

The “New” Dishonored Check/Overdraft Notice Reporting Rule

by

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In its 39 years of existence, the New York Lawyers' Fund for Client Protection has reimbursed over \$233 million to over 9,000 eligible law clients for losses caused by the dishonest conduct of 1,316 former lawyers, out of a cumulative population of registered attorneys in that time span of well over 700,000. New York's legal profession makes this reimbursement possible with what amounts to an annual \$30 allocation from the biennial registration fee.

The Lawyers' Fund is administered by a seven-member Board of Trustees appointed by the Court of Appeals. While the Fund's primary focus is reimbursement of client losses, prevention of thefts has always been a vital aspect of New York's client protection program.

Towards this end, the reporting of bounced checks from escrow accounts and insurance company notification directly to the client when settlement checks have been forwarded to counsel have proved effective early warning alerts. Another step on the road to theft prevention has now been adopted.

Effective on **April 1, 2021**, New York's Dishonored Check Notice Reporting Rule has been expanded to include reporting of overdrafts on all attorney trust, special and escrow accounts. In addition, the new rules prohibit attorneys from carrying overdraft protection on attorney trust, special and escrow accounts.

A dishonored attorney escrow account check has proven a reliable indicator of the possible misuse of client funds. Since 1992, when adopted by the courts, New York's Dishonored Check Notice Reporting rule has been limited to trust account checks returned solely for insufficient funds.

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Over the past 29 years, the "Bounced Check Rule" has been remarkably effective, detecting 327 lawyers who had been misusing client funds. Attorney Grievance Committees have credited the "Bounced Check Rule" with identifying dishonest conduct as well as providing an opportunity to educate the Bar on proper trust accounting and record keeping practices.

Disciplinary rules, however, did not prohibit overdraft protection on client funds accounts. Despite the success of the "Bounced Check Rule", Attorney Grievance Committees reported that attorneys were able to circumvent the "Bounced Check Rule", to the detriment of their clients, by carrying overdraft protection on attorney trust, special and escrow accounts, or by linking these client funds accounts to non-escrow accounts to conceal a shortfall. A concrete example for the Lawyers' Fund involved our reimbursement of \$1.6 million to ten former law clients of disbarred Manhattan attorney Luigi Rosabianca. After reviewing bank records, we discovered that Mr. Rosabianca was able to conceal his thefts by regularly transferring funds between his operating and escrow accounts. He was permitted to carry overdraft protection on his escrow account despite multiple negative balances which he used to avoid triggering a bounced check report that may have revealed his thefts earlier.

The Lawyers' fund analyzed its own experience with dishonored check reports from 2016 through 2018, learning that most major banking institutions already report, or have the capacity to expand their reporting ability to include overdraft notification. Presently, 38 states have some form of trust account overdraft notification.

How the "New" Rules Work

The mechanics of the "new" rules remain effectively unchanged. Rule 1.15 of the New York Rules of Professional Conduct requires that a lawyer in possession of funds belonging to another person incident to the lawyer's practice of law must maintain such funds in a special account separate from the lawyer's business, personal or other accounts. The separate fiduciary account must be designated "*Attorney Special Account*", "*Attorney Trust Account*", or "*Attorney Escrow Account*". Lawyers must deposit client funds with banks that have agreed to report dishonored checks and/or overdrafts on these accounts. A list of approved banks has been

and remains available on the Fund's website at www.nylawfund.org. Lawyers also must alert their financial institutions that their attorney trust, special or escrow account is reportable under 22 NYCRR Part 1300.1, and that the bank's reporting obligations will apply to that account.²

Within five business days, a copy of the dishonored check/overdraft notice is mailed to the Lawyers' Fund. The Fund receives essentially a duplicate copy of a notice that has been sent to the account holder. Notices are held for (10) business days to permit a bank to withdraw an item reported as a result of bank error. If the notice is not withdrawn within (10) business days due to bank error, the Fund forwards the notice to the appropriate Attorney Grievance Committee for investigation. After a notice is forwarded, the Lawyers' Fund's file is closed.

The Attorney Grievance Committee then commences a *sua sponte* investigation requesting the attorney/law firm to provide a written explanation for the item, as well as six months of bank records. The overwhelming majority of notices are caused by innocent mistakes in law office banking practice. In these cases, the rule serves an educational role, alerting lawyers to the accounting, banking and recordkeeping requirements of the Rules of Professional Conduct.

Added Protections

Overdraft protection was not proscribed by the former trust accounting and record keeping rules, but if discovered during a disciplinary investigation, the use of overdraft funds to cover an escrow account shortfall was deemed to constitute an impermissible commingling of personal funds in the attorney escrow account (Rule 1.15(a) of the Rules of Professional Conduct (22 NYCRR 1200)). The new rules will now prohibit attorneys from carrying overdraft protection on attorney trust, special or escrow accounts.

² This includes IOLA participating accounts and attorney escrow accounts that are maintained in out-of-state banks with the prior written permission of a client.

Conclusion

In 1993, the Lawyers' Fund accurately predicted that the Dishonored Check Reporting Rule would effectively detect and prevent some thefts in the practice of law. In nearly 30 years, that rule has served the Bar well. Equally important, the Rule has educated the legal profession on proper trust accounting and recordkeeping rules. Viewed in this light, the amended Dishonored Check/Overdraft Notice Reporting Rules provide even greater protection for the public and strengthen ongoing efforts by the judicial system to help lawyers observe their vital banking and recordkeeping obligations as set forth in Rule 1.15 of the New York Rules of Professional Conduct.

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