hire an outside accountant to analyze every document, check, and ledger to reconcile the account. Another suggestion is to open and operate through a new account with scrupulously "clean" records, while allowing depletion of the old account until only the few questionable items remain, with the hope that no one makes an inquiry later.

Such alternatives ultimately miss the point. To do less than use an effective software accounting program or an outside accountant to reconcile trust and bank account records ultimately invites errors, inquiries, and trouble. The stakes are high, indeed. Error is no excuse, and one's professional license is at stake. However, this may be a practical approach for the lawyer to consider.

BANKING REALITIES

Recent challenges to the United States banking system raise the specter of bank failures, with wide impact on the public. Lawyers, for example, are the subject of recent inquiries because of issues related to Interest on Lawyers Trust Accounts (IOLTA).

The problem arises when any single account, in one person's name, exceeds the Federal Deposit Insurance Corporation guaranteed limit of $100,000. (Note: Under the recent U.S. legislation to "bail out" financial institutions, the guaranteed limit has been raised after 28 years at the lower level. While the amount has been raised, the principles remain the same, though with a larger

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number. A few more lawyers, therefore, will escape the problems created by future bank failures.) In an active family law, real estate, personal injury, or debt collection practice, it's easy to grow beyond the cap. For example, if a lawyer holds $10,000 for each of 10 (now 25) people, the cap was exceeded. Because most practices have more than 10 clients, the problem is obvious.

Check your jurisdiction's banking regulations to determine whether the bank will combine all of your clients' funds in one trust account, or whether the bank will treat each of your clients as a distinct person so long as your funds can be identified and attributed to distinct and different individuals.
Is it the lawyer's responsibility to be in the banking business? No, but the lawyer is responsible for acts of an agent, which in the case of client trust accounts is the bank. If the bank fails, the lawyer (in light of Rule 1.15) is responsible. One way to ensure client safeguards is to identify in bank records the client's name and the amount of money held for that client, in effect creating sub-accounts. Another, more direct approach is to maintain a separate trust account for each client whose funds exceed $5,000 to $10,000 and are likely to be held for an extended period of time. The interest on such a separate account will belong to the client. This is not an IOLTA account.

Does this increase the expense of a lawyer's trust fund accounting? Yes. Lawyers will see it as a standard cost of doing business. For others, when it is anticipated that funds for the accounts will pass through the law office, it might be advantageous to provide in the engagement agreement for an administrative charge to cover the cost of account administration.

Also, remember that trust funds are large and stable deposits for the bank, and thus are desirable accounts because they bolster the financial assets against which a bank makes the loans that are its source of income. For that reason, a law firm may have considerable leverage to negotiate reduced service fees for multiple trust accounts.

JURISDICTIONAL RULES

Lawyers must stay cognizant of the rules in their jurisdictions that may require client funds in excess of certain amounts, and expected to be held for short periods of time, be placed into IOLTA accounts. In Connecticut, for example, an IOLTA account is the only place where lawyers and law firms may deposit a client's or third person's funds which are less than $10,000 in amount or are expected to be held for a period of not more than 60 business days. In these circumstances, more than one IOLTA account may be advisable.
However a client's trust account is structured, the engagement agreement must document that structure, and the client should agree to it. In some cases, the client may instruct a lawyer to open a separate trust account as a source of interest income; in others, the client will seek the lawyer's guidance. Whatever decision is made, in today's financial environment, it should be researched carefully, disclosed openly, and made in full accord with all ethical rules on safekeeping client property. ❇

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