



Ethics and Professionalism:
Attorney Trust Accounts and Law Office
Record Keeping for New York Lawyers

Appendix of CLE Materials

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Attorney Trust Accounts, Escrow and Record Keeping*

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Fiduciary and Law Office Record Keeping Rule

Effective April 1, 2009, the Rules of Professional Conduct were promulgated as joint rules of the Appellate Divisions of the Supreme Court, and superseded Part 1200 (Disciplinary Rules of the Code of Professional Responsibility). Rule 1.15 of the Rules of Professional Conduct is a uniform rule of court adopted by the four Appellate Divisions of the Supreme Court in the exercise of their authority to regulate members of the bar and the practice of law, principally pursuant to section 90 of the Judiciary Law. Rule 1.15 is published at 22 NYCRR Part 1200.

Rule 1.15 contains the basic fiduciary standards set forth in Rule 1.15 of the American Bar Association's Model Rules of Professional Conduct. But the New York rule is much more comprehensive than the ABA rule in its detail and practical scope in the day-to-day management of a private law practice.

**RULE 1.15:
Preserving Identity of Funds and Property of Others; Fiduciary Responsibility; Commingling and Misappropriation of Client Funds or Property; Maintenance of Bank Accounts; Record Keeping; Examination of Records**

(a) Prohibition Against Commingling and Misappropriation of Client Funds or Property.

A lawyer in possession of any funds or other property belonging to another person, where such possession is incident to his or her practice of law, is a fiduciary, and must not misappropriate such funds or property or commingle such funds or property with his or her own.

(b) Separate Accounts. (1) A lawyer who is in possession of funds belonging to another person incident to the lawyer's practice of law shall maintain such funds in a banking institution within New York State that agrees to provide dishonored check reports in accordance with the provisions of 22 N.Y.C.R.R. Part 1300. "Banking institution" means a state or national bank, trust company, savings bank, savings and loan association or credit union. Such funds shall be maintained, in the lawyer's own name, or in the name of a firm of lawyers of which the lawyer is a member, or in the name of the lawyer or firm of lawyers by whom the lawyer is employed, in a special account or accounts, separate from any business or personal

accounts of the lawyer or lawyer's firm, and separate from any accounts that the lawyer may maintain as executor, guardian, trustee or receiver, or in any other fiduciary capacity; into such special account or accounts all funds held in escrow or otherwise entrusted to the lawyer or firm shall be deposited; provided, however, that such funds may be maintained in a banking institution located outside New York State if such banking institution complies with 22 N.Y.C.R.R. Part 1300 and the lawyer has obtained the prior written approval of the person to whom such funds belong specifying the name and address of the office or branch of the banking institution where such funds are to be maintained.

(2) A lawyer or the lawyer's firm shall identify the special bank account or accounts required by Rule 1.15(b)(1) as an "Attorney Special Account," "Attorney Trust Account," or "Attorney Escrow Account," and shall obtain checks and deposit slips that bear such title. Such title may be accompanied by such other descriptive language as the lawyer may deem appropriate, provided that such additional language distinguishes such special account or accounts from other bank accounts that are maintained by the lawyer or the lawyer's firm.

(3) Funds reasonably sufficient to maintain the account or to pay account charges may be deposited therein.

(4) Funds belonging in part to a client or third person and in part currently or potentially to the lawyer or law firm shall be kept in such special account or accounts, 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 or third person, in which event the disputed portion shall not be withdrawn until the dispute is finally resolved.

(c) Notification of Receipt of Property; Safekeeping; Rendering Accounts; Payment or Delivery of Property.

A lawyer shall:

- (1) promptly notify a client or third person of the receipt of funds, securities, or other properties in which the client or third person has an interest;
- (2) identify and label securities and properties of a client or third person promptly upon receipt and place them in a safe deposit box or other place of safekeeping as soon as practicable;
- (3) maintain complete records of all funds, securities, and other properties of a client or third person coming into the possession of the lawyer and render appropriate accounts to the client or third person regarding them; and
- (4) promptly pay or deliver to the client or third person as requested by the client or third person the funds, securities, or other properties in the possession of the lawyer that the client or third person is entitled to receive.

(d) Required Bookkeeping Records.

- (1) A lawyer shall maintain for seven years after the events that they record:
 - (i) the records of all deposits in and withdrawals from the accounts specified in Rule 1.15(b) and of any other bank account that concerns or affects the lawyer’s practice of law; these records shall specifically identify the date, source and description

of each item deposited, as well as the date, payee and purpose of each withdrawal or disbursement;

- (ii) a record for special accounts, showing the source of all funds deposited in such accounts, the names of all persons for whom the funds are or were held, the amount of such funds, the description and amounts, and the names of all persons to whom such funds were disbursed;
- (iii) copies of all retainer and compensation agreements with clients;
- (iv) copies of all statements to clients or other persons showing the disbursement of funds to them or on their behalf;
- (v) copies of all bills rendered to clients;
- (vi) copies of all records showing payments to lawyers, investigators or other persons, not in the lawyer’s regular employ, for services rendered or performed;
- (vii) copies of all retainer and closing statements filed with the Office of Court Administration; and
- (viii) all checkbooks and check stubs, bank statements, prenumbered canceled checks and duplicate deposit slips.

(2) Lawyers shall make accurate entries of all financial transactions in their records of receipts and disbursements, in their special accounts, in their ledger books or similar records, and in any other books of account kept by them in the regular course of their practice, which entries shall be made at or near the time of the act, condition or event recorded.

(3) For purposes of Rule 1.15(d), a lawyer may satisfy the requirements of maintaining “copies” by maintaining any of the following items: original records, photocopies, microfilm, optical imaging, and any other medium that preserves an image of the document that cannot be altered without detection.

(e) Authorized Signatories.

All special account withdrawals shall be made only to a named payee and not to cash. Such withdrawals shall be made by check or, with the prior written approval of the party entitled to the proceeds, by bank transfer. Only a lawyer admitted to practice law in New York State shall be an authorized signatory of a special account.

(f) Missing Clients.

Whenever any sum of money is payable to a client and the lawyer is unable to locate the client, the lawyer shall apply to the court in which the action was brought if in the unified court system, or, if no action was commenced in the unified court system, to the Supreme Court in the county in which the lawyer maintains an office for the practice of law, for an order directing payment to the lawyer of any fees and disbursements that are owed by the client and the balance, if any, to the Lawyers' Fund for Client Protection for safeguarding and disbursement to persons who are entitled thereto.

(g) Designation of Successor Signatories.

(1) Upon the death of a lawyer who was the sole signatory on an attorney trust, escrow or special account, an application may be made to the Supreme Court for an order designating a successor signatory for such trust, escrow or special account, who shall be a member of the bar in good standing and admitted to the practice of law in New York State.

(2) An application to designate a successor signatory shall be made to the Supreme Court in the judicial district in which the deceased lawyer maintained an office for the practice of law. The application may be made by the legal representative of the deceased lawyer's estate; a lawyer who was affiliated with the deceased lawyer in the practice of law; any person who has a beneficial interest in such trust, escrow or special account; an officer of a city or county bar association; or counsel for an attorney disciplinary committee. No lawyer may charge a legal fee for assisting with an application to designate a successor signatory pursuant to this Rule.

(3) The Supreme Court may designate a successor signatory and may direct the safeguarding of funds from such trust, escrow or special account, and the disbursement of such funds to persons who are entitled thereto, and may order that funds in such account be deposited with the Lawyers' Fund for Client Protection for safeguarding and disbursement to persons who are entitled thereto.

(h) Dissolution of a Firm.

Upon the dissolution of any firm of lawyers, the former partners or members shall make appropriate arrangements for the maintenance, by one of them or by a successor firm, of the records specified in Rule 1.15(d).

(i) Availability of Bookkeeping Records: Records Subject to Production in Disciplinary Investigations and Proceedings.

The financial records required by this Rule shall be located, or made available, at the principal New York State office of the lawyers subject hereto, and any such records shall be produced in response to a notice or *subpoena duces tecum* issued in connection with a complaint before or any investigation by the appropriate grievance or departmental disciplinary committee, or shall be produced at the direction of the appropriate Appellate Division before any person designated by it. All books and records produced pursuant to this Rule shall be kept confidential, except for the purpose of the particular proceeding, and their contents shall not be disclosed by anyone in violation of the attorney-client privilege.

(j) Disciplinary Action.

A lawyer who does not maintain and keep the accounts and records as specified and required by this Rule, or who does not produce any such records pursuant to this Rule, shall be deemed in violation of these Rules and shall be subject to disciplinary proceedings.

A Practical Guide to Attorney Trust Accounting and Recordkeeping

What follows is the text of a pamphlet guide published by the New York Lawyers' Fund in 2009 -- "A Practical Guide to Attorney Trust Accounting and Recordkeeping" -- which outlines the fiduciary, banking and record keeping standards of Rule of Professional Conduct 1.15.

Dear Colleague:

We are pleased to contribute this revised version of *A Practical Guide* as a public service for the bar of New York, law-office staffs, and law students.

It is intended as a plain-English guide to current court rules, statutes and bar association ethics opinions on the subject of attorney trust accounts and law office recordkeeping. This brochure provides a summary of the applicable rules and standards when a lawyer holds client money and escrow funds. It is not a substitute for the black-letter provisions of the New York Rules of Professional Conduct or court rules in each of the four judicial departments in the State .

A Practical Guide was first published in April 1988, with the help of the Committee on Professional Ethics of the New York County Lawyers' Association. This new version is prompted by recent ethics opinions, changes in federal banking law and adoption of the Rules of Professional Conduct which replace existing Disciplinary Rules effective on April 1, 2009.

This brochure may be reproduced without further permission of the Lawyers' Fund, in connection with any educational, law office or bar association activity. We hope you find *A Practical Guide* to be informative and helpful in your practice.

Eleanor Breitel Alter, Chairman
Nancy M. Burner, Patricia L. Gatling, Charlotte Holstein, Charles J. Hynes, Theresa Mazzullo, Eric A. Seiff, Trustees

What are a lawyer's ethical obligations regarding client funds?

A lawyer in possession of client funds and property is a fiduciary.¹ The lawyer must safeguard and segregate those assets from the lawyer's personal, business or other assets.

A lawyer is also obligated to notify a client when client funds or property are received by the lawyer. The lawyer must provide timely and complete accountings to the client, and disburse promptly all funds and property to which the client is entitled. A client's non-cash property should be clearly identified as trust property and be secured in the lawyer's safe or safe deposit box.

These fiduciary obligations apply equally to money and property of non-clients which come into a lawyer's possession in the practice of law.

What is an attorney trust account?

It's a "special" bank account, usually a checking account or its equivalent, for client money and other escrow funds that a lawyer holds in the practice of law. A lawyer can have one account, or several, depending on need. Each must be maintained separately from the lawyer's personal and business accounts, and other fiduciary accounts, like those maintained for estates, guardianships, and trusts.

An attorney trust account must be maintained in a banking institution located within New York State; that is, a "state or national bank, trust company, savings bank, savings and loan association or credit union". Out-of-state banks may be used only with the prior and specific written approval of the client or other beneficial owner of the funds. In all cases, lawyers can only use banks that have agreed to furnish "dishonored

¹22 NYCRR Part 1200 (Rule 1.15). The Appellate Divisions' Rules of Professional Conduct are published in 22 NYCRR Part 1200; McKinney's Judiciary Law (Appendix); and McKinney's New York Rules of Court.

check notices" pursuant to statewide court rules.² While some banking institutions may offer overdraft protection on a client funds account, an attorney trust account should never be overdrawn and should not carry overdraft protection.

These rules also require lawyers to designate existing or new bank accounts as either *Attorney Trust Account*, *Attorney Special Account*, or *Attorney Escrow Account*, with pre-numbered checks and deposit slips imprinted with that title. These titles may be further qualified with other descriptive language. For example, an attorney can add "IOLA Account" or "Closing Account" below the required title.³

What is the purpose of an attorney trust account?

To safeguard clients' funds from loss, and to avoid the appearance of impropriety by the lawyer-fiduciary. The account is used solely for funds belonging to clients and other persons incident to a lawyer's practice of law. Funds belonging partly to a client and partly to the lawyer, presently or potentially, must also be deposited in the attorney trust account. The lawyer's portion may be withdrawn when due, unless the client disputes the withdrawal. In that event, the funds must remain intact until the lawyer and client resolve their dispute.

Withdrawals from the attorney trust account must be made to named payees, and not to cash. A lawyer may not issue a check from an attorney escrow account drawn against a bank or certified check that has not been deposited or has not cleared⁴. A lawyer is also not permitted to make an ATM withdrawal from a client funds account. Deposits by ATM may be permitted if the attorney carefully reviews and adequately documents the deposit transaction, and otherwise complies with the records retention requirements of Rule 1.15⁵

Only members of the New York bar can be signatories on the bank account. In certain instances, a lawyer may allow a paralegal to use the lawyer's signature stamp to

execute escrow checks from a client trust account so long as the lawyer supervises the delegated work closely. The lawyer though remains completely responsible for any misuse of funds.⁶

What about bank service charges?

A lawyer may deposit personal funds into the attorney trust account that are necessary to maintain the account, including bank service charges.

Should interest-bearing accounts be used?

Lawyers, as fiduciaries, should endeavor to make client funds productive for their clients. By statute, every lawyer has complete discretion to determine whether client and escrow funds should be deposited in interest-bearing bank accounts.⁷

For funds nominal in amount, or which will be held only briefly by a lawyer or law firm, the statute authorizes their deposit in so-called IOLA bank accounts.

But lawyers may also establish interest-bearing accounts for individual clients. For all client funds, lawyers may use pooled accounts in banks which have the capability to credit interest to individual client sub-accounts. A lawyer or law firm may also do the calculations necessary to allocate interest to individual clients or other beneficial owners.

What is IOLA?

IOLA is the acronym for the Interest On Lawyer Account Fund and program.⁸ IOLA is a state agency which uses interest on IOLA attorney trust accounts to fund non-profit agencies which provide civil legal services for the poor, and programs to improve the administration of justice.

The IOLA account is designed for nominal and short-term client deposits which, in the sole discretion of the attorney, would not generate income for the client-owner, net of bank fees and related charges.⁹

²22 NYCRR Part 1200 (Rule 1.15 (b)(1)). The Dishonored Check Notice Reporting Rules, effective January 1, 1993, are reported at 22 NYCRR Part 1300.

³22 NYCRR Part 1200 (Rule 1.15 (b)(2)).

⁴See, NYSBA Op. 737 (2001).

⁵See, NYSBA Op. 759 (2002).

⁶See, NYSBA Op. 693 (1997).

⁷Judiciary Law §497.

⁸State Finance Law §97-v; Judiciary Law §497.

⁹21 N.Y.C.R.R. 7000.2(e)

A lawyer's participation in IOLA has no income tax consequences for the lawyer, or for the client. In addition, IOLA assumes the cost of routine bank service charges and fees on the account. IOLA's offices are at 11 E. 44th Street, Suite 1406, New York, NY 10017. Telephone (646) 865-1541 or 1-800-222-IOLA. The IOLA Fund also has a site on the internet at www.iola.org.

FDIC Insurance and Attorney Trust Accounts

Attorneys are not required by court rules to deposit client funds in an FDIC insured banking institution. Nevertheless, as a fiduciary of client funds, an attorney is wise to consider FDIC insured institutions in order to provide an added layer of protection. A lawyer who fails to consider the relative safety of a depository banking institution might be exposed to civil liability.¹⁰

The Federal Deposit Insurance Corporation (FDIC) provides insurance coverage to various types of deposit accounts.

The FDIC considers attorney escrow accounts as single accounts. An attorney must comply with New York record keeping rules to demonstrate the fiduciary nature of an escrow account in order to extend FDIC coverage to individual client deposits.¹¹

FDIC coverage of depositor funds is in the aggregate. Lawyers must therefore consider if their client has other funds on deposit with the lawyer's depository bank. If a client has accumulated deposits in excess of FDIC coverage, then lawyers should discuss deposit alternatives with their client.

In light of an ever-changing financial landscape, practitioners are encouraged to visit the FDIC's website at www.fdic.gov to obtain the most current rules regarding available insurance coverage.

How should large trust deposits be handled?

When a client's funds and the anticipated holding period are sufficient to generate meaningful interest, a

¹⁰ See, *Bazinet v. Kluge*, 14 A.D.2d 324, 10 788 NYS 2d 77 (2005).

¹¹ See, 12 CFR § 330.5 and FDIC Advisory Opinion 98-2, June 16, 1998.

lawyer may have a fiduciary obligation to invest the client's funds in an interest-bearing bank account.¹²

In that case, prudence suggests that a lawyer consult with the client or other beneficial owner. And when dealing with large deposits and escrows, lawyers and clients should be mindful of federal bank deposit insurance limits.¹³

There may also be income tax implications to consider. Using the law client's social security or federal tax identification number on the bank account can avoid tax problems for the lawyer.

May a lawyer retain the interest on an attorney trust account?

No. A lawyer, as a fiduciary, cannot profit on the administration of an attorney trust account. While a lawyer is permitted to charge a reasonable fee for administering a client's account, all earned interest belongs to the client. A lawyer's fee cannot be pegged to the interest earned.¹⁴

What happens if a trust account check bounces?

A bounced check on an attorney trust account is a signal that law client funds may be in jeopardy. Banks in New York State report dishonored checks on attorney trust accounts to the Lawyers' Fund for Client Protection. Notices that are not withdrawn due to bank error are referred by the Lawyers' Fund to the proper attorney grievance committee for such inquiry as the committee deems appropriate.

These bank notices are required by the Appellate Divisions' Dishonored Check Notice Reporting Rules.¹⁵ A "dishonored" instrument is a check which the lawyer's bank refuses to pay because of insufficient funds in the lawyer's special, trust, or escrow account.

¹² See, NYSBA, Comm. on Prof. Ethics, Ops. 554 (1983), 575 (1986); Assoc. Bar, NYC, Comm. on Prof & Jud. Ethics, Op. 86-5 (1986).

¹³ See, 22 NYCRR Part 1200 (Rule 1.15 (b)(1)), and *Bazinet v. Kluge*, 14 A.D.2d 324, 788 NYS 2d 77 (2005).

¹⁴ NYSBA, Ops. 532 (1981), 582 (1987); Assoc. Bar, NYC, Op. 81-68 (1981).

¹⁵ 22 NYCRR Part 1200 (Rule 1.15 (b)(1)). The Dishonored Check Notice Reporting Rules, effective January 1, 1993, are reported at 22 NYCRR Part 1300.

The Lawyers' Fund holds each dishonored check notice for 10 business days to permit the filing bank to withdraw a report that was sent in error. However, the curing of an insufficiency of funds by a lawyer or law firm will not constitute reason for the withdrawal of a dishonored check notice.

Are there special banking rules for down payments?

Yes. A buyer's down payment, entrusted with a seller's attorney pending a closing, generally remains the property of the buyer until title passes. The lawyer-escrow agent is serving as a fiduciary, and must safeguard and segregate the buyer's down payment in a special trust account. The purchase contract should make provisions for depositing the down payment in a bank account, the disposition of interest, and other escrow responsibilities.

A 1991 statute codifies the fiduciary obligations of lawyers and realtors who accept down payments in residential purchases and sales, including condominium units and cooperative apartments.¹⁶

This statute requires that the purchase contract identify: (1) the escrow agent; and (2) the bank where the down payment will be deposited pending the closing.

There are also special rules, promulgated by the New York State Department of Law, where escrow accounts are established in connection with the conversion of buildings into condominiums and cooperatives.¹⁷

Are other bank accounts needed?

Yes. A practitioner needs a business account as a depository for legal fees, and to pay operating expenses. A typical designation is **Attorney Business Account**. Lawyers also need special bank accounts when they serve as fiduciaries for estates, trusts, guardianships, and the like.

Where are advance legal fees deposited?

This depends upon the lawyer's fee agreement with the client. The presumption in New York State is that the advance fee becomes the lawyer's property when it is paid by the client. As such, the fee should be deposited

in the business account, and not in the attorney trust account.

If, on the other hand, by agreement with the client, the advance fee remains client property until it is earned by the lawyer, it should be deposited in the attorney trust account, and withdrawn by the lawyer or law firm as it is earned.¹⁸

In either event, a lawyer has a professional obligation to refund unearned legal fees to a client whenever the lawyer completes or withdraws from a representation, or the lawyer is discharged by the client.¹⁹ It is good business practice to deposit advance legal fees in a non-escrow fee account and draw upon the deposit only when legal fees are earned. This practice will ensure that a lawyer will be able to fulfill the professional obligation to refund unearned legal fees.

In the event of a fee dispute, court rules provide that a client may elect mandatory fee arbitration in most civil representation which commenced on or after January 1, 2002 when the disputed amount is between \$1,000 and \$50,000.²⁰ Fee arbitration is also mandatory in fee disputes in domestic relations matters.²¹

And advances from clients for court fees and expenses?

This also depends upon the lawyer's fee agreement with the client. If the money advanced by the client is to remain client property until it is used for specific litigation expenses, it should be segregated and safeguarded in the attorney trust account, or in a similar special account.

How are unclaimed client funds handled?

If a lawyer cannot locate a client or another person who is owed funds from the attorney trust account, the lawyer is required to seek a judicial order to fix the lawyer's fees and disbursements, and to deposit the client's share with the Lawyers' Fund for Client

¹⁶See, General Business Law, Article 36-c, §§778, 778-16 a.

¹⁷See, General Business Law, §352-e (2-b).

¹⁸See, NYSBA Op. 570 (1985) and Op. 816 (2007).

¹⁹22 NYCRR Part 1200(Rule 1.16 (e)).

²⁰22 NYCRR Part 137

²¹22 NYCRR Part 136

Protection.²² To preserve client funds, the Lawyers' Fund will accept deposits under \$1,000 without a court order.²³

What happens when a sole signatory dies?

The Supreme Court has authority to appoint a successor signatory for the attorney trust account. The procedures are set forth in court rules adopted in 1994.²⁴

What accounting books are required?

No specific accounting system is required by court rule, but a basic trust accounting system for a law firm consists of a trust receipts journal, a trust disbursements journal, and a trust ledger book containing the individual ledger accounts for recording each financial transaction affecting that client's funds.

At a minimum, each client's ledger account should reflect the date, source, and a description of each item of deposit, as well as the date, payee, and purpose of each withdrawal.

Many practitioners find that the so-called "one-write" or "pegboard" manual systems provide an efficient and economical method of trust accounting.

There are also approved computer software packages for law office trust accounting. Whether it be an attorney trust account or the lawyer's operating account, each should be maintained daily and accurately to avoid error. All documents like duplicate deposit slips, bank statements, canceled checks, checkbooks and check stubs must be preserved for seven years.

Internal office controls are essential. It is good business practice to prepare a monthly reconciliation of the balances in the trust ledger book, the trust receipts and disbursements journals, the bank account checkbook, and bank statements.

What bookkeeping records must be maintained?

Every lawyer and law firm must preserve²⁵, for

seven years after the events they record:

- books of account affecting all attorney trust and office operating accounts; and
- original checkbooks and check stubs, bank statements, pre-numbered canceled checks and duplicate deposit slips²⁶

Also, copies of:

- client retainer and fee agreements;
- statements to clients showing disbursements of their funds;
- records showing payments to other lawyers or non-employees for services rendered; and
- retainer and closing statements filed with the Office of Court Administration.

"Copies" means original records, photo copies or other images that cannot be altered without detection. Records required to be maintained by the Rules in the form of "copies" may be stored by reliable electronic means. Records that are initially created by electronic means may be retained in that form. Other records specifically described by the Rules that are created by entries on paper books of account, ledgers or other such tangible items should be retained in their original format.²⁷

How are these rules enforced?

A violation of a Rule of Professional Conduct constitutes grounds for professional discipline under section 90 of the Judiciary Law. Also, the accounts and records required of lawyers and law firms by court rule may be subpoenaed in a disciplinary proceeding.

Lawyers are also required to certify their familiarity and compliance with Rule 1.15 in the biennial

²² 22 NYCRR Part 1200 (Rule 1.15 (f)).

²³ See, Bar Assoc. Erie Co., Cttee. Prof. Ethics Op. #xx1-1/15/04

²⁴ 22 NYCRR Part 1200 (Rule 1.15 (g)).

²⁵ 22 NYCRR Part 1200 (Rule 1.15 25 (d)).

²⁶ N.B. With the advent of electronic banking and Check 21, the 'substitute check' provided by participating banking institutions is considered the legal equivalent of the canceled check and thus the original record that must be maintained by 22 NYCRR Part 1200 (Rule 1.15 (d)). See also, NYSBA Op. 758.

²⁷ See, NYSBA Ops. 680 (1996), 758 (2002).

registration form that is filed with the Office of Court Administration.

What losses are covered by the Lawyers' Fund?

The New York Lawyers' Fund for Client Protection is financed by a \$60 share of each lawyer's \$350 biennial registration fee. The Lawyers' Fund receives no revenues from tax revenues or the IOLA program.

The Lawyers' Fund, established in 1982, is administered *pro bono publico* by a Board of Trustees appointed by the State Court of Appeals.²⁸ The Trustees provide approximately \$8 million in reimbursement each year to victims of dishonest conduct in the practice of law.

The Lawyers' Fund is authorized to reimburse law clients for money or property that is misappropriated by a member of the New York bar in the practice of law. Awards are made after a lawyer's disbarment, and in situations where the lawyer is unable to make restitution. The Fund's current limit on reimbursement is \$300,000 for each client loss.

To qualify for reimbursement, the loss must involve the misuse of law clients' money or property in the practice of law. The Trustees cannot settle fee disputes, nor compensate clients for a lawyer's malpractice or neglect. Typical losses reimbursed include the theft of estate and trust assets, down payments and the proceeds in real property transactions, debt collection proceeds, personal injury settlements, and money embezzled from clients in investment transactions. The Lawyers' Fund is located at 119 Washington Avenue, Albany, New York 12210. Telephone (518) 434-1935, or 1-800-442-FUND. The Lawyers' Fund also has a site on the internet at www.nylawfund.org.

²⁸Judiciary Law, §468-b; State Finance Law, §97-t.

Attorney Registration

Sections 468 and 468-a of the Judiciary Law create a biennial registration program for the legal profession in New York State. The statutes establish a central registry of admitted attorneys which is maintained by the Office of Court Administration, and a \$375 biennial registration fee which is divided as follows: \$60.00 is deposited to the Lawyers' Fund for Client Protection; \$50.00 to the Indigent Legal Services Fund, \$25.00 to the Legal Services Assistance Fund, and the remainder in the Attorney Licensing Fund.

The Lawyers' Fund reimburses clients and escrow beneficiaries for money and property that is misappropriated by attorneys in the practice of law in situations where the dishonest attorney is unable to make restitution. The Attorney Licensing Fund is used to finance the operations of the New York State Board of Law Examiners; the Appellate Divisions' Committees on Character and Fitness; the Attorney Grievance Committees in the State's four judicial departments; and the Office of Court Administration's Attorney Registration program.

Rules of the Chief Administrative Judge governing the registration of attorneys are reported at 22 NYCRR Part 100. The Office of Court Administration maintains a directory of attorneys on the court system's Internet site: www.courts.state.ny.us

Judiciary Law § 468:

1. It shall be the duty of the chief administrator of the courts to enter in a bound book or volume to be kept by him for that purpose, which shall be known and designated as and is hereby made the "official register of attorneys and counsellors-at-law in the state of New York," the names and residences of attorneys newly admitted to practice in the alphabetical order of the first letter of their surnames, the title of the court and the time and place where admitted. The said "official register of attorneys and counsellors-at-law in the state of New York," is hereby declared to be a public record and presumptive evidence that the individuals therein named were admitted to practice as attorneys and counsellors-at-law in the courts of record of this state.

2. The chief administrator shall provide the public with information contained in such official register. Upon request, the office of court administration shall disclose whether a person is registered as an attorney as required by section four hundred sixty-eight-a of this chapter. Where the official register indicates that an attorney has resigned from the bar, or has been removed or

suspended from practice by an appellate division of the supreme court and has not been readmitted to practice, that fact shall also be disclosed.

Judiciary Law §468-a:

1. Every attorney and counsellor-at-law admitted to practice in this state on or before January first, nineteen hundred eighty-two, whether resident or nonresident, shall file a biennial registration statement with the administrative office of the courts on or before March first, nineteen hundred eighty-two in such form as the chief administrator of the courts shall prescribe. An attorney who is admitted to practice after January first, nineteen hundred eighty-two and on or before January first, nineteen hundred eighty-six, shall file a registration statement within sixty days after the date of admission. An attorney who is admitted to practice after January first, nineteen hundred eighty-six shall file a registration statement prior to taking the constitutional oath of office.

2. Attorneys shall register biennially on the dates prescribed by the chief administrator. In the event of a

change in information previously submitted, an attorney shall file an amended statement within thirty days of such change.

3. The chief administrator shall prescribe the form in which such registry of attorneys shall be maintained and the procedures for public access thereto, and may make all such other rules and regulations necessary and appropriate to implement and enforce the provisions of this section.

4. The biennial registration fee shall be three hundred seventy-five dollars, sixty dollars of which shall be allocated to and be deposited in a fund established pursuant to the provisions of section ninety-seven-t of the state finance law, fifty dollars of which shall be allocated to and shall be deposited in a fund established pursuant to the provisions of section ninety-eight-b of the state finance law, twenty-five dollars of which shall be allocated to be deposited in a fund established pursuant to the provisions of section ninety-eight-c of the state finance law, and the remainder of which shall be deposited in the attorney licensing fund. Such fee shall be required of every attorney who is admitted and licensed to practice law in this state, whether or not the attorney is engaged in the practice of law in this state or elsewhere, except attorneys who certify to the chief administrator of the courts that they have retired from the practice of law.

5. Noncompliance by an attorney with the provisions of this section and the rules promulgated hereunder shall constitute conduct prejudicial to the administration of justice and shall be referred to the appropriate appellate division of the supreme court for disciplinary action.

New York Lawyers' Fund for Client Protection

The principal sources of revenue for the New York Lawyers' Fund are a \$60 share of the \$375 biennial registration fee and earned interest on the fund's trust account in the State Treasury. That account was created in 1981 pursuant to section 97-t of the State Finance Law.

Other revenues include recoveries secured by the fund in the enforcement of its subrogation rights against dishonest attorneys and collateral sources like banks and insurance companies, contributions, and sanctions imposed on attorneys for failure to appear or for engaging in frivolous conduct in the course of civil litigation (see 22 NYCRR Parts 130-1 and 130-2). The Lawyers' Fund gets no money from the Interest On Lawyer Account (IOLA) program, or from the state's general tax revenues.

The administration of the Lawyers' Fund is governed by section 468-b of the Judiciary Law. Section 468-b is a broad grant of authority to the fund's Board of Trustees to determine the merits of claims seeking reimbursement from the fund. That authority, and the fund's procedures, are fleshed out in the Trustees' Regulations, which are reported at 22 NYCRR Part 7800, et seq.. The Trustees' Regulations are also available at the fund's Internet Website: www.nylawfund.org

The offices of the Lawyers' Fund are located at 119 Washington Avenue, Albany, NY 12210. Telephone: (800) 442-3863. Fax: (518) 434-5641.

State Finance Law § 97-t.

1. There is hereby established in the custody of the state comptroller a special fund to be known as the "lawyers' fund for clients protection of the state of New York".

2. The full amount of the allocable portion of the biennial registration fee collected pursuant to the provisions of section four hundred sixty-eight-a of the judiciary law and such other monies as may be credited or otherwise transferred from any other fund or source, pursuant to law, including voluntary contributions, together with any interest accrued thereon, shall be deposited to the credit of the lawyers' fund for client protection of the state of New York. All deposits of such revenues not otherwise required for the payment of claims as hereinafter prescribed shall be secured by obligations of the United States or of the state having a market value equal at all times to the amount of such deposits and all banks and trust companies are

authorized to give security for such deposits. Any such revenues in such fund, may be invested in obligations of the United States or of the state, or in obligations the principal and interest on which are guaranteed by the United States or by the state.

Judiciary Law §468-b

1. The court of appeals shall appoint a board of trustees to administer the lawyers' fund for client protection of the state of New York established pursuant to section ninety-seven-t of the state finance law. Such board shall consist of seven members. Of the trustees first appointed, three shall be appointed for a term of three years; two for a term of two years; and two for a term of one year. As each such term expires, each new appointment shall be for a term of three years. The court of appeals may require such reports or audits of the board as it shall from time to time deem to be necessary or desirable.

2. The board shall have the power to receive, hold, manage and distribute the funds collected hereunder for the purpose of maintaining the integrity and protecting the good name of the legal profession by reimbursing, in the discretion of the trustees to the extent they may deem proper and reasonable, losses caused by the dishonest conduct of attorneys admitted to practice in this state. For purposes of this section, the term "dishonest conduct" shall mean misappropriation or wilful misapplication of clients' money, securities, or other property, by an attorney admitted to practice in this state.
3. The board of trustees shall adopt regulations for the administration of the lawyers' fund for client protection of the state of New York and the procedures for presentation, consideration, allowance and payment of claims, including the establishment of a maximum limitation for awards to claimants.
4. The board of trustees shall have the sole discretion to determine the merits of claims presented for reimbursement, the amount of such reimbursement and the terms under which such reimbursement shall be made. Such terms of reimbursement shall require that the claimant execute such instruments, take such action or enter into such agreements as the board of trustees shall require, including assignments, subrogation agreements and promises to cooperate with the board of trustees in making claims against the attorney whose dishonest conduct resulted in the claim.
5. The board of trustees shall serve without compensation but shall be entitled to receive their actual and necessary expenses incurred in the discharge of their duties.
6. The board of trustees may employ and at pleasure remove such personnel as it may deem necessary for the performance of its functions and fix their compensation within the amounts made available therefor.
7. The board of trustees shall be considered employees of the state for the purpose of section seventeen of the public officers law.
8. All payments from the lawyers' fund for client protection of the state of New York shall be made by the state comptroller upon certification and authorization of the board of trustees of said fund.
9. Acceptance of an award of reimbursement from the lawyers' fund for client protection shall, to the extent of such award, (a) subrogate the fund to any right or cause of action that accrued to the claimant as a consequence of the dishonest conduct that resulted in the claimant's award and (b) create a lien in favor of the fund that shall attach to any money asset that is designated to be paid to the claimant from, or on behalf of, the attorney who caused the claimant's loss. If the fund fully reimburses the claimant's loss, as determined by the board of trustees, the lien shall be in the amount of the fund's award. If the claimant's loss exceeds the fund's award, the lien shall not extend to the claimant's right to recover additional restitution from the attorney for the claimant's unreimbursed loss. In the event of a recovery by the fund, a claimant shall be entitled to any money recovered in excess of the fund's award of reimbursement to the claimant.

Interest On Lawyer Account (IOLA) Program

New York law encourages attorneys who have been entrusted with client and escrow funds to make those funds productive in interest-bearing bank accounts. Section 497 of the Judiciary Law also authorizes practitioners to utilize special bank accounts (sometimes called IOLA bank accounts) for the deposit of "qualified funds" belonging to law clients and escrow beneficiaries in the practice of law.

An IOLA bank account is a species of the attorney trust account that is required by court rule (DR 9-102). Section 497 of the Judiciary Law grants broad discretion to attorneys to participate in the IOLA program. It also immunizes them from disciplinary and civil liability should they determine not to use IOLA bank accounts.

The IOLA statute requires participating banks to remit the earned interest on IOLA bank accounts, net after bank service charges and fees, to the IOLA state agency. That fund's Trustees distribute the pooled revenue, in the form of grants, to organizations which provide civil legal services to needy persons and projects which improve the administration of justice in New York. The Trustees' regulations are reported at 21 NYCRR Part 7000.

"Qualified funds" are defined in subdivision (2) of section 497. IOLA's Trustees have determined that a deposit of client funds is "qualified", for purposes of the statute, if the escrow deposit is too small in amount or is reasonably expected to be held for too short a time to generate sufficient interest income to justify the expense of administering a segregated account for the benefit of the client or beneficial owner.

The offices of the IOLA Fund are located at 36 West 44th Street, New York, NY 10036. Telephone: (800) 222-IOLA (4652). Fax: (212) 944-9836.

Judiciary Law §497

1. An "interest on lawyer account" or "IOLA" is an unsegregated interest-bearing deposit account with a banking institution for the deposit by an attorney of qualified funds.

2. "Qualified funds" are moneys received by an attorney in a fiduciary capacity from a client or beneficial owner and which, in the judgment of the attorney, are too small in amount or are reasonably expected to be held for too short a time to generate sufficient interest income to justify the expense of administering a segregated account for the benefit of the client or

beneficial owner. In determining whether funds are qualified for deposit in an IOLA account, an attorney may use as a guide the regulation adopted by the board of trustees of the IOLA fund pursuant to subdivision four of section ninety-seven-v of the state finance law.

2-a. "Funds received in a fiduciary capacity" are funds received by an attorney from a client or beneficial owner in the course of the practice of law, including but not limited to funds received in an escrow capacity, but not including funds received as trustee, guardian or receiver in bankruptcy.

3. A "banking institution" means a bank, trust company, savings bank, savings and loan association, credit union

or foreign banking corporation whether incorporated, chartered, organized or licensed under the laws of this state or the United States, provided that such banking institution conducts its principal banking business in this state.

4. (a) An attorney shall have discretion, in accordance with the code of professional responsibility, to determine whether moneys received by an attorney in a fiduciary capacity from a client or beneficial owner shall be deposited in non-interest, or in interest bearing accounts. If in the judgment of an attorney any moneys received are qualified funds, such funds shall be deposited in an IOLA account in a banking institution of his or her choice offering such accounts.

(b) The decision as to whether funds are nominal in amount or expected to be held for a short period of time rests exclusively in the sound judgment of the lawyer or law firm. Ordinarily, in determining the type of account into which to deposit particular funds held for a client, a lawyer or law firm shall take into consideration the following factors:

- (i) the amount of interest the funds would earn during the period they are expected to be deposited;
- (ii) the cost of establishing and administering the account, including the cost of the lawyer or law firm's services;
- (iii) the capability of the banking institution, through subaccounting, to calculate and pay interest earned by each client's funds, net of any transaction costs, to the individual client.

(c) All qualified funds shall be deposited in an IOLA account unless they are deposited in:

- (i) a separate interest bearing account for the particular client or client's matter on which the interest will be paid to the client; or
- (ii) an interest bearing trust account at a banking institution with provision by the bank or by the depositing lawyer or law firm for computation of interest earned by each client's funds and the payment thereof to the client.

(d) Notwithstanding the deposit requirements of this subdivision, no attorney or law firm shall be liable in damages nor held to answer for a charge of professional misconduct for failure to deposit qualified funds in an IOLA account.

5. No attorney or law firm shall be liable in damages nor held to answer for a charge of professional misconduct because of a deposit of moneys to an IOLA account pursuant to a judgment in good faith that such moneys were qualified funds.

6. a. An attorney or law firm which receives qualified funds in the course of its practice of law and establishes and maintains an IOLA account shall do so by (1) designating the account as "(name of attorney/law firm IOLA account)" with the approval of the banking institution; and (2) notifying the IOLA fund within thirty days of establishing the IOLA account of the account number and name and address of the banking institution where the account is deposited.

b. The rate of interest payable on any IOLA account shall be not less than the rate paid by the banking institution on similar accounts maintained at that institution, and the banking institution shall not impose on such accounts any charges or fees greater than it imposes on similar accounts maintained at that institution.

c. With respect to IOLA accounts, the banking institution shall:

- (i) Remit at least quarterly any interest earned on the account directly to the IOLA fund, after deduction of service charges or fees, if any, are applied.
- (ii) Transmit to the IOLA fund with each remittance a statement showing at least the name of the account, service charges or fees deducted, if any, and the amount of net interest remitted from such account.
- (iii) Transmit to each attorney or law firm which maintains an IOLA account a statement showing at least the name of the account, service charges or fees deducted, if any, and the amount of interest remitted from such account.
- (iv) Be permitted to impose reasonable service charges for the preparation and issuance of the statement.
- (v) Have no duty to inquire or determine whether deposits consist of qualified funds.

7. a. Payment from an IOLA account to or upon the order of the attorney maintaining such account shall be a valid and sufficient release of any claims by any person or entity against any banking institution for any payments so made.

b. Any remittance of interest to the IOLA fund by a banking institution pursuant to this section shall be a valid and sufficient release and discharge of any claims by any person or entity against such banking institution for any payment so made, and no action shall be maintained against any banking institution solely for opening, offering, or maintaining an IOLA account, for accepting any funds for deposit to any such account or for remitting any interest to the IOLA fund.

8. Nothing contained in this section shall be construed to require any banking institution to offer, accept or maintain IOLA accounts.

9. All papers, records, documents or other information identifying an attorney, client or beneficial owner of an IOLA account shall be confidential and shall not be disclosed by a banking institution except with the consent of the attorney maintaining the account or as permitted by any law, regulation or administrative requirement.

10. An attorney or law firm that can establish that compliance with subdivision six of this section has resulted in any banking service charges or fees shall be entitled to reimbursement of such expense from the interest on lawyer account fund by filing a claim with supporting documentation with the fund.

State Finance Law Section 97-v.

1. There is hereby established in the custody of the state comptroller a fiduciary fund to be known as the New York interest on lawyer account (IOLA) fund. A board of trustees shall be appointed to administer the New York IOLA fund.

2. The board shall consist of fifteen members appointed by the governor. All members shall be residents of the state of New York and shall be knowledgeable and supportive of the delivery of civil legal services to the poor and the improvement of the administration of justice. At least eight of the members shall be attorneys licensed to practice law in the state of New York. Two members shall be appointed upon the recommendation of the temporary president of the senate, at least one of whom shall be an attorney; two members shall be appointed upon the recommendation of the speaker of the assembly, at least one of whom shall be an attorney; one member shall be appointed upon the

recommendation of the minority leader of the senate; and one member shall be appointed upon the recommendation of the minority leader of the assembly. Two members shall be appointed upon the recommendation of the court of appeals, each of whom shall be an attorney. The governor shall designate one of the members of the board as chairman.

a. The term of office shall be three years, provided, however, that of the members first appointed, five shall be appointed for terms expiring on December thirty-first, nineteen hundred eighty-four, five shall be appointed for terms expiring on December thirty-first, nineteen hundred eighty-five and five shall be appointed for terms expiring on December thirty-first, nineteen hundred eighty-six. Vacancies shall be filled in the manner of original appointments for the remainder of the term.

b. The members shall receive no compensation for their services as members, but shall be reimbursed for their actual and necessary expenses incurred in the performance of their duties.

c. The members shall be considered employees of the state for the purposes of section seventeen of the public officers law.

d. No member of the senate or assembly shall be eligible to serve as a member of the board.

3. a. The board shall have the power to receive, hold and manage any moneys and property received from any source. It shall distribute funds as grants and contracts to not-for-profit tax-exempt entities for the purpose of delivering civil legal services to the poor and for purposes related to the improvement of the administration of justice, including, but not limited to, the provision of civil legal services to groups currently underserved by legal services, such as the elderly and the disabled, and the enhancement of civil legal services to the poor through innovative and cost-effective means, such as volunteer lawyer programs and support and training services.

b. No less than seventy-five percent of the total funds distributed in any fiscal year shall be allocated to not-for-profit tax-exempt providers for the purpose of delivering civil legal services to the poor. The funds distributed annually to legal services providers shall be allocated according to the geographical distribution of

poor persons throughout the state based on the latest available figures from the United States department of commerce, bureau of census, as prescribed by rules and regulations of the board of trustees.

c. The remaining funds shall be allocated for purposes related to the improvement of the administration of justice, including, but not limited to, the provision of civil legal services to groups currently underserved by legal services, such as the elderly and the disabled, and the enhancement of civil legal services to the poor through innovative and cost-effective means, such as volunteer lawyer programs and support and training services.

d. The board shall adopt rules and regulations for the administration of the IOLA fund to carry out the purposes and provisions of this section and of section four hundred ninety-seven of the judiciary law. Such regulations shall be adopted in accordance with article two of the state administrative procedure act.

e. The board may employ and remove such personnel as it may deem necessary for the performance of its functions and fix their compensation within the amounts made available therefor and may allocate funds for the actual and necessary nonpersonnel administrative costs of the program. No more than ten percent of the funds available in any fiscal year shall be spent on personnel and related services, and on necessary nonpersonnel administrative costs of the program provided, however, that such limitations may be waived by the board by the adoption of a resolution and such waiver shall remain in effect until the board determines by a subsequent resolution that the program is fully operational.

f. The board shall insure that grants and contracts are made with not-for-profit providers of civil legal services for the poor to provide stable, economical and high quality delivery of civil legal services to the poor throughout the state.

g. Notwithstanding any statute or rule to the contrary, the board shall maintain all papers, records, documents or other information identifying an attorney, client or beneficial owner of an IOLA account on a private and confidential basis and shall not disclose such information unless such disclosure is necessary to accomplish the purposes of this section and section four

hundred ninety-seven of the judiciary law, or unless disclosure is pursuant to compulsory legal process.

h. All payments from the IOLA fund shall be made by the state comptroller upon certification and authorization of the board of trustees of the fund.

4. a. The board of trustees shall establish by regulation a specific dollar amount equivalent to the cost of administering a segregated interest bearing account for a client or beneficial owner. This dollar amount may be used by participating attorneys as a guide when determining whether the moneys are qualified funds.

b. The board of trustees shall also establish by regulation the qualifications of a recipient of funds and the nature and scope of civil legal services to be provided to poor persons by the funds disbursed under this section.

5. If it shall appear to the satisfaction of the board of trustees that, because of a mistake of fact, error in calculation or erroneous interpretation of the provisions of this chapter or of section four hundred ninety-seven of the judiciary law, or of any regulation adopted by the board, a banking institution has remitted to the IOLA fund any moneys not required by such provisions to be remitted, the board shall refund such moneys upon application of any aggrieved party. Any such refund shall be paid from the IOLA fund without interest and without the deduction of any service charge, and shall be and constitute a full satisfaction and discharge of any claim for such refund.

Dishonored Check Reporting Rule

Banks in New York State which offer fiduciary accounts to attorneys are required to report all instances of bounced checks on attorney trust, special and escrow accounts. The reports are forwarded to the New York Lawyers' Fund for Client Protection, which serves as a statewide clearing house for these reports. Banks have 10 days to withdraw reports that have been issued in error. If not withdrawn, the reports are sent to the appropriate Attorney Grievance Committee for investigation. A bounced-check report generally triggers an audit of the attorney's trust, special or escrow account. The Appellate Divisions' uniform court rule is reported at 22 NYCRR Part 1300.1.

Dishonored Check Reporting Rules for Attorney Special, Trust and Escrow Accounts (22 NYCRR 1300.1):

(a) Special bank accounts required by Disciplinary Rule 9-102 (22 NYCRR 1200.46) shall be maintained only in banking institutions which have agreed to provide dishonored check reports in accordance with the provisions of this section.

(b) An agreement to provide dishonored check reports shall be filed with the Lawyers' Fund for Client Protection, which shall maintain a central registry of all banking institutions which have been approved in accordance with this section, and the current status of each such agreement. The agreement shall apply to all branches of each banking institution that provides special bank accounts for attorneys engaged in the practice of law in this State, and shall not be cancelled by a banking institution except on 30 days' prior written notice to the Lawyers' Fund for Client Protection.

(c) A dishonored check report by a banking institution shall be required whenever a properly payable instrument is presented against an attorney special, trust or escrow account which contains insufficient available funds, and the banking institution dishonors the instrument for that reason. A properly payable instrument means an instrument which, if presented in the normal course of business, is in a form requiring payment under the laws of the State of New York.

(d) A dishonored check report shall be substantially in the form of the notice of dishonor which the banking institution customarily forwards to its customer, and

may include a photocopy or a computer-generated duplicate of such notice.

(e) Dishonored check reports shall be mailed to the Lawyers' Fund for Client Protection, 119 Washington Avenue, Albany, NY 12210, within five banking days after the date of presentment against insufficient available funds.

(f) The Lawyers' Fund for Client Protection shall hold each dishonored check report for 10 business days to enable the banking institution to withdraw a report provided by inadvertence or mistake; except that the curing of an insufficiency of available funds by a lawyer or law firm by the deposit of additional funds shall not constitute reason for withdrawing a dishonored check report.

(g) After holding the dishonored check report for 10 business days, the Lawyers' Fund for Client Protection shall forward it to the attorney disciplinary committee for the judicial department or district having jurisdiction over the account holder, as indicated by the law office or other address on the report, for such inquiry and action that attorney disciplinary committee deems appropriate.

(h) Every lawyer admitted to the Bar of the State of New York shall be deemed to have consented to the dishonored check reporting requirements of this section. Lawyers and law firms shall promptly notify their banking institutions of existing or new attorney special, trust, or escrow accounts for the purpose of facilitating the implementation and administration of the provisions of this section.

Escrow Funds of Missing Clients and Deceased Lawyers

Rule 1.15 (f) of the new Rules of Professional Conduct provides that an application can be made for a court order directing that unclaimed escrow funds or funds owed to a missing client be deposited with the Lawyers' Fund for safeguarding and disbursement to persons entitled thereto. To prevent the depletion of nominal deposits, the Fund's policy is to accept deposits of \$1,000 or less without a court order.

Rule 1.15 (e) of the Rules of Professional Conduct provides that only an attorney admitted to practice law in New York State shall be an authorized signatory on an attorney's trust, escrow or special account in order to protect law clients from the misuse of their money. Practical problems arise when a sole practitioner dies without a successor signatory. Rule 1.15 (g) of the Rules of Professional Conduct permits a Justice of the Supreme Court to designate a successor signatory for a deceased attorney's trust, escrow or special account under. The Court may as well direct that money from a deceased attorney's client funds account be disbursed to persons who are entitled thereto, or deposited with the Lawyers' Fund for safeguarding.

These rules prevent the escheat of law client escrow funds to the State which were unclaimed or owed to missing clients as abandoned property. Sample pleadings pursuant to these rules can be found on the Fund's website at www.nylawfund.org in the escrow and ethics material section.

RULE 1.15 (f) Missing Clients.

Whenever any sum of money is payable to a client and the lawyer is unable to locate the client, the lawyer shall apply to the court in which the action was brought if in the unified court system, or, if no action was commenced in the unified court system, to the Supreme Court in the county in which the lawyer maintains an office for the practice of law, for an order directing payment to the lawyer of any fees and disbursements that are owed by the client and the balance, if any, to the Lawyers' Fund for Client Protection for safeguarding and disbursement to persons who are entitled thereto.

RULE 1.15 (g) Designation of Successor Signatories.

(1) Upon the death of a lawyer who was the sole signatory on an attorney trust, escrow or special account, an application may be made to the Supreme Court for an order designating a successor signatory for such trust, escrow or special account, who shall be a member of the bar in good standing and admitted to the practice of law in New York State.

(2) An application to designate a successor signatory shall be made to the Supreme Court in the

judicial district in which the deceased lawyer maintained an office for the practice of law. The application may be made by the legal representative of the deceased lawyer's estate; a lawyer who was affiliated with the deceased lawyer in the practice of law; any person who has a beneficial interest in such trust, escrow or special account; an officer of a city or county bar association; or counsel for an attorney disciplinary committee. No lawyer may charge a legal fee for assisting with an application to designate a successor signatory pursuant to this Rule.

(3) The Supreme Court may designate a successor signatory and may direct the safeguarding of funds from such trust, escrow or special account, and the disbursement of such funds to persons who are entitled thereto, and may order that funds in such account be deposited with the Lawyers' Fund for Client Protection for safeguarding and disbursement to persons who are entitled thereto.

**New York State Bar Association
Committee on Professional Ethics
Ethics Opinions**

Opinion #90 - 10/7/68 (17-68)

Question

May an attorney who is holding client's funds in escrow deposit those funds in an interest-bearing savings account?

Opinion

This is largely a question of law rather than ethics, and this Committee does not answer questions of law. The lawyer's professional duty is to treat the funds in all respects as the client's property and if any income is realized on the funds, it would, of course belong to the client. [N.Y.City 181 and 590; ABA Inf. 859.)

Whether it is proper to deposit the funds in an interest-bearing savings account will depend upon the circumstances. In some cases the client may believe he has the right of immediate withdrawal not subject to the notice and waiting period which sometimes applies to savings accounts. In some cases, the right of immediate withdrawal may be immaterial and it would be to the client's advantage to have the funds draw interest. Basically, it is a matter of the attorney's authority. The safest procedure would be to have the client's specific instructions whenever possible.

Opinion 532 - 5/27/81 (39-80)

Question

May a lawyer representing a client in a transaction in which the lawyer serves as an escrow agent accept or seek as compensation for such service the interest earned on funds held in escrow?

Opinion

The question comes to this Committee in the context of a specific inquiry as to the ethical propriety of a lawyer including in a real estate contract a clause that provides:

“The deposit monies received pursuant to this contract shall be held in escrow by Seller's attorneys, pending close of title or until earlier termination pursuant to the terms hereof, in an interest bearing savings account with the interest accruing thereon, if any, to belong to and to be retained by said attorneys to cover the cost and expense of administrating [sic] such escrow account, without being required to account for the amount of interest to either Seller or Purchaser.”

In the opinion of the Committee it would be ethically improper under the Code for a lawyer to accept or seek the interest earned on funds held in an escrow account as compensation for serving as an escrow agent. Such a fee arrangement presents so great a danger of unfairness, deception, overreaching and conflict of interest, or the appearance thereof, that we find any such arrangement per se improper under the standards incorporated into such Code provisions as Canons 5 and 9, EC 2-17, EC 2-18, EC 5-3, EC 9-.5, EC 9-6, DR 2-106 (A), and DR 9-102(A) and (B). Cf., DR 5-104(A).

A recent opinion, N.Y. City 79-48 (1980), identified a number of the ethical dangers involved where a lawyer seeks to enter into an agreement, which would permit the lawyer to retain escrow interest as compensation for "the cost and expense of administering [an] escrow account." This opinion, inter alia, states:

“[B]ecause of the fiduciary nature of the attorney--client relationship, agreements between lawyer and client where the attorney may be in the superior bargaining position, present a clear danger of overreaching.... The attorney bears the burden of demonstrating that the agreement was fair and that it was made by the client with full knowledge of all material circumstances known to the attorney....

“Several aspects of the proposed clause present problems of fairness and adequacy of disclosure. Use of the phrase ‘to defray the cost and expense of administering such escrow account’ may well mislead the client, since it is likely that in all but the most unusual situations, the costs of administration would be negligible and the interest accrued would far exceed such costs. For the same reason, the clause might result in a violation of DR 2-106(A), which prohibits a lawyer from entering into an agreement for, charging or collecting a clearly excessive fee.

“Use of the proposed clause may also impair the lawyer's ability to exercise independent professional judgment on behalf of a client as required by Canon 5, since the lawyer will have a financial interest in delaying the event which would terminate the escrow.

N.Y. City 79-48 then concluded:

“[W]hile... use of the proposed clause would [not] be improper per se, we do believe that it cannot properly be used without the exercise of extreme caution to ensure that it is fair under the particular circumstances of the representation and that the client has given his or her fully informed consent to the arrangement.”

Our Committee agrees that N.Y. City 79-48 correctly identifies the serious dangers of unfairness, deception, overreaching and conflict of interest involved in agreements permitting a lawyer to retain the interest on escrowed funds. We disagree, however, with the opinion's conclusion that the dangers are not so great as to require interpreting the Code as imposing a per se prohibition against such fee arrangements. In serving as an escrow agent the lawyer is a fiduciary. Any provision which permits possible self-dealing with an escrow fund should be rejected unless there is some strong countervailing consideration. None has been shown here. The potential for abuse, or at least the appearance thereof, is great. We can find no countervailing interest which would justify this type of arrangement.

When a lawyer serves as an escrow agent, his obligations are those of a trustee. Farago v. Burke, 262 N.Y. 229, 233; 186 N.E. 683,684 (1933); see also, Herman v. Dixon, 71 Misc. 2d 1057, 1059, 338 N.Y. 2d 139, 142 (Civil Ct. N.Y.C. 1972) and cases therein cited. The lawyer escrow agent must meet the same fiduciary and professional standards that are mandated for lawyers as well as for trustees with respect to the preservation, safekeeping and use of client funds and of trust property. These include maintaining proper trust accounts for all such funds, not commingling them with his own funds, and not using them for his own benefit. EC 9-5, DR 9- 102(A) and (B). See also former Canon 9; Drinker, Legal Ethics, pp. 89-92 (1953); Scott on Trusts, §§170.17, 180.2 (3rd ed. 1967).

Ethics opinions either requiring an accounting to clients for interest earned on client funds or condemning the retention of such interest "to defray expenses of maintaining the account" or "to offset... the expense of running the account" include N.Y. State 90 (1968); N.Y. City 181 (1931); ABA Inf. 991 (1967); ABA Inf. 545 (1962); Arizona 225, 6 Ariz. B.J. 36 (1970), Maru 5979 (1970 Supp.); Florida 72-13 (1972), Maru 8157 (1975 Supp.); Massachusetts 74-6, 59 Mass. L.Q. 298 (1974), Maru 8653 (1975 Supp.); North Carolina Opinion CPR 30, 21 N.C. Bar 15 (1974), Maru 9624 (1975 Supp.); and Los Angeles Inf. 1961-7, Maru 7782 (1975 Supp.)

Although we recognize, as do some of the above cited opinions, that no impropriety would be involved in a lawyer making a reasonable charge for escrow or administrative expenses, the fiduciary nature of the lawyer's role makes it especially inappropriate for a lawyer to ask parties to a real estate transaction, one of whom the lawyer represents, to approve an escrow compensation agreement measured by interest earned on escrowed funds.

While we interpret the Code as requiring a per se prohibition against retaining interest earned on escrowed funds in the circumstances stated, we recognize a possible distinction where interest is paid on a special account in which a lawyer

deposits such non-escrow client funds as advances for costs, expenses or fees not yet earned, or on other client funds which are to be promptly and routinely disbursed. Such funds should, of course, be kept in an identifiable client account, in which the funds of a number of different clients may properly be deposited. EC 9-5, DR 9-102 (A). Where the amount of interest allocable to any one client's account is relatively small in relation to the bookkeeping expense which would be required to determine the precise amount of interest earned as of any given date, it would not be inappropriate for a lawyer and client to agree that the amount of interest earned could be approximated and applied against any fees or charges owed to, the lawyer. Cf., Massachusetts 74-6, supra, with N.Y. State 90, supra.

For the reasons stated, the question posed is answered in the negative.

Opinion 554 - 11/21/83 (22-83)

Question

May a lawyer participate in a program established by state statute to provide financial assistance to civil legal services programs and for other purposes affecting the administration of justice through deposit in a commingled interest-bearing trust account of client funds held for a short period of time or nominal in amount?

Opinion

The New York State Bar Association's Special Committee to study Alternative Sources of Funding for the New York Legal Services Council, having supported the enactment of legislation which would establish a non-mandatory program to provide financial support for legal services and other purposes through deposit by lawyers in an interest-bearing trust account ("IOLA program") of client funds held for a short period of time or nominal in amount, asks what would be the ethical obligations

of an attorney who elects to participate in the IOLA program.

Over the past several years concern has mounted in the legal community as to how best to meet the need to provide civil legal assistance to the poor in the face of substantial cutbacks in federal funding of programs providing these services. In a number of states, programs have been proposed, and in some cases implemented, to provide financial support for these programs and other similar public service projects from interest earned on lawyers' trust accounts in depository institutions. Ethical questions arise as to the propriety of depositing client funds in such a commingled trust account.

A basic tenet of general application with respect to the lawyer-client relationship is contained in DR 9-102, which requires that funds deposited in a lawyer's trust account, which by definition are the client's funds, be kept separate and apart from the lawyer's funds and that any interest earned on those funds belongs to the clients. N.Y. State 90 (1968); N.Y. City 81-68 (1982); N.Y. City 79-48 (1980). In most instances these funds are held by an attorney for a short period of time to be used for a specific purpose by the attorney on behalf of the client. Generally separate accounts are not established; rather, the funds are commingled with other client funds, but because suballocation of interest is neither practical nor cost-effective the funds are held in non-interest bearing accounts. However, if any interest is earned by these accounts or on any separate trust account maintained by a lawyer for the benefit of a client, that interest, absent the client's consent, belongs to the client. DR 9-102(B); N.Y. City 81-68 (1982).

Where a lawyer holds a sum for a client which is sufficient to earn interest, the lawyer has a fiduciary obligation to invest that sum, 2 Scott, Law of Trusts, Sections 180.3, 181 (3d ed. 1967), and an ethical obligation to notify the client of receipt of the funds, and any interest thereon, maintain adequate records and make prompt payment of both principal and interest. DR 9-102 (B)(1),(3),(4).

The question remains whether this ethical analysis is applicable to interest earned on clients' funds, too nominal in amount or held for too short a period of time to generate interest in a separate account, but which when aggregated with other client funds may generate interest which by statute is to be paid to tax-exempt organizations for the support of legal services or other purposes defined by the legislature.

The question can be resolved by examining whether or not the income generated by the aggregated funds can be classified as clients' property. Since it is currently not economically feasible for financial institutions to suballocate these funds and provide clients with interest, it can be fairly said that the client does not have a reasonable expectation of receiving interest sufficient to support a claim of entitlement. Where other similar programs have been established the Internal Revenue Service has ruled that as long as the client has no right to determine whether the funds will be placed in the trust account the income generated is not taxable to the client. Thus, courts (see Matter of Interest on Trust Accounts, 402 So. 2d 389 (Fla. 1981)), legislatures and other ethics committees (see ABA 348 (1982)) have concluded that the ethical constraints set forth in Canon 9 are not applicable to interest so generated.

Under the plan adopted by statute in New York the lawyer who elects to participate in the program will continue to have the same fiduciary and ethical responsibilities with respect to treatment of clients' funds that are likely to generate income for the client. The decision as to which funds may be appropriately placed in the IOLA program is left to the discretion of the lawyer to whom the funds are entrusted.

Judiciary Law §497(5) expressly provides that "No attorney shall be . . . held to answer for a charge of professional misconduct because of a deposit of moneys to an IOLA account pursuant to a judgment in good faith that such moneys were qualified funds." See Judiciary Law §497(2) for definition of "qualified funds." Accordingly, there can be no ethical impropriety in the event an attorney makes a

deposit in an IOLA account under such circumstances. N.Y. State 415 (1975); cf. N.Y. State 323 (1974); N.Y. State 328 (1974).

For the reasons stated, the question posed is answered in the affirmative.

Opinion 570 - 6/7/85 (37-84)

Questions

- (1) Must a lawyer deposit advance payment of legal fees in a trust account as funds of a client, when such payments are refundable to the extent not earned?
- (2) Is a lawyer prohibited from depositing advance payments of legal fees in a trust account as funds of a client?
- (3) Must a lawyer remit to the client interest earned on advance payments of legal fees?

Opinion

A lawyer has adopted the common practice of receiving from a new client advance payment of legal fees expected to be earned in the course of the representation. To the extent that the fees thus advanced are not earned, in whole or in part, during the representation, the lawyer agrees to return them to the client.¹

The lawyer assumes that these advance fee payments are not client funds and that they are not required to be deposited in a client trust account, although it has been the lawyer's practice to deposit them in a trust account nevertheless. The lawyer asks whether she may retain any interest earned on these advance fee payments.

The answer to this inquiry turns upon whether the lawyer is correct in the assumption that advance payments of legal fees are not client funds and are not required to be deposited in a client trust account pursuant to DR 9-102(A). If, contrary to the

lawyer's assumption, the fee advances are client funds, it is clear that any interest earned on them belongs to the client and not the lawyer. E.g., ABA 348, at 4-6 (1982); N.Y. State 532 (1981); Nassau County 84-2 (1984); cf. N.Y. City 79-48 (1980).

We conclude that advance payments of legal fees need not be considered client funds and need not be deposited in a client trust account, and that any interest earned on fee advances may therefore be retained by the lawyer. Of course, the lawyer is obliged promptly to return any portion of the fee advance that is not earned in rendering legal services. DR 2-110(A)(3). If the lawyer treats advance payments of fees as the lawyer's own (and therefore retains any interest earned on them), it follows that the lawyer may not deposit the fee advances in a client trust account, as this would constitute impermissible commingling. On the other hand, the lawyer may agree to treat advance payments of legal fees as client funds and deposit them in a client trust account; in that event any interest earned on the funds while in the client trust account must be remitted to the client.

(1) Must Fee Advances Be Deposited in a Trust Account as Client Funds?

DR 9-102(A) provides:

“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.”

Lawyers frequently come into possession of the funds and property of others in a wide variety of situations. They may receive the proceeds of a settlement or judgment, a distribution from an estate or trust, or funds to be distributed upon closing of a real estate conveyance or sale of a business, to mention but a few examples. Such funds clearly are not the property of the lawyer, even though in some circumstances the lawyer's fee may be payable out of them or the lawyer may have a lien upon them to secure payment of a fee.

DR 9-102 (A) is an expression of the lawyer's duty, in common with all fiduciaries, to preserve the identity of property belonging to others and not to commingle others' property with the lawyer's own. E.g., Restatement (Second) of Agency §§ 381-82 1207, 1334-35 (1957). Even though DR 9-102(A) by its terms is applicable only to the funds and property of a client, lawyers nevertheless are legally and ethically required to observe the same duty of segregation with respect to the property of third parties. E.g., In re Lurie, 113 Ariz. 95, 98, 546 P.2d 1126, 1129 (1976); Worth v. State Bar, 17 Cal. 3d 337, 341, 551 P.2d 16, 18 (1976); In re Kramer, 92 Ill. 2d 305, 310, 442 N.E.2d 171, 173 (1982); In re Gallop, 85 N.J. 317, 426 A.2d 509 (1981); N.Y. City 82-8 (1983).

DR 9-102(A) parallels the normal common law rule against commingling, to which specific reference is made in the drafters' notes:

“[C]ommingling is committed when a client's money is intermingled with that of his attorney and its separate identity lost so that it may be used for the attorney's personal expenses or subjected to claims of his creditors. . . The rule against commingling was adopted to provide against the probability in some cases, the possibility in many cases, and the danger in all cases that such commingling will result in the loss of clients' money. ABA Code of Professional Responsibility DR 9-102 n.10 (1969), quoting Black v. State Bar,

57 Cal. 2d 219, 225-26, 368 P.2d 118, 122 (1962).”

Textually, it appears that the drafters of the Code of Professional Responsibility did not consider advance payments of fees to be client funds necessitating their deposit in a trust account. DR 9-102(A) makes no explicit reference to advance fee payments. The Code does make explicit reference to advance fee payments in DR 2-110(A)(3), which requires that any unearned fee advance be promptly refunded upon termination of the representation; it does not require that the advance be deposited in a trust account until earned. Indeed, DR 2-110 treats fee advances and client property as different things. It provides specifically in DR 2-110(A)(2) for the return of all client property to the client upon withdrawal from employment, and then provides separately for the refund of any unearned fee advance in DR 2-110 (A)(3).

Nor is there any suggestion in any of the Code's numerous provisions dealing with legal fees or client funds that advance payments of legal fees are deemed client funds to be deposited in a trust account. See generally DR 2-103(C)-(D), 2-106, 2-107, 2-110 (A)(3), 3-102, 4-101(C)(4), 5-103 (A), 5-106 (A) ; EC 2-8, 2-15 to -25, 2-32, 9-5.

Further it strains the normal meaning of words to interpret the phrase "funds of clients" as embracing advance legal fees paid to the lawyer. Although the lawyer receiving an advance fee payment has a legal and ethical obligation to render the services agreed upon and to refund any unearned portion of the fee advanced, it does not follow that the advance remains client property until earned. Normally, when one pays in advance for services to be rendered or property to be delivered, ownership of the funds passes upon payment, absent an express agreement that the payment be held in trust or escrow, and notwithstanding the payee's obligation to perform or to refund the payment. The lawyers who drafted the Code should not lightly be assumed to have overlooked these fundamental principles in choosing the language of DR 9- 102 (A).

We are also mindful that the very reason that many lawyers require advance fee payments in the first place is so that they will not be subject to a client's refusal to pay for legal services after they are rendered. If fee advances were required to be deposited in a client trust account, it would follow that this purpose of requiring advance payment could be easily defeated by a client who, after services are rendered, disputes a justly earned fee. Under DR 9-102(A)(2), the disputed portion of the fee would have to be retained in the client trust account, and would not be available to the lawyer, until the dispute was resolved.²

Our conclusion that legal fees paid in advance need not be considered client funds and therefore need not be deposited in a client trust account is supported by some, albeit a minority, of the ethics committee opinions that have considered this question. D.C. 113 (1982), 110 Daily Washington L. Rptr. 2772 (1982), digested in Lawyers' Man. Prof. Cond. 801:2306 (ABA/BNA)(1984); Fla. 76-27 (1976), Fla. Bar Comm. on Professional Ethics, Selected Opinions 88 (1977), indexed in Maru's Digest No. 10867 (Supp. 1980); Md. 83-62 (1983), digested in Lawyers' Man. Prof. Cond. 801:4330 (ABA/BNA) (1984).

We recognize that our conclusion is contrary to the majority of opinions by other ethics committees that have addressed the issue, which would require that advance payments of legal fees be deposited in a client trust account and retained there until earned. Ind. 4-197,7, 21 Res Gestae 402 (1977), indexed in Maru's Digest No. 11061 (Supp. 19.80); Mass. 78-11, 63 Mass. L. Rev. 231 (1978), indexed in Maru's Digest No. 11441 (Supp. 1980); Ore. 251 Opinion 570 (1973), indexed in Maru's Digest No. 9812 (Supp. 1975);³ Tex. 391 (1978), 41 Tex. B.J. 322 (1978), indexed in Maru's Digest No. 12749 (Supp. 1980); Va. 186-A (1981); San Francisco Inf. 1973-14 (1973), indexed in Maru's Digest No. 10669 (Supp. 1980). For the reasons set forth above, we decline to follow these opinions.⁴

Based on the foregoing, we must clarify the dictum in N.Y. State 532, at 3-4 (1981), which refers to "advances for costs, expenses or fees not yet

earned," among other things, and states: "Such funds should, of course, be kept in an identifiable client account," citing DR 9-102(A). Insofar as this dictum states that advances for costs and expenses must be kept in a client trust account, it is inconsistent with DR 9-102(A), which specifically exempts "advances for costs and expenses." To the extent this dictum would impose the same requirement upon advances for legal fees, it is contrary to our analysis set forth above.

(2) May Fee Advances Be Deposited in a Trust Account as Client Funds?

As seen from the above analysis, the Code does not require a lawyer to treat advance payments of legal fees as client funds. Nevertheless, we recognize that many lawyers consider it more appropriate to treat advances for unearned fees as client funds until the fees are earned through services rendered. We conclude that DR 9-102(A) does not prohibit lawyers from agreeing with their clients to treat fee advances as client funds and depositing them in a client trust account. Where a lawyer agrees to treat advance fee payments in this manner, all of the requirements of DR 9-102 applicable to client funds and trust accounts would govern. These include the prohibition against withdrawing any portion of the lawyers' fee that is disputed by the client, DR 9-102(A)(2), and all of the detailed accounting, recordkeeping, and reporting requirements of DR 9-102(B) and of the applicable Appellate Division rules,⁵ with which all lawyers should be familiar.

Absent an agreement to treat an advance fee payment as client property, it would be inappropriate for the lawyer to deposit advance fees in a client trust account, as this would constitute commingling prohibited by DR 9-102(A). Further, once a lawyer agrees to treat a fee advance as client property, the lawyer is bound by that agreement and all of its consequences.

(3) Who Earns Interest on Fee Advances?

If a lawyer does not agree to treat a fee advance as client property, the lawyer may use the money as

the lawyer chooses (except that the lawyer may not deposit it in a client trust account), subject only to the requirement that any unearned fee paid in advance be promptly refunded to the client upon termination of the employment. DR 2-110(A)(3). In that case, any interest earned on the advance payment of fees would belong to the lawyer.

If the lawyer agrees to treat an advance fee payment as client property, it follows that any interest earned on it must be reported and remitted to the client. E.g., ABA 348, at 4-6 (1982); N.Y. State 532 (1981); Nassau County 84-2 (1984); cf. N.Y. City 79-48 (1980).

Conclusion

For the reasons stated, and subject to the qualifications set forth above, the questions posed are answered in the negative.

¹ Although commonly referred to as a "retainer," such an advance payment of legal fees that is not earned until legal services are performed and that is refundable to the extent not earned should be distinguished from the "classic retainer" or "general retainer" more common in earlier times. Such a retainer is a payment to the lawyer for being available to the client in the future and for being unavailable to the client's opponents, and is earned upon receipt. See generally Baranowski v. State Bar, 24 Cal. 3d 153, 164 n.4, 593 P.2d 613, 618 n.4, 154 Cal. Rptr. 752, 757 n.4 (1979); Greenberg v. Remick & Co., 230 N.Y. 70, 75, 129 N.E. 211, 212 (1920); Conover v. West Jersey Mortgage Co., 96 N.J. Eq. 441, 451, 126 A. 855, 859 (1924); Bright v. Turner, 205 Ky. 188, 191, 265 S.W. 627, 628 (1924); Union Surety Co. v. Tenny, 200 Ill. 349, 353, 65 N.E.688,689 (1902); Severance v Bizallion, 67 Misc. 103, 106, 121 N.Y.S. 627, 629 (App. T. 1st Dep't 1910); Jacobson v. Sassower 113 Misc. 2d 279, 281, 452 N.Y.S.2d 981 983 (Civ. Ct. N.Y. Co. 1982), aff'd, 122 Misc. 2d 862 474 N.Y.S.2d 167 (App. T. 1st Dep't (1983); H. Drinker, Legal Ethics 172 (1953).

² Of course, even if fees paid in advance are deposited in a lawyer's general account, a client could still dispute, justly or unjustly, whether the fee was earned. The difference is that the lawyer would not be deprived of all use of the funds pending resolution of the dispute, a result that the lawyer and client bargained for at the outset of the representation in agreeing to advance payment of the fee.

³ Ore. 251 cites as support Ore. 205 (1972), indexed in Maru's Digest No. 9766 (Supp. 1975). however, Ore. 205 was withdrawn on December 15, 1972. Maru's Digest at 444 (Supp. 1975).

⁴ We are also aware that a view contrary to that adopted here is taken in the textual portion of the Lawyers' Manual On Professional Conduct, 45:104-05 (ABA/BNA)(1984). The textual material relies on some of the ethics committee opinions cited above and also relies heavily on State v. Hilton, 217 Kan. 694, 538 P.2d 977 (1975). We do not agree with the statements in that textual material as to what the court said or held in State v. Hilton.

⁵ 22 NYCRR 603.15 (1st Dep't); 22 NYCRR §691.12 (2d Dep't); 22 NYCRR §§ 1022.5, 1022.7 (4th Dep't).

⁶ We do not consider whether or under what circumstances a lawyer's receipt of fee advances may constitute income subject to taxation.

Opinion - 575 - 4/18/86 (46-85)

Question

When an attorney representing a party to a real estate transaction also acts as escrow agent, what ethical duties does the attorney have to place the contract deposit in an interest-bearing account?

Opinion

A lawyer acting as attorney for the seller in a real estate transaction has received the buyer's contract

deposit, and is holding the funds as escrow agent/attorney. The lawyer asks whether he has an ethical duty to deposit the funds in an interest-bearing account.

It is settled that an attorney for one party to a real estate transaction may act as an escrow agent for both sides with full disclosure of the facts and with the consent of both parties. ABA Inf. 923 (1966) In that capacity, the attorney is merely carrying out the escrow instructions of both parties. In N.Y. State , 532 (1981), where we opined that a real estate contract permitting the lawyer/escrow agent to retain interest earned on escrow funds as compensation for administrative costs and expenses was per se improper, we noted as follows:

“When a lawyer serves as an escrow agent, his obligations are those of a trustee. Farago v. Burke, 282 N.Y. 229, 233, 186 N.E. 683, 684 (1933); see also, Helman v. Dixon, 71 Misc. 2d 1057, 1059, 338 N.Y.S.2d 139,142 (Civil Ct. N.Y.C. 1972, and cases therein cited. The lawyer/escrow agent must meet the same fiduciary and professional standards that are mandated for lawyers as well as for trustees with respect to the preservation, safekeeping and use of client funds and of trust property.”

The professional standards mandated for lawyers with respect to clients' funds place emphasis on using one or more identifiable bank accounts without commingling funds belonging to the lawyer, maintaining complete records and rendering appropriate accounts to the client, and promptly paying such funds as requested by the client. See DR 9-102. The Code of Professional Responsibility is silent as to whether the account in which such funds are deposited should be interest-bearing. In N.Y. State 90 (1968), at a time when withdrawals from interest-bearing bank accounts were generally subject to notice and a waiting period, this Committee noted that such restrictions may conflict with the client's desire and right to prompt payment (cf. DR 9-102(B)(4)) and advised obtaining the client's specific instructions before depositing the funds in an interest-bearing account.

In ABA 348(1982), the Committee on Ethics and Professional Responsibility of the American Bar Association addressed a range of questions on placing clients funds at interest. That Committee noted that client funds are generally commingled and left un-invested because of the administrative expense of establishing a separate account for each client and the impracticability of calculating and allocating interest on commingled funds.

However, consistent with our comments in N.Y. State 554 (1983), the A.B.A. Committee concluded that "where the amount of funds held for a specific client and the expected holding period make it obvious that the interest which would be earned would exceed the lawyer's administrative costs and bank charges, the lawyer should consult the client and follow the client's instructions as to investing." ABA 348(1982). See also N.Y. State 554(1983) ("where a lawyer holds a sum for a client which is sufficient to earn interest, the lawyer has a fiduciary obligation to invest that sum, and an ethical obligation to notify the client of receipt of the funds, and any interest thereon, maintain adequate records, and make prompt payments of both principal and interest"); N.Y. State 532(1981) (requiring an accounting to clients for interest earned on client funds); N.Y. City 81-68(1981)(interest earned on client funds belongs to the client). See generally DR 9-102(B)(1),(3),(4).

The same principles apply to a lawyer acting as escrow agent/attorney, whether the lawyer is acting for the seller or the buyer. As an escrow agent, the attorney owes fiduciary duties to both parties to the contract with respect to the preservation, safekeeping and use of client funds and of trust property. See N.Y. State 532 (1981); N.Y. City 80-56 (1980); *cf.*, In re Solomon, 87 A.D.2d 137, 450 N.Y.S.2d 804 (1st Dep't 1982) (sellers' attorney disciplined for withdrawing funds from escrow account without authorization despite lack of harm to buyers or sellers).

In the opinion of the Committee, when an attorney is requested to act as escrow agent/attorney for a contract deposit sufficient in amount that it might warrant being placed in an interest-bearing account

if it were client's funds, the attorney should recommend to the contracting parties that specific instructions be included in the escrow agreement on whether such funds should be placed in an interest-bearing account and how the interest earned should be apportioned between the parties. In making this recommendation, the attorney should consider the amount of the deposit, the expected holding period, and the costs and expenses involved in making such a deposit. See Nassau County 85-9(1985). Where the contract pursuant to which the deposit is made is silent about placing the funds at interest but the amount thereof and other circumstances might warrant its being placed at interest, the attorney should consult with the parties for their specific instructions. If the parties then are unable to agree, the duty of an escrow agent/attorney with respect to placing the funds at interest ceases to be an ethical question and becomes one as to what, if any, duties in that regard are imposed by law in light of the terms of the escrow agreement. This Committee does not opine on questions of law.

Of course, as discussed above, the escrow agent/attorney has the same duties respecting record keeping and accounting as an attorney has with respect to client funds.

Opinion 582 - 5/4/87 (13-87)

Question

Where an attorney receives a settlement check on behalf of a client and deposits it in an interest-bearing escrow account, is it permissible for the attorney to retain the interest earned on the funds from the date of deposit of the check into the account until the date the settlement check clears?

Opinion

An attorney proposes to maintain an interest-bearing escrow account which would be used solely for the deposit of checks representing settlements of personal injury cases. A check payable to the

order of the client for the client's full share of the settlement amount would be issued on the date that the settlement check "cleared". Interest would be paid to the client on a daily basis from the date the settlement check cleared until the date the check to the client was charged to the escrow account. Personal funds of the attorney would not be commingled in this account and clients would sign a written agreement to the above arrangement. In the event that a significant amount of interest was paid to the client, Form 1087 would be filed by the attorney with the Internal Revenue Service.

This Committee held in N.Y. State 532 (1981) that it is ethically improper for a lawyer to receive interest earned on funds held in an escrow account as compensation for serving as the escrow agent. We stated in that opinion, "Such a fee arrangement presents so great a danger of unfairness, deception, overreaching and conflict of interest or the appearance thereof, that we find any such arrangement per se improper under the standards incorporated into such Code provisions as Canons 5 and 9, EC 2-17 EC 2-18, EC 5-3, EC 9-5, EC 9-6, DR 2-106(A), and DR 9-102(A) and (B)."

It is the opinion of the Committee that N.Y. State 532 is fully applicable to the facts set forth herein. Under the proposed arrangement the interest paid to the attorney would clearly be compensatory for the attorney's service as escrow agent.

While we recognized in N.Y. State 532 that it might be permissible for an attorney subject to the client's consent, to retain the interest on client funds which are to be promptly and routinely disbursed, that statement was limited to instances "[w]here the amount of interest allocable to any one client's account is relatively small in relation to the bookkeeping expense which would be required to determine the precise amount of interest earned as of any given date." *Id.* Under the proposed arrangement, the attorney is willing to calculate a client's interest on a daily basis commencing with the date the settlement money becomes available. We therefore, see no reason why it should be administratively burdensome for the attorney to

calculate the interest earned from the date of deposit.

For the reasons stated the question posed is answered in the negative.

Opinion 600 - 5/16/89 (2-88)

Questions

1. May an attorney use a credit line supported by checks deposited in a multiple-client escrow account where the bank would provide immediate credit in the form of bank cashier's checks or certified checks based on the attorney's credit-worthiness and the balance in the account?
2. May an attorney use an "attorney exchange account" in which the proceeds of a single closing are deposited, against which funds the bank would provide immediate credit in the form of a bank cashier's check if the bank relies solely on the personal credit-worthiness of the attorney?

Opinion

A lawyer proposes to use one or both of the products described above that a bank may offer to its attorney customers. The first arrangement is impermissible in that it would involve improper use of other clients' funds in the escrow account for the benefit of the client for whom the check is drawn. DR 9-102. Were the check to bounce, the bank would be protected against any loss by the deposits in the multiple client escrow account, but that use of the funds of Client A to benefit Client B would be an impermissible conversion. See Pa. Op. 85-172 (1986), indexed in ABA/BNA 901:7301; N.C. Op. 358 (1984), indexed in ABA/BNA 801:6614; S.C. Op. 20-78, indexed in Maru's No. 12726 (1980).

In the second arrangement, however, the funds of other clients are not involved. Furthermore, since no funds of the lawyer are actually deposited in the escrow account, there would be no impermissible

commingling of the lawyer's and client's funds. See DR 9-102 and the rules of the four Judicial Departments, which each require that a client's funds be identified and deposited separately from the lawyer's funds, remaining at all times the property of the client. 22 NYCRR 603.15, 691.12, 806.8, 1022.5.

This second service is tantamount to a lawyer lending funds to a client or guaranteeing funds advanced by the bank. In litigated matters, such an arrangement is prohibited by DR 3-103(B). There is no express prohibition against a lawyer lending a client funds in connection with a non-litigated matter. C. Wolfram, *Modern Legal Ethics* 507 n. 75 (1986). *But see* ABA Inf. 1170 (1970). Since the lawyer may directly lend or guarantee the funds to the client, it is not per se unethical for a lawyer to permit the bank to use the lawyer's credit-worthiness to provide immediate credit to a client based on a single closing account. Washington Op. 177, indexed in ABA/BNA 801:8902. In order to use this service, however, the lawyer must explain the arrangement to the client who must then consent. Pa. Op. 85-172 (1986), indexed in ABA/BNA 901:7301. DR 5-104(A) provides:

“A lawyer shall not enter into a business transaction with a client if they have differing interests therein and if the client expects the lawyer to exercise his professional judgment therein for the protection of the client, unless the client has consented after full disclosure.”

The lawyer and the client have potentially differing interests in the loan transaction. Should the payor not make good on the deposited check, the bank may proceed against the lawyer who would in turn seek indemnification from the client. Therefore, the lawyer should enter into this arrangement only where the lawyer is confident that the client understands the ramifications and the potential conflict, including the fact that the lawyer may have to withdraw from representation at some point in the future. In addition, the client must fully comprehend his obligations to the lawyer. The extent of the disclosure will depend on the client's experience and sophistication and it may be

impossible in some situations to obtain knowing consent.

Despite the fact that the lawyer is extending a benefit to the client, it is important that he exercise caution when considering personal involvement in client affairs.

For the reasons stated above, Question 1 is answered in the negative and, subject to the qualifications set forth, Question 2 is answered in the affirmative.

Opinion 680 - 1/10/96 (57-95)

Question

May lawyers comply with the mandatory record-retention provisions of the Code by storing records in the form of computer-generated images or by other electronic means?

Opinion

Canon 9 of the New York Lawyer's Code of Professional Responsibility contains, in DR 9-102(D), mandatory record-retention requirements applicable to all members of the New York bar. Retainer agreements, bills to clients, bank statements, and records of transactions in escrow accounts are among the categories of records that the Code requires be maintained "for seven years after the events which they record." In addition, DR 9-102(H) provides that all such records must be "located, or made available at the principal New York State office of the lawyers subject hereto" for production in connection with disciplinary proceedings.

With the increasing computerization of the law office, and the recent development of electronic imaging and storage technology, the question naturally arises as to whether New York lawyers are required, as an ethical matter, to retain records in original, hard-copy form for the seven-year period provided in the Code, or whether the Code

permits record retention by more technologically advanced means.

We take it that the possibly higher cost of creating records in the form of (or transferring existing records to) computer images may be more than offset by the savings in storage costs attributable to dramatically reducing the volume of the retained records.

Our review of the pertinent Disciplinary Rule persuades us that the Code permits some records to be maintained in the form of computer images, while other records must, as the Code is now written, be retained in their original, hard-copy form. We note that DR 9-102(D)(3)-(7) refer explicitly to "copies" of the documents referred to in those subsections (e.g., retainer and compensation agreements, statements to clients or others showing disbursements of funds, bills to clients), while DR 9-102(D)(8) refers not to "copies" but explicitly to: "all checkbooks and checkstubs, bank statements, prenumbered canceled checks and duplicate deposit slips....".

We conclude that the items referred to in DR 9-102(D)(8) must be retained in just the form described by the Code; that is, the actual checkbooks, checkstubs, bank statements and the other documents referred to in that subsection must be retained as is, in paper form, for the seven-year period prescribed by that Rule.

We also conclude, however, that those documents for which the Rule explicitly permits "copies" to be retained may be stored in the form of computer images. In reaching this conclusion, we have relied upon our understanding that the computer images are stored electronically as images on storage media (such as CD-ROMs) that are "read-only" and therefore are not any more likely to be altered or destroyed inadvertently than the paper copies they replace, and that when such images are ultimately printed onto paper they produce an accurate reproduction of the original document.

We also understand that techniques are now commercially available under which electronic data

can be recorded and stored on optical disks in a manner that the information cannot be modified or removed from the disk without detection. R. Raysman and P. Brown, "The New Technology for Storing Business Records," N.Y.L.J. at 3 (Aug. 9, 1994). We note that the staff of the Securities and Exchange Commission ("SEC") has recently relied upon such a system to conclude that storage on optical disks was acceptable to satisfy the records-retention requirements imposed upon investment advisers under SEC rules. See 1995 SEC No-Act. LEXIS 684, Oppenheimer Management Corporation, August 28, 1995.

We recognize, of course, that any electronic storage technique is subject to abuse, and that the stored electronic data is susceptible of being transferred from an unalterable format to a readily manipulable one so that without inspection of the original disk itself there can be no assurance that a paper purportedly printed out from such a disk does not reflect an alteration.

Paper copies retained as such are also susceptible of being intentionally altered, however, by the use of a photocopier, or in a more technologically sophisticated manner by transferring the paper document (even one that has been retained for years in that form) to a computer file by means of an electronic scanner, altering it, and then printing it back out onto paper before producing it in connection with a disciplinary proceeding. In short, the various different means of record storage do not by themselves appear to affect the potential for fraud in a material way.

The importance of the Code's record retention requirements, and associated provisions assuring that such records will be readily available to authorities, cannot be over-emphasized. Before any lawyer determines to change the form in which such records are maintained, the lawyer must make certain that the new storage means to be used safeguards the records from inadvertent destruction or alteration at least as effectively as the traditional paper record, and that the new technique will permit the prompt production of accurate, unaltered copies upon request pursuant to DR 9-102(H).

Moreover, any lawyer who chooses to transfer existing paper records to computer images must insure that all required copies are in fact transferred before any paper records are disposed of; the lawyer who fails to do so acts at the peril of engaging in spoliation, and will be at risk to suffer the severe consequences of such conduct. DR 9-102(I) (failure to maintain and produce records as specified by disciplinary rules subjects lawyer to discipline).

Finally, DR 9-102(D)(1), (2) and the text following (8) require the maintenance of records in any bank accounts involved in the lawyer's practice, of all financial transactions in "books of account" kept in the regular course of business, and of other similar records. We do not believe that anything in those Code provisions requires that such records be made in the first instance on paper as distinguished from in the form of electronic data entry. Consequently, we conclude that any such records that are created in electronic form may be retained in that form. Records described by these provisions that are created by entries on paper books of account, ledgers, or other such tangible items, however, should be retained in their original form.

Conclusion

Records required to be maintained by the Code in the form of "copies" may be stored by reliable electronic means, as noted above, and records that are initially created by electronic means may be retained in that form, but other records that are specifically described by the Code must be retained in their original format.

Opinion 693 - 8/22/97 (68-96)

Question

May a lawyer allow a paralegal to use a stamp bearing the lawyer's signature to execute checks drawn on a client escrow account?

Opinion

This Committee and others have frequently addressed issues arising from a lawyer's delegation of tasks to a non-lawyer employee. See, e.g., N.Y. State 677 (1995); N.Y. State 255 (1972); N.Y. State 44 (1967); N.Y. City 1995-11 (1995); N.Y. City 666 (1985); Nassau County 90-13; ABA 316 (1967). The question in this inquiry is whether, consistent with DR 9-102(E), a lawyer may allow a non-lawyer employee to use a signature stamp to execute checks drawn on the lawyer's client escrow account. See DR 9-102(B). The inquirer notes that the purpose of the signature stamp is to facilitate procedures at the closings of real estate transactions.

The New York Lawyer's Code of Professional Responsibility contemplates that lawyers will delegate tasks to nonlawyers. DR 1-104; EC 3-6; See N.Y. City 1995-11. We have recently opined that it is permissible for lawyers to delegate attendance at a real estate closing to a paralegal, where the delegating lawyer is available by telephone as necessary, the particular closing is "ministerial" and several other conditions are satisfied. N.Y. State 677 (1995).

In our opinion we noted that all tasks assigned to a paralegal must be "within the limits prescribed by law" and "clearly limited to those functions not involving independent discretion or judgment." N.Y. State 677; see ABA 316 (1967); N.Y. State 255 (1972); N.Y. City 666 (1985). We acknowledged that many real estate and mortgage closings do not require the paralegal to exercise independent discretion or judgment. N.Y. State 677.

It is the attorney or a member of the attorney's firm who is the custodian of the funds of the client. DR 9-102; N.Y. State 570 (1985); Nassau County 88-31. DR 9-102(A) and (B) generally require that a lawyer deposit client funds in identifiable bank accounts within the state and segregate such funds from the lawyer's general funds. N.Y. State 570 (1985). An attorney is personally and professionally liable for funds and property

entrusted to him or her by a client and must exercise the highest degree of care in preserving and protecting such funds and property. Nassau County 88-31. Consistent with these principles, DR9-102(E) provides that "[o]nly an attorney admitted to practice law in New York State shall be an authorized signatory of a special account." A non-lawyer may not be a signatory on a special account and a lawyer may not give such a person signatory power on such account. In re Gambino, 205 A.D.2d 212, 619 N.Y.S. 2d 305, (2d Dep't 1994) (lawyer violated DR 9-102(E) by permitting non-lawyer daughter to be signatory on special account); In re Stenstrom, 194 A.D.2d 277, 605 N.Y.S. 2d 603 (4th Dep't 1993) (lawyer violated DR 9-102(E) by permitting non-lawyer ex-wife to be signatory on special account).

Although it is clear that only a lawyer may control the lawyer's client escrow account and be a signatory of it, the Rule does not address whether a lawyer may delegate the task of signing his or her name to escrow account checks to others, and if so whether a signature stamp can be used for that purpose. Based on the analysis of proper delegation in our previous opinions, we believe that it is ethically permissible for a lawyer to authorize a paralegal to make use of the lawyer's signature stamp on checks drawn from a special account at closings under certain conditions and with proper controls.

As with the rest of a paralegal's duties at a real estate closing, N.Y. State 677, the lawyer must consider in advance how the paralegal will use the signature stamp including approving the purpose of the anticipated payments to be made by such checks, the nature of the payee and the authorized dollar amount range for each check to be issued and review afterwards what actually happened to assure that the delegation of authority has been utilized properly. As a practical matter, compliance with these restrictions will limit the use of the signature stamp by a paralegal to those circumstances in which the lawyer can reliably forecast events at the closing.

Attorneys must be aware that responsibility for client funds may not be delegated, and attorneys authorizing paralegals to use signature stamps on checks drawn from escrow accounts are "completely responsible" to the client for any errors or misuse of the stamp. N.Y. State 677; DR 1-104. Attorneys must take steps to safeguard the use of the signature stamp to avoid any misappropriation of client funds.

Conclusion

A lawyer may allow a paralegal to use a signature stamp to execute escrow checks from a client trust account so long as the lawyer supervises the delegated work closely as provided in this Opinion and exercises complete professional responsibility for the acts of the paralegal.

Opinion 697 - 12/30/97 (41-97)

Topic: Legal fees; combination of hourly and contingency fee.

Digest: It is proper for a lawyer to charge a combination of an hourly and a contingency fee.

Code: DR 2-106(A), 2-106(C)(1).

Question

May a lawyer charge both an hourly fee, irrespective of outcome, and, in the event of a recovery by settlement or verdict, a percentage of the net recovery? Such a combined fee is sometimes referred to as a "modified contingent fee" or a "hybrid fee."

Opinion

DR 2-106(A) provides that a lawyer may not enter into an agreement for an excessive fee. In determining whether a fee is excessive, one of the criteria is whether the fee is fixed or contingent.

Contingent fees are normally greater than the hourly fees that would be charged for the same

representation, because the contingent fee lawyer bears the risk of receiving no pay if the client loses and the higher fee is compensation for that risk. See Boston & Maine Corp. v. Sheehan, Phinney, Bass & Green, P.A., 778 F.2d 890, 897 (1st Cir. 1985); see generally American Law Institute, Restatement of the Law Third, Restatement of the Law Governing Lawyers, §47, comment c (Proposed Final Draft No. 1). Similarly, a contingent fee may be upheld, even though the lawyer devoted relatively little time to the representation, since the lawyer risks having to provide services without extra pay if the representation entails a greater expenditure of time than the lawyer anticipated when the contingent fee was negotiated. However, it has been held that large fees are unreasonable when they are unearned by either effort or a significant period of risk. Id.

Of course, a lawyer may never charge a contingent fee for representing a defendant in a criminal case. DR 2-106(C)(1). Similarly, the Rules of the Appellate Division of the New York Supreme Court limit the amount of legal fees in certain actions for personal injury or wrongful death where the fee is dependent in whole or in part upon the amount of recovery. See, e.g., 22 NYCRR §603.7(e)(1st Dep't). Consequently, any combination of an hourly fee and a contingent fee in such a case would have to conform to the maximum fee schedules in the court rules. See DR 2-106(A)(a lawyer shall not charge an illegal fee).

We believe a hybrid or modified contingent fee is permissible as a matter of ethics as long as the total fee is not excessive. This will usually mean that the contingency percentage will be lower than it would be if the fee were based on a pure contingency. Whether the hourly fee must also be reduced depends on whether the fee as a whole exceeds a reasonable fee.

Although the lawyer who charges a modified contingent fee does not assume the full risk of no recovery (since the lawyer is receiving an hourly fee), we believe that the lower risk to the lawyer is balanced by the lower bonus in the event of a successful completion, as defined in the retainer

agreement. Moreover, if the hourly fee is reduced, it is likely to make counsel available to clients whose cases do not have such a high probability of success that a straight contingency fee would be attractive to prospective counsel. Thus it meets the goal expressed in EC 2-20 of providing a means by which a client may economically afford, finance and obtain the services of a competent lawyer to prosecute a claim.

Modified contingent fees have also been upheld in other jurisdictions. See Boston & Main Corp. v. Sheehan, Phinney, Bass & Green, P.A., *supra* (hourly fee and reduced contingent fee was reasonable even though the justification for a pure contingency fee - lawyer's risk of no compensation - was not present. In return for the lower risk, Sheehan accepted a much lower contingency fee - 15%); Nevada Formal Op. 4 (1987)(reduced hourly fee plus bonus).

Conclusion

In a case in which a lawyer could charge a contingency fee, the lawyer may charge a modified contingency fee (for example, an hourly fee less than the lawyer would charge for a retainer on an hourly fee basis, and a contingent fee less than the lawyer would charge for a pure contingency retainer) as long as the total fee is reasonable. A fee in a personal injury matter that exceeded the Appellate Division's fee schedule for certain contingency fees would not be reasonable.

Opinion 710 11/6/98 (35-98)

Topic: Lawyer as escrow agent; Release of funds in escrow to client.

Digest: Absent authorization by all parties, lawyer who serves as escrow agent may not release funds to client except as provided in the escrow agreement; while lawyer may resign as escrow agent, provision must be made to protect funds in escrow.

Code: DR 9-102.

Question

A lawyer has been holding funds in escrow for a number of years pursuant to a written agreement made incident to a real estate transaction in which the lawyer represented the sellers. The purpose of the escrow was to secure the purchasers against loss which they might sustain through "an assessment with regard to [a certain sidewalk] violation" by the local municipality. The inquirer states that a representative of the municipality has recently advised that for various reasons there is no possibility the municipality will issue an assessment. Still, the purchasers have refused to permit the lawyer to return the escrowed funds to the sellers, notwithstanding the purchasers' apparent awareness of the recent communications with the municipality. Further, the escrow agreement failed to authorize the lawyer to release the funds to the seller upon ascertaining that no assessment would be made with respect to the sidewalk violation. Nor did it provide for a procedure to resolve disputes relating to the funds in escrow.

Under such circumstances, may the lawyer return the escrowed funds to the clients upon furnishing the purchasers' attorney with an affidavit recounting the investigation and findings?

Opinion

As a general rule, an escrow agent has contractual and fiduciary duties to all parties to an escrow arrangement which may be discharged only in accordance with the terms of the escrow agreement or with the informed consent of all parties.

Although the Code of Professional Responsibility imposes some additional obligations on the lawyer who serves as an escrow agent, see, e.g., N.Y. State 575 (1986); N.Y. State 532 (1981), the lawyers obligations derive principally from the substantive law of contracts and agency. To the extent that the inquiry in this case encompasses issues of substantive law, we are obliged to decline to provide the inquirer with guidance because the

resolution of such matters is beyond the jurisdiction of this Committee.

In the event of a dispute relating to the funds in escrow, the escrow agent is required to follow the procedures set forth in the escrow agreement for its resolution. Unfortunately, the escrow agreement in question is silent with respect to dispute resolution. Without such a provision, it would be inappropriate for the lawyer to assume the power to resolve the dispute by releasing the escrow and returning the funds to the sellers, because the stipulated contingency for release of the funds has not occurred. See Brooklyn Op. 19931 (1993) (attorney escrowee may urge the parties to resolve the dispute, but, if the parties cannot do so amicably, the attorney escrowee may not disburse the funds based on his or her own notions of fairness); see also N.Y. City 828 (1982); N.Y. County 672 (1989).

The inquirer may resign as escrow agent; however, in such case the mandate of DR 9-102 to protect the property of others entrusted to the lawyer's custody requires that the lawyer take steps to preserve intact the funds in escrow and initiate a process whereby the dispute may be resolved. Unless the parties agree to some other arrangement, one way to do this would be for the lawyer to commence a stakeholder's action and deposit the funds with the court. See Brooklyn Op. 19931 (1993) (the attorney may commence an interpleader action or [a]wait a suit by a party claiming entitlement to the funds and defensively interplead the remaining party); cf. N.Y. City 1986-5 (1986).

The inquirer's predicament underscores the importance of anticipating problems which may arise when agreeing to act as an escrow agent and of making certain that the escrow agreement provides a means of dispute resolution. See New York City 1986-5 (1986) (We stress the importance of having a carefully drafted escrow agreement that covers, among other things, possible disputes over the escrowed funds.). Attorneys should avoid the danger that such arrangements will be made casually in the press of a real estate closing, without much thought being given to the possibility

that the event stipulated for release of the funds in escrow may not occur.

Conclusion

For the reasons stated, the question posed is answered in the negative.

Opinion 717 – 4/15/99 (43-98)

Topic: Medical liens; duty to pay funds to third party; missing lienor.

Digest: Plaintiff's attorney should pay holder of valid lien from settlement proceeds. If client disputes amount or validity of lien, attorney should remit to client funds not in dispute and hold remaining funds pending resolution of dispute. In event of missing lienor, attorney should consider several options, including application for court order concerning disbursement of funds.

Code: DR 9-102(C)(1),(4); DR 9-102(F).

Question

A lawyer has received a settlement check payable to a client and containing the legend "...for treatment or services and interest rendered." The check represents full settlement of a claim arising from a motor vehicle accident. The attorney's fee is not in issue. The client had incurred five medical bills for treatment as a result of the accident and they remain unpaid. The lawyer's preliminary research indicates that two of the five medical service providers have liens and that one of the two is "no longer in business." One of the providers without a lien is also out of business.

May the attorney turn the check over to the client, relying on the client to pay the providers from the proceeds of the check?

If the attorney has an obligation to pay the holders of valid liens directly, how would that be

accomplished in the case of the lienor which is out of business?

Opinion

DR 9-102(C)(1) states that a lawyer must: "Promptly notify a client or third person of the receipt of funds, securities, or other properties in which the client or third person has an interest." Therefore, the attorney must notify the client and the holders of valid liens and assignments when the check is received.¹

DR 9-102(C)(4) requires the lawyer to "promptly pay or deliver to the client or third person as requested by the client or third person the funds, securities, or other properties in the possession of the lawyer which the client or third person is *entitled to receive*" (emphasis added). The attorney should make a reasonable effort to ascertain whether the provider has an interest in or is entitled to receive payment from the funds in the attorney's possession. *See Nassau County 96-13*. Absent an assignment or lien, a provider would not have an interest in and be entitled to payment from the funds. Leon v. Martinez, 84 NY2d 83 (1994).

If a provider asserts that it has a valid lien or assignment, but the client disputes the provider's assertion, the attorney should hold the check or its proceeds, pending resolution of the dispute. *Nassau County 92-10, 96-13*. If the check is payable to the *client*, the attorney should counsel the client to endorse the check for deposit in the attorney's trust fund to avoid the check becoming stale.²

If the client refuses to do so, the attorney should retain possession of the check pending resolution of the dispute. If, on the other hand, the client endorses the check, the attorney should promptly remit the balance due the client to comply with the prompt payment mandate of DR 9-102(C)(4) and hold the disputed portion. The attorney may attempt to resolve disputes by way of negotiation or, alternatively, commence an interpleader action to enable a court to resolve the dispute. *See Nassau County 94-19, 91-21*.³

There is no provision in the Code specifically addressing the obligation to pay a lienor who is out of business. Nevertheless, to fulfill the requirements of DR 9-102(C)(4), the attorney might consider the following options:

(a) If the attorney has exhausted all reasonable efforts to locate any persons or entities who might succeed to the assets of the out-of-business lienor, the attorney might disburse the funds to the client.

(b) The attorney might employ the procedure described in DR 9-102(F) for dealing with money owed to a missing client, which is to apply to the Supreme Court in the county in which the attorney maintains an office for the practice of law for an order directing the payment of the money to the "Lawyers' Fund for Client protection for safeguarding and disbursement to persons who are entitled thereto."

(c) If the lienor was a *hospital*, the attorney might fulfill the ethical responsibility by depositing the funds with the Commissioner of Finance in New York City or the applicable County treasurer where the lien was filed. *See* N.Y. Lien Law, §189 (9).

Conclusion

If a provider undisputedly has a valid lien through statute or assignment by the client, the attorney should pay the provider directly from the proceeds of the check. If the client disputes the validity of the lien or assignment, pending resolution of the dispute the attorney should hold the disputed funds while disbursing any funds that are not in dispute. If the check is payable to the client and the client refuses to endorse it for deposit in the attorney's trust account, the lawyer should hold the check itself until the dispute is resolved. An interpleader action would be an appropriate procedure to resolve the dispute. If the provider with a valid lien is no longer in business and reasonable search locates no successor with a valid claim to the entity's assets, the attorney should consider several options, including applying to the Supreme Court for an order directing the money to be paid to the Lawyers' Fund for Client Protection.

¹ While this committee does not render *legal* opinions, it would seem that there are no common law or statutory liens for doctors' medical services. *Iaiello v. Levine*, 255 N.Y.S. 2d 921 (S. Ct. Nassau Co. 1965); *Healy v. Brotman*, 409 N.Y.S. 2d 72 (S. Ct. Suffolk Co. 1978).

² Some banks will declare checks stale in as few as 90 days.

³ Although, as we recently opined in another context, filing an interpleader action would be an appropriate vehicle "...to protect the property of others," N.Y. State 710, the attorney would not be *ethically* required to employ this alternative. See Nassau County 91-21.

Opinion 737 (2/1/01)

Topic: Escrow accounts

Digest: A lawyer may not issue a check from an attorney escrow account drawn against a bank or certified check that has not been deposited or has not cleared.

Code: DR 9-102

QUESTION

In payment of a client's obligations to a third party, may a lawyer issue an attorney escrow check against undeposited or uncleared client funds delivered to the lawyer in the form of a bank or certified check?

OPINION

Disciplinary Rule (DR) 9-102 establishes the framework for how lawyers must handle clients' funds. For example, DR 9-102(A) provides that a lawyer is a fiduciary with respect to the client whose funds are maintained in the lawyer's escrow account and prohibits the lawyer from commingling such funds with the lawyer's own. DR 9-102(B)(1) requires a lawyer to maintain an

escrow account for client funds "separate from any business or personal accounts of the lawyer or the lawyer's firm, and separate from any accounts which the lawyer may maintain as executor, guardian, trustee or receiver, or in any other fiduciary capacity." DR 9-102(C)(4) requires a lawyer to promptly pay to the client from escrow those funds which the client is entitled to receive. DR 9-102(D) requires certain bookkeeping records be maintained for escrow accounts which, pursuant to subdivision (1) thereof, "specifically identify the date, source and description of each item deposited, as well as the date, payee and purpose of each withdrawal or disbursement."

Implicit in this framework is that a lawyer will not draw on funds belonging to Client A for the benefit of Client B. Yet this is literally what occurs where a lawyer maintains funds belonging to multiple clients in a single unsegregated escrow account and issues a check in payment of the obligation of one client before certified checks or bank checks delivered to the attorney's possession for the benefit of that client in amounts sufficient to cover that obligation are deposited into the lawyer's escrow account and cleared. The issue before this Committee is whether there are practical considerations which, with appropriate safeguards, may permit a relaxation of the ethical proscription against a lawyer, in effect, granting Client B a temporary loan out of funds belonging to Client A.

The issue arises most often in the context of residential real estate closings. In many parts of the State, the seller's attorney or a real estate broker typically holds funds from the buyer in an escrow account. The amount, which in some transactions may be as much as ten percent of the purchase price, represents the buyer's down payment delivered upon execution of a residential purchase contract. This down payment — cleared by the time of closing — may be sufficient for the seller's closing obligations if there is adequate pre-closing planning and communication between the attorneys for the seller, the attorneys for the purchaser and the attorneys for the purchaser's lending institution concerning the correct closing figures and the manner of the purchaser's payment of the balance

due. Sometimes, however, open taxes, open judgments or other liens will first appear in a continuation title search run immediately prior to or at the closing in amounts that exceed the funds already cleared and in escrow. As these encumbrances constitute a cloud on title that must be cleared at the closing in order for the seller to convey good title, the purchaser's title agent must be given adequate funds from or on behalf of the seller to cure the problem or to omit them from the title commitment. For this purpose, only a bank check, a certified check or an attorney's check will typically be accepted.

In these circumstances — where the earnest money or down payment deposited and cleared in escrow is insufficient to satisfy the seller's closing obligations and where bank or certified checks in the proper amounts are not available at the closing — it might seem that a practical solution to avoid the delay, inconvenience and expense of an adjournment would be for the seller's attorney to accept for deposit in his or her escrow account the bank or certified checks tendered by the purchaser or the purchaser's lender for the balance of the purchase price, checks usually made payable to the seller, which the seller then endorses over to the seller's attorney for deposit in the escrow account.

The seller's attorney would then issue checks drawn on the escrow account payable in the amounts required to satisfy the seller's closing obligations, including the open taxes, judgments or other liens that encumber the good title that the seller is contractually obligated to convey, and remits the balance of the proceeds to his or her client.

Apparently, the title companies and others will accept the escrow check of the seller's attorney, notwithstanding actual knowledge that the bank checks and certified checks delivered to the seller's attorney at the closing have not yet been deposited into the attorney's escrow account and, perforce, have not yet cleared.

The seller's attorney is often willing to issue such escrow checks because there are sufficient funds, already cleared on deposit in the attorney's escrow account, to cover the checks issued at the closing.

To the extent the total amount of the escrow checks issued at closing thus exceeds the buyer's down payment or earnest money, the funds on deposit in the attorney's escrow account that are used to cover the excess are indisputably funds belonging to other clients.

There are a number of arguments that can be advanced in favor of interpreting DR 9-102 to allow a lawyer to issue escrow checks on behalf of Client B that are covered by cleared funds in the same escrow account deposited on behalf of Client A where the lawyer is in physical possession of bank or certified checks appropriately endorsed for deposit into the lawyer's escrow account on behalf of Client B that, if and when cleared, would be sufficient to cover those escrow checks. Some of these arguments have been favorably considered by the authorities in other states. Thus, Florida and Illinois have adopted specific rules permitting lawyers to disburse uncleared funds. See Rule 1.15 of the Illinois Rules of Professional Conduct; Rule 5-1.1(g) of the Rules Regulating the Florida Bar. In addition, New Jersey, North Carolina, and Virginia have approved of the practice, see N.J. Eth. Op. 454 (1980), N.C. Eth. Op. RPC 191 (1997), and Va. Eth. Op. 183 (1996), while South Carolina has not. See *In re Hensel*, 2000 WL 640239 (S.C. Sup. Ct. May 15, 2000), S.C. Adv. Op. 78-20 (1978). On balance, however, we find none of the arguments sufficiently persuasive to subvert the obvious intended core purpose of DR 9-102 — to maintain the integrity of a client's funds for the benefit of that client only, until payment of those funds to, for or on behalf of that client and no other client, is due.

First, it can be argued that an attorney comes into "possession" of funds on behalf of Client B within the meaning of DR 9-102(A) when he or she receives the bank checks or certified checks properly endorsed for deposit into his escrow account on behalf of Client B at the closing. Because the risk that a certified check or bank check will not clear is considered to be negligible, it can be argued that the receipt should be analogized to the receipt of cash. However, even cash can be lost or stolen between the time of the

closing and the time of the bank deposit, and until the cash is deposited and credited to the escrow account, the cash does not generate available funds. A bank or cashier's check may also be subject to a stop payment order if the check was procured by fraud. See, e.g., *U.S. Printnet, Inc. v. Chemung Canal Trust Co.*, 270 A.D.2d 544, 703 N.Y.S.2d 821, 823 (3rd Dept. 2000), and cases cited therein. In addition, the checks themselves may turn out to be forgeries. See, e.g., *U.S. v. Van Shutters*, 163 F.3d 331 (6th Cir. 1998) (counterfeit bank checks were used to purchase automobiles) and *U.S. v. Werber*, 787 F. Supp. 353 (S.D.N.Y. 1992) (same).

Finally, there has been at least one recent case where a fully licensed mortgage broker was unable to meet its obligations, defaulting on its own checks. See "New York State Banking Department Suspends Mortgage Banker's License," Press Release issued July 5, 2000 by NYS Banking Department, available at (visited 12/5/00).

Second, it is doubtless correct that bank checks and certified checks are ordinarily accepted as a proper tender of payment in business transactions and it is therefore argued to be unreasonable to hold an attorney to a higher standard in the administration of his escrow account. The commercial reasonableness of the practice, however, does not fairly address the situation where one client's funds are being used to cover the checks issued on behalf of another client. If a commercial party chooses to accept the minimal risk of loss associated with the acceptance of a bank check or certified check, that same party will bear any loss that actually comes to pass. However, if Client A's funds are used to cover the checks written by an attorney for the benefit of Client B, and the bank or certified check deposited after the checks are issued to cover Client B's obligations is for whatever reason unpaid, it is Client A, a stranger to the transaction, not Client B, a party to the transaction, who will suffer the loss.

Third, it may indeed be true that in most cases it is incidental closing expenses that will be paid if the subject practice is allowed and that, therefore, any loss, already a remote possibility, will likely be in a nominal amount. In the same vein, it is argued that

prohibiting the practice will engender delay and inconvenience and may adversely affect the economy.

Whether or not these are accurate statements of the risk and the peril seems, however, beside the point. If a client's funds may not be invaded for the benefit of another, the principle must hold no matter what the size or extent of the planned invasion and no matter what may be the detriment to third parties of withholding the use of that client's funds.

Fourth, the practice of writing escrow checks at a closing drawn on the funds of other clients and against undeposited or uncleared bank or certified checks, if prohibited as unethical, can be argued to have a greater adverse impact upon persons of moderate or low income. This is because, where the price of real estate in a given community is lower, the legal fees associated with the closings are often lower as well. There is more pressure upon attorneys who practice in these communities to generate fees on a volume basis and less time may be spent in preparing for closings generally with a view toward "working out" what title and other problems exist at that time. It is these attorneys who may be compelled to raise their fees in order to carry on their residential real estate practices if more pre-closing preparation time is required to satisfy ethical obligations. Alternatively, if additional pre-closing preparation time is eschewed in favor of an occasional adjournment of a closing in order to allow the seller additional time to clear an unexpected title objection or to allow the purchaser additional time to obtain a bank or certified check in a previously uncalculated or uncommunicated pay-off amount, this is still likely to result in additional cost to the parties, as the purchaser's lender will often charge a fee to adjourn a closing and the lender itself will often charge a fee to extend a loan commitment.

Although the Committee is sympathetic to the concerns of all parties to a residential real estate transaction who quite understandably would prefer to avoid the increased legal fees or costs that might be associated with an adjournment of a closing,

these considerations are insufficient to overcome the fiduciary obligation that an attorney owes to the attorney's other clients whose funds must not be invaded.

Fifth, it has been suggested that Client A, by allowing his funds to be deposited in an unsegregated attorney escrow account has implicitly consented to the possibility that those funds might be drawn upon in behalf of a Client B, including the small risk that a bank or certified check deposited into the escrow account for the benefit of Client B might be dishonored. The implied consent is said to arise from knowledge of the widespread practice of attorneys writing escrow checks against undeposited or uncleared bank or certified checks. Far from assuming Client A's consent to the practice, this Committee would assume the very opposite — that Client A, if asked, would vigorously object to putting his funds at risk and granting a no-interest loan for the benefit of Client B with whom Client A shares neither a social nor a business bond.

Nor can we ascertain any conditions or qualifications to the issuance of attorney escrow checks against undeposited or uncleared bank or certified checks that might ethically purify the practice. For example, the practice has been found acceptable provided, among other things, that the attorney immediately makes good any loss. See N.C. Eth. Op. RPC 191 (1997). But if the attorney is personally willing to take the risk that the checks will not clear, we see no reason why the attorney should not simply advance the disbursements necessary to effect the closing out of his own operating account and await a refund from his escrow account if and when the bank or certified check clears. From a practical as well as a fiduciary perspective, it is far more appropriate for the attorney for both Client A and Client B to make a temporary, no-interest loan to Client A than it is for Client B to make such loan. The attorney has knowledge of the facts and circumstances pertaining to the closing and can evaluate the degree of risk associated with acceptance of the proffered bank or certified check. Client B, on the other hand, neither knows or controls anything

and has consented to nothing.

Finally, we note that our conclusion appears to be in seeming conformance with several recent disciplinary determinations of the Appellate Division, Second Department, and we are unaware of any determinations of the First, Third or Fourth Departments which suggest a contrary result. See *Matter of Abbatine*, 263 A.D.2d 228, 700 N.Y.S.2d 211 (2d Dept. 1999) (five year suspension ordered for attorney who, inter alia, issued escrow check for \$4,147.18 from unsegregated escrow account against \$10,000 deposit made 16 days later); *Matter of Ferguson*, 259 A.D.2d 186, 694 N.Y.S.2d 113 (2d Dept. 1999) (one year suspension ordered for attorney who, inter alia, issued escrow check against "wired" funds not yet received); and *Matter of Joyce*, 236 A.D.2d 116, 119, 665 N.Y.S.2d 430, 431 (2d Dept. 1997) (indefinite suspension ordered for attorney who, inter alia, "[o]n at least four occasions...issued checks from his escrow account for a particular transaction in advance of depositing the subject funds into his escrow account, causing checks to clear against the funds of other clients or third parties").

CONCLUSION

The Committee welcomes further study of the problem addressed in this opinion with a view toward devising solutions that adhere to ethical requirements. However, for the reasons stated, the question is answered in the negative.
(22-00)

Opinion 758 – 12/10/02

Topic: Retention of Original Trust Account Documents

Modifies: N.Y. State 680 (1996) Digest: Trust account documents required to be retained in original form should be retained as paper copies where available to lawyer in the ordinary course of business; otherwise, these documents may be retained in electronic form.

Code: DR 9-102(D)

QUESTION

May the items listed in DR 9-102(D)(8) – "checkbooks and check stubs, bank statements, prenumbered canceled checks and duplicate deposit slips" – be retained by the attorney in electronic form (rather than in the form of paper copies) for the designated seven-year period?

OPINION

N.Y. State 680 (1996) makes clear that the items referred to in DR 9-102(D)(8) must be retained in their original form; the items listed are "checkbooks and check stubs, bank statements, prenumbered canceled checks and duplicate deposit slips." Opinion 680, which was issued in 1996, assumes that the original form of the enumerated records will be paper hard copies and that the attorney will be in possession of the cancelled checks and deposit slips. Under modern bookkeeping and banking practices, neither of those assumptions is necessarily correct. The checkbook and bank statement may exist as electronic documents in the first instance; paper checks may be replaced by electronic transfers; even if paper checks are used, they may not be returned to the lawyer by the drawee bank after payment – instead, the bank may provide the lawyer with images of the checks or with a mere descriptive listing of checks paid.

In these circumstances, we interpret DR 9-102(D)(8) to require the lawyer to retain the listed items in their original form, be it paper or electronic. If these items are returned to the lawyer in paper form by the lawyer's bank in the ordinary course of business, the lawyer should retain them in that form.

However, the lawyer is not required to undertake extraordinary effort or incur extra expense to obtain these items in paper form.

CONCLUSION

The items listed in DR 9-102(D)(8) – "checkbooks and check stubs, bank statements, prenumbered canceled checks and duplicate deposit slips" – should be retained by the attorney in their original form. Where these items are returned to the lawyer in paper form by the lawyer's bank in the ordinary course of business, the lawyer should retain them in that form.

However, the lawyer is not required to undertake extraordinary effort or incur extra expense to obtain these items in paper form.

(24-02)

Opinion 759 – 12/10/02

Topic: Deposits into special accounts

Digest: Lawyer may use ATM for making deposits into special account.

Code: DR 9-102

QUESTION

May an attorney use an automated teller machine ("ATM") for the purpose of making deposits into a special account required by DR 9-102(B)?

OPINION

DR 9-102 contains several provisions regarding the safekeeping of client property, including the rules on maintenance of client trust accounts and the maintenance of required bookkeeping records.

The many demands of DR 9-102 are designed to safeguard clients' funds from loss and to avoid the appearance of impropriety by the lawyer. The rules also assist the lawyer in providing an audit trail to the client documenting the history and status of the funds entrusted to the attorney's care. A discussion of the aspects of DR 9-102 that are relevant to this inquiry follows.

A lawyer possessing funds belonging to another person incident to the practice of law must maintain them "in a banking institution within the State of New York which agrees to provide dishonored check reports" in accordance with rules of the Appellate Division. DR 9-102(B). The funds must be maintained in a "special account" separate from any business or personal accounts of the lawyer or the lawyer's firm. *Id.* The lawyer must identify the special account as an "Attorney Special Account," "Attorney Trust Account," or "Attorney Escrow Account," and must obtain checks and deposit slips bearing such title. DR 9-102(B)(2).

DR 9-102 also imposes rigorous record keeping requirements. DR 9-102(C)(3) requires the lawyer to maintain complete records of all funds of a client or third person coming into her possession and to render accounts to the client or third person regarding same. DR 9-102(D)(1) requires a lawyer to maintain the records of all deposits in trust accounts and "any other bank account which concerns or affects the lawyer's practice of law." See N.Y. State 680 (1996). The record must "specifically identify the date, source and description of each item deposited." DR 9-102(D)(1). The lawyer must also maintain a record for all special accounts showing, among other things, the source of all funds deposited in such accounts. The lawyer must also retain a copy of all "duplicate deposit slips with respect to the special accounts specified in DR 9-102(B)." DR 9-102(D)(8). The latter three requirements, imposed by DR 9-102(D), provide that the lawyer must maintain the records for seven years after the events they record. All of the financial records required by DR 9-102 must be made available for inspection on demand at the firm's principal New York State office. DR 9-102(I); see also 22 NYCRR § 603.15 (1st Dep't), 22 NYCRR § 691.12 (2d Dep't) (establishing procedures for random review of bookkeeping records). DR 9-102(J) emphasizes that a lawyer who fails to retain the records required by DR 9-102, or who fails to produce the records, "shall be deemed in violation of these Rules and shall be subject to disciplinary proceedings."

In N.Y. State 680 (1996), we concluded that, for purposes of complying with the mandatory record-retention provisions of the Code, some records may be maintained in the form of computer images, while other records must be maintained in their original, hard-copy form. In that regard, we concluded that duplicate deposit slips must be maintained in paper form for the seven-year period.

In addition, all of the other records noted in the previous paragraph must be maintained in their original form. See also N.Y. State 758 (2002).

We believe that it is permissible for an attorney to use an ATM for the purpose of making deposits into a special account, provided the above requirements are satisfied. Therefore, in making the deposit, the attorney must use a deposit slip bearing the title of the special account and must maintain a copy of a duplicate deposit slip recording such transaction for seven years.

The record provided by the ATM must also show the amount, account, date, time and place of the transaction so the attorney will have sufficient proof of the deposit prior to receiving official verification from the bank. This record must be maintained with the duplicate deposit slip. The attorney must also verify that the deposit is accurately recorded in the subsequent bank statement.

The attorney must also maintain an independent record of the deposit that includes the "date, source and description of each item deposited." DR 9-102(D)(1).

Although we could find no case in New York addressing a lawyer's use of an ATM in conjunction with a special account, authorities in other jurisdictions have condoned its use if accompanied by careful oversight and review of the transaction. See *Matter of Heiner*, 1 Cal. State Bar Ct. Rptr. 301, 316-317 (Cal. Bar Ct. 1990); see also Vapneck, Tuft, Peck and Weiner, California Practice Guide, Professional Responsibility, p. 9:246-247 (2001) (use of ATM card for deposits only does not pose real danger to client trust funds,

provided lawyer can document amount deposited on behalf of each client); Vecchione, Working with Client's Trust Accounts, www.state.ma.us/obcbbo/ctatips.htm (use of ATM for deposits is permitted, but ATM should never be used for withdrawals).

While we believe that a lawyer depositing funds in a special account via an ATM can comply with the requirements of DR 9-102, a lawyer may not use an ATM for withdrawals from a special account. Doing so would, in effect, violate the dictates of DR 9-102(E), which provides that "[a]ll special account withdrawals shall be made only to a named payee and not to cash."

CONCLUSION

An attorney may use an ATM for the purpose of making deposits into a special account if the attorney carefully reviews the transaction and otherwise complies with the requirements of DR 9-102.
(27-02)

Opinion 760 – 1/27/03

Topic: Retainer agreement – power of attorney; Lawyer settling matter under power of attorney; Lawyer endorsing settlement check on behalf of client under power of attorney.

Digest: A lawyer may obtain or use a revocable power of attorney, either in a stand-alone document or as part of the lawyer's retainer agreement, that authorizes the lawyer to settle a case and to endorse the client's name to the settlement check, provided that the lawyer makes full disclosure as to the effect of such power of attorney and provided that (i) the lawyer may only settle a case on terms indicated in advance by the client or if the settlement is submitted to the client for approval, and (ii) a lawyer who endorses a settlement check on behalf of the client must promptly comply with the notice,

record keeping and disbursement requirements of DR 9-102.

Code: DR 1-102(A)(1), (4), (5), (6); DR 9-102(B)(4), (C), (C)(1), (D); EC 7-7.

QUESTION

May a lawyer's retainer agreement contain a power of attorney authorizing the lawyer to sign a general release and stipulation of discontinuance for the client upon settling the case, or to endorse a settlement check on behalf of the client? May an attorney use a power of attorney executed separately by the client in favor of the lawyer to sign a settlement agreement or to endorse a settlement check made out jointly to the lawyer and the client or solely to the client?

OPINION

The Code of Professional Responsibility ("Code") does not expressly prohibit a lawyer from obtaining or using a power of attorney from the client authorizing the lawyer to perform a variety of acts on behalf of the client. Indeed, the relationship between attorney and client is generally considered to be an agency relationship in which the client gives the lawyer authority to act on his or her behalf in connection with the representation.

Moreover, there are good reasons why a client might wish to give a general or specific power of attorney to the lawyer. See, e.g., N.Y. State 746 (2001) (lawyer with a durable power-of-attorney should not petition for the appointment of a guardian without the client's consent if the client becomes incompetent unless there is no practical alternative, through the use of the power of attorney or otherwise, to protect the client's best interests).

However, without the client's informed consent the lawyer should never use a stand-alone power of attorney or a power of attorney contained in a retainer agreement to exercise rights or prerogatives reserved to the client under the Code or substantive law.

Authority to Agree to Settlement

Even without a power of attorney, a lawyer is authorized to make many decisions on behalf of the client. For example, the lawyer generally is entitled to make decisions in certain areas of legal representation not affecting the merits of the cause or substantially prejudicing the right of the client. EC 7-7. In civil cases, however, it is for the client to decide whether to accept a settlement offer. EC 7-7; American Law Institute, Restatement (Third) of the Law Governing Lawyers (hereinafter, "Restatement"), § 22, comment d (A lawyer may not make a settlement without the client's authorization. A lawyer who does so may be liable to the client or the opposing party and is subject to discipline.) Nevertheless, a client may authorize the lawyer to negotiate a settlement that is subject to the client's approval or to settle a matter on terms indicated by the client. Restatement, § 22, Comment c. A retainer agreement is generally signed before the commencement of the representation or within a reasonable time thereafter, before the lawyer has had an opportunity to ascertain the facts of the case and the willingness of the parties to settle. See, e.g., 22 NYCRR Part 1215 (Joint Order of Appellate Divisions establishing requirement to provide written letter of engagement or obtain retainer agreement). Consequently, it is unlikely that at the time of entering into the retainer agreement the lawyer would have been able to make the disclosures necessary to validate using the settlement authority.

Therefore, if the lawyer obtains a general power of attorney in advance of the settlement, the lawyer should not use the power to settle the matter without obtaining more explicit instructions from the client after the lawyer and the client have discussed the merits of the case, the client's willingness to settle and the settlement terms that are acceptable to the client. Court rules may require a lawyer to appear at a settlement conference with the authority to settle a matter. See, e.g., 22 NYCRR 202.19(b)(3) (Uniform Rules - Trial Courts; compliance conference to explore potential settlement); NYCRR 202.16(f)(2)(iii) and (3)

(matrimonial matters); 22 NYCRR 600.17(e)(1st Dep't), 22 NYCRR 670.4(a)(2d Dep't) and 22 NYCRR 800.24-b (3d Dept) (all civil matters); Federal Rules of Civil Procedure 16(a) ("At least one of the attorneys for each party participating in any conference before trial shall have authority to enter into stipulations and to make admissions regarding all matters that the participants may reasonably anticipate may be discussed. If appropriate, the court may require that a party or its representative be present or reasonably available by telephone in order to consider possible settlement of the dispute.") While the lawyer may comply with such rules by appearing with the client, the lawyer may also comply by obtaining express settlement authorization from the client.

We see nothing unethical about the lawyer obtaining such authorization in advance.

We believe, however, that it would be inconsistent with the Code for the lawyer to use such settlement authorization without obtaining explicit instructions from the client after the lawyer and the client have discussed the merits of the case, the client's willingness to settle and the settlement terms that are acceptable to the client.

Any power of attorney granted to the lawyer for settlement purposes, whether general or specific, must be revocable. See *Hayes v. Eagle-Picher Indus., Inc.* 513 F.2d 892 (10th Cir. 1975); cf. Model Rule 1.2, comment 5: An agreement concerning the scope of representation must accord with the Rules of Professional Conduct and other law. Thus, the client may not be asked ... to surrender the right ... to settle litigation that the lawyer might wish to continue.

See also Restatement, § 22(3) ("Regardless of any contrary contract with a lawyer, a client may revoke a lawyer's authority to make the decisions described in Subsection (1) [including whether and on what terms to settle a claim]"); Restatement, § 22, comment d (A lawyer may not enter into an irrevocable contract that the lawyer will decide on the terms of settlement. A contract that the lawyer

as well as the client must approve any settlement is also invalid.)

Settlement Checks

It is not per se unethical for a lawyer to obtain a power of attorney that would authorize the lawyer to sign a settlement check on behalf of a client. Indeed, it will usually be convenient in contingent fee matters for the proceeds of a settlement check to be deposited into the lawyer's trust account for further disposition and accounting. See, e.g., *Rohrbacher v. BancOhio Nat'l Bank*, 171 A.D. 2d 533, 567 N.Y.S.2d 431 (1st Dep't 1991) (retainer agreement stated "We hereby authorize you to endorse my name on any check or draft obtained herein, if said check or draft is deposited to your escrow-trust account pending distribution of the proceeds pursuant to the terms of this retainer").

Nevertheless, neither a general power of attorney in favor of the lawyer nor a specific power of attorney authorizing the lawyer to sign settlement checks on behalf of the client would override the provisions of the Code that apply to client money in the possession of the lawyer. In particular, DR 9-102(B)(4) provides that all funds belonging in part to the client – which would include the proceeds of a settlement or judgment where the lawyer claims part of the proceeds as a fee or for reimbursement of expenses -- must be deposited in the lawyer's attorney trust account, and the lawyer may not withdraw the part that the lawyer claims to the extent that the client disputes the lawyer's entitlement thereto: Funds belonging in part to a client or third person and in part presently or potentially to the lawyer or law firm shall be kept in such special account or accounts [the attorney trust account], 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 or third person, in which event the disputed portion shall not be withdrawn until the dispute is finally resolved.

Moreover, under DR 9-102(C) the lawyer must promptly notify the client of the receipt of funds in

which the client has an interest and, under DR 9-102(D), the lawyer must properly account for all such funds.

We note that the Appellate Division, Second Department has upheld a disciplinary action against an attorney for using an irrevocable power of attorney in a personal injury action to authorize him to endorse a settlement check. In *re Stanley S. Hansen*, 108 A.D.2d 206, 488 N.Y.S.2d 742 (2d Dep't 1985). The respondent in that case had received a letter of admonition that the routine inclusion of an unconditional power of attorney in his retainer agreements in no-fault collection cases "represented over-reaching and created a dangerous possibility of abuse."

We do not read this case as prohibiting any use of a power of attorney to authorize a lawyer to endorse the client's name on a settlement check. Rather, we believe the court was objecting to the irrevocable nature of the power of attorney used by the respondent: Notwithstanding the fact that he may (as the Special Referee found) have intended to delete the word "irrevocably" therefrom, there is nothing in the record which would even tend to support his decision to procure an unconditional power of attorney from the client in the first instance.

We are not aware of any cases in New York holding that a revocable power of attorney authorizing a lawyer to sign a settlement check would be per se unethical.

We note that it is a common practice in certain lawsuits – for example, where the defendant's potential liability is the subject of an insurance policy – for the check paying a judgment or settlement to be made out to both the plaintiff and his or her lawyer. This is particularly true in personal injury actions, where plaintiff's counsel may be charging a contingent fee and may have a lien on the proceeds. As the Second Circuit Court of Appeals noted in *Haft v. Farkas*, 498 F.2d 587 (2d Cir. 1974), drawing a settlement check in the names of both the plaintiff and his or her attorney is a way for the debtor to ensure that both the creditor

and his or her lawyer are made aware of the satisfaction. *Id.* at 590.

The regulations of the New York State Insurance Department do not mandate that settlement checks be made out to both the plaintiff and his or her attorney. However, Regulation 64 of the Insurance Department provides that, when an insurer is paying \$5,000 or more in settlement of a third-party liability claim to a natural person, it must mail written notice to the claimant at the same time payment is made to the claimant's attorney or other representative. 11 NYCRR §216.9(a). According to an interpretation issued by the office of the General Counsel of the Insurance Department, this provision, which was adopted in 1988, was added to the Insurance Department's Rules at the request of the Clients' Security Fund (now the Lawyers' Fund for Client Protection), which saw it as a necessary response to documented instances of theft where an attorney would forge a client's endorsement on a check and pocket the proceeds. See N.Y. Department of Insurance, NY General Counsel Opinion 4-1-2002, available on the Insurance Department's website at <http://www.ins.state.ny.us/rg204011.htm> (last visited January 8, 2003). Thus, the regulations of the Insurance Department are consistent with DR 9-102. We do not believe that the existence of the Insurance Department regulation obviates the need for the lawyer to give the notice required by DR 9-102(c).

For all these reasons, we believe that it is not per se unethical for an attorney to seek such a power of attorney. If the lawyer uses this authority promptly to cash the check and to deposit the proceeds in the lawyer's trust account, and (i) promptly notifies the client of the receipt of the funds in accordance with DR 9-102(C)(1), (ii) maintains complete records of such funds in accordance with DR 9-102(D), including the deposit and disbursement thereof, and (iii) promptly pays to the client as requested any funds the client is entitled to receive, then no violation of the Code would have occurred. See also Wolfram, *Modern Legal Ethics*, Section 4.8, footnote 21 (The need to renegotiate the instrument promptly in order to protect against non-payment

argues for obtaining the client's signed permission to sign the client's name to the check as designated endorsee.)

Prompt deposit of the endorsed check into a trust account fully complies with the safekeeping requirements of DR 9-102. If, on the other hand, the lawyer uses the power of attorney to endorse the client's name on the check and does not promptly notify the client and otherwise comply with DR 9-102, then the lawyer will have violated not only DR 9-102, but also DR 1-102(A)(1) (lawyer shall not violate a disciplinary rule), DR 1-102(A)(4) (lawyer shall not engage in conduct involving deceit), DR 1-102(A)(5) (conduct prejudicial to the administration of justice), and DR 1-102(A)(7) (conduct that adversely reflects on fitness to practice law). The lawyer will therefore be subject to discipline and possibly a law suit for conversion of the client's funds. See, e.g., *In re Theodore L. Malatesta*, 124 A.D.2d 62, 511 N.Y.S.2d 246 (1st Dep't 1987). Malatesta involved an attorney who converted the proceeds of a settlement check by signing a settlement check made out to the attorney and client. The lawyer argued that he was authorized to do so based on a handwritten notation on the retainer agreement which stated "[subject to] full authority to settle, sign release and endorse check." Although the court found that the client had not added the language to the retainer agreement, it concluded that, even if the language had been agreed to by the client, it did not excuse the lawyer's conversion of the funds.

CONCLUSION

A lawyer may obtain and use a revocable power of attorney, either in a stand-alone document or as part of the lawyer's retainer agreement, that authorizes the lawyer to settle a case and to endorse the client's name to the settlement check, provided that the lawyer makes full disclosure as to the effect of such power of attorney and provided that (i) the lawyer may only settle a case on terms indicated in advance by the client or if the settlement is submitted to the client for approval, and (ii) a lawyer who endorses a settlement check on behalf of the client must promptly comply with the notice,

record keeping and disbursement requirements of DR 9-102.

(25-02)

Opinion 764 – 7/22/03

Topic: Escrow funds; fee agreements; conflicts of interest; Interest on Lawyer Account (IOLA).

Digest: Lawyer may only accept IOLA account earnings credit with consent of client after full disclosure

Code: DR 2-106(A), 5-101(A), 5-107(A)(2), 7-101(A)(3), 9-102(A); EC 2-21

QUESTION

May an attorney accept an earnings credit against bank charges based upon balances held in the attorney's IOLA account?

OPINION

A bank is developing a package of banking products designed specifically for attorneys that will include an "earnings credit" based on balances held in an attorney's operating accounts. Subject to this committee's approval, the earnings credit will also be given with respect to balances maintained in an attorney's IOLA account, but not with respect to non-IOLA attorney trust accounts. The earnings credit would only be applied to reduce or eliminate monthly bank fees otherwise chargeable to the attorney, and would not result in a cash payment or bank credit over and above the monthly bank fees.

Because the bank would, in addition, waive the monthly maintenance fee associated with the IOLA account, the IOLA Fund would receive more money from IOLA accounts maintained by attorneys who have accepted the earnings credits than from other IOLA accounts.

IOLA accounts are unsegregated interest-bearing transaction accounts with check writing privileges.

The interest on IOLA accounts is used to help finance legal services for the poor. The current IOLA interest rate paid by the bank state wide is .35 percent per annum. Pursuant to New York Judiciary Law §497(4)(c)(i) and (ii), "qualified funds" that are not deposited in an unsegregated IOLA account must be deposited in a segregated interest-bearing attorney trust account for the client's benefit, or in an unsegregated interest-bearing attorney trust account provided the bank or the depositing lawyer can separately compute and pay to each client the interest earned by such client's funds.

"Qualified funds" are defined by Judiciary Law §497(2) as: moneys received by an attorney in a fiduciary capacity from a client or beneficial owner and which, in the judgment of the attorney, are too small in amount or are reasonably expected to be held for too short a time to generate sufficient interest income to justify the expense of administering a segregated account for the benefit of the client or beneficial owner. In determining whether funds are qualified for deposit in an IOLA account, an attorney may use as a guide the regulation adopted by the board of trustees of the IOLA fund pursuant to subdivision four of section ninety-seven-v of the state finance law.

The qualified funds determination "guideline" authorized by § 497(2) is found at 21 NYCRR §7000.10, and provides that where the deposit is not expected to "generate at least \$150 in interest or such larger sum as the attorney or law firm in the exercise of his professional judgment deems may be equivalent to the cost of administering a separate account," the attorney "may choose to place these funds in a pooled IOLA account." The guideline thus reaffirms, in the context of a \$150 "safe harbor," the broad IOLA deposit standard of New York Judiciary Law §497(4)(b), which states:

The decision as to whether funds are nominal in amount or expected to be held for a short period of time rests exclusively in the sound judgment of the lawyer or law firm. Ordinarily, in determining the type of account into which to deposit particular

funds held for a client, a lawyer shall take into consideration the following factors:

- (i) the amount of interest the funds would earn during the period they are expected to be deposited;
- (ii) the cost of establishing and administering the account, including the cost of the lawyer or law firm's services;
- (iii) the capability of the banking institution, through subaccounting, to calculate and pay interest earned by each client's funds, net of any transaction costs, to the individual client.

Judiciary Law §497 also limits a lawyer's exposure to damages or professional misconduct charges arising out of his or her decision to deposit client funds into an IOLA account to "bad faith" claims. Subdivision (5) of the statute states: "No attorney or law firm shall be liable in damages nor held to answer for a charge of professional misconduct because of a deposit of moneys to an IOLA account pursuant to a judgment in good faith that such moneys were qualified funds."

Most segregated interest-bearing attorney trust accounts maintained by the bank are savings accounts. When funds from the attorney trust account need to be disbursed, a transfer is made to the IOLA account from which checks are then drawn. In the metropolitan region, the interest paid by the bank on such savings accounts is currently .65 percent interest per annum. The upstate interest rate is currently .50 percent per annum.

The earnings credit factor to be employed by the bank is progressive. In the metropolitan region, if the aggregate amount of the qualifying account balances, including an IOLA account, were \$5,000 or less, there would be no earnings credit. If the amount were between \$5,000 and \$50,000, there would be a credit of .9 percent annually. For aggregate balances above \$50,000, the credit would be 1.0 percent annually. The regime would be the same upstate, except \$2,500, not \$5,000, would represent the breakpoint between an earnings credit of zero and an earnings credit of .9 percent.

There are a number of ethical concerns which touch upon the question presented, some of which have been brought to our attention by the inquirer. Each concern arises from the same basic dynamic – namely, the statute and regulations governing IOLA accounts give an attorney considerable discretion in determining whether to deposit client funds into an account that pays interest to the client or into an account that pays interest to the IOLA Fund, and where the anticipated interest would be less than \$150, such discretion is arguably beyond all review.

Whether or not the IOLA Fund benefits from the bank's proposed special program for attorneys, both the bank and the attorney would benefit whenever an attorney exercised his or her discretion in favor of a deposit into an IOLA account. The bank would benefit from paying a lower interest rate and, more importantly, the lawyer would benefit from paying lower monthly bank charges.

Notwithstanding, this arrangement would not, in our opinion, run afoul of the prohibition against charging or collecting "an illegal or excessive fee" set forth in DR 2-106(A), as the earnings credit is not a client generated "fee." Similarly, the bar of DR 9-102(A) against misappropriation of client "funds" or client "property" does not apply, as the proposed earnings credit is neither. In this respect, our prior opinions in N.Y. State 532 (1981) (a lawyer may not seek or accept interest earned on funds held in an escrow account as compensation for serving as an escrow agent), N.Y. State 582 (1987) (a lawyer may not retain interest earned on a settlement check deposited into an escrow account from the date of deposit until the date of check clearance), and N.Y. State 570 (1985) (a lawyer may not retain interest earned on an advance fee where the lawyer and client have agreed to treat the advance fee as client property), which the inquirer seeks to distinguish, are largely irrelevant.

Nor do we believe it is necessary to decide whether the determination to deposit client funds in an unsegregated IOLA account or in a segregated attorney trust account (i) is or is not "the exercise of professional judgment" within the meaning of DR

5-101(A), thereby implicating a potential financial conflict of interest, or (ii) might "prejudice or damage the client" within the meaning of DR 7-101(A)(3).

Rather, the disposition of this inquiry is clearly governed by DR 5-107(A)(2) and EC 2-21. DR 5-107(A)(2) provides: "Except with the consent of the client after full disclosure a lawyer shall not: Accept from one other than the client anything of value related to his or her representation of or employment by the client." EC 2-21 provides: "A lawyer shall not accept compensation or anything of value incident to the lawyer's employment or services from one other than the client without the knowledge and consent of the client after full disclosure."

In N.Y. State 320 (1973), we opined that, absent disclosure and client consent, an attorney could not retain the discount received from title companies without crediting his or her client the amount of the discount. In N.Y. State 461 (1977), we opined that the acceptance of a portion of the commission obtained by a fire adjuster in connection with the loss sustained by the lawyer's client would not be unethical "provided the client, with full knowledge of the facts, has consented to the arrangement and all proceeds secured therefrom by the lawyer are credited or otherwise disbursed to the client." In N.Y. State 576 (1986) (which opinion amplified N.Y. State 351 [1974]), we opined that absent express consent to the contrary, a real estate attorney also acting as title insurance agent must reduce the client's legal fee by the amount of remuneration from such title company. In N.Y. State 667 (1994), we reached the same conclusion with regard to requiring disclosure and client consent before an attorney could accept a referral fee from a mortgage broker; however, we there stated that the attorney was not required to remit the referral fee to the client if the client consented to its retention by the attorney. Each of these opinions rested upon the authority of DR 5-107(A)(2), and two of them (N.Y. State 461 and 667) cited EC 2-21.

As the trust funds to be deposited by the attorney into an attorney trust account (IOLA or non-IOLA) will only come into the attorney's hands as a consequence of the representation of a client, and as the proposed earnings credit would reduce or eliminate monthly bank charges that would otherwise be debited from the attorney's accounts, there is clearly something "of value" that is being offered to the attorney by "one other than the client" which is "related to his or her representation of or employment by the client." That the earnings credit will not influence his or her conduct with regard to the negotiation of a transaction or the prosecution or defense of a claim for which the lawyer was retained does not, in our view, take the matter outside the sweeping purview of DR 5-107(A)(2). For example, if an attorney maintains an average monthly IOLA balance in excess of \$50,000, the bank will credit him or her at least \$500 in reduction of bank fees for the year, not an insignificant or de minimus sum. Such an earnings credit may well influence the attorney's decision as to where client trust funds should be deposited, and that decision would have a direct decision as to where client trust funds should be deposited, and that decision would have a direct and adverse financial impact upon the client if an IOLA account is chosen.

We do not, however, see the proposed earnings credit on IOLA accounts as presenting "so great a danger of unfairness, deception, overreaching and conflict of interest, or the appearance thereof" as to warrant a per se prohibition. Compare N.Y. State 532 (1981) ("While we interpret the Code as requiring a per se prohibition against retaining interest earned on escrowed funds in the circumstances stated [lawyer representing client and also serving as escrow agent in real estate transaction], we recognize a possible distinction where interest is paid on a special account in which a lawyer deposits [certain] non-escrow client funds..."). Therefore, as contemplated by DR 5-107(A), provided the client has consented to the arrangement after full disclosure, an attorney may accept an earnings credit against bank charges based upon balances held in the attorney's IOLA account.

CONCLUSION

An attorney may only accept an earnings credit against bank charges based upon balances held in the attorney's IOLA account with the consent of the client after full disclosure.

(26-03)

Opinion 816 (10/26/07)

Topic: Advance payment retainer; client trust account.

Digest: A lawyer may ethically accept an advance payment retainer, place such funds in the lawyer's own account, and retain any interest earned. The Lawyer may require the client to forward an advance payment retainer to pay for final fees that accrue at the end of the relationship.

Rules: DR 2-106(C), DR 2-110(A); DR 9-102(A), (C).

QUESTIONS

1. May a lawyer ethically accept an advance payment retainer and place such funds in the lawyer's own account while retaining any interest earned from such amount?
2. If so, may a lawyer request the client to forward an advance payment retainer to pay for final fees that accrue at the very end of the relationship, with interim fees billed out as they are performed?

OPINION

3. Recently, we have received inquiries regarding the continued validity of our opinion in N.Y. State 570 (1985), which addressed the ethical propriety of what is commonly known as an advance payment retainer. An advance payment retainer is a sum provided by the client to the lawyer to cover payment of legal fees expected to be earned during the representation. To the extent the fees advanced

are not earned during the representation, the lawyer agrees to return them to the client.

This form of retainer should be distinguished from a general retainer, which is a sum paid to the lawyer for being available to the client. A general retainer is earned upon receipt.[1] The recent inquiries regarding advance payment retainers may stem from the fact that since we issued Opinion 570 in 1985, there have been several significant developments on the subject of retainer agreements and the language in DR 9-102 has been substantially amended. Therefore, it is now appropriate to revisit the principles stated in N.Y. State 570.

4. In N.Y. State 570 we concluded that fees paid to a lawyer in advance of services rendered are not necessarily client funds and need not be deposited in a client trust account. Therefore, any interest earned on these fee advances may be retained by the lawyer. The opinion cautioned, however, that the lawyer is obliged to return any portion of the fee advance that is not earned during the representation.[2]

5. If the parties agree to treat advance payment of fees as the lawyer's own, the lawyer may not deposit the fee advances in a client trust account, as this would constitute impermissible commingling.[3] "On the other hand, the lawyer may agree to treat advance payment of legal fees as client funds and deposit them in a client trust account; in that event any interest earned on the funds while in the client trust account must be remitted to the client." [4]

6. Since 1985, we have cited N.Y. State 570 on several occasions.[5] N.Y. State 570 has also been cited with approval by the Appellate Division, Fourth Department and the New York City Bar ethics committee.[6] The validity of such an advance payment retainer has also been recently recognized by the Supreme Court of Illinois.[7]

7. In opinion 570, we noted that "it appears that the drafters of the Code of Professional Responsibility did not consider advance payments of fees to be

client funds necessitating their deposit in a trust account." Although DR 9-102 has been substantially amended since 1985, the deposit in a trust account." Although DR 9-102 has been substantially amended since 1985, the changes do not affect the reasoning of that opinion. DR 2-110(A)(3) requires a lawyer who withdraws from representing a client to "refund promptly any part of a fee paid in advance that has not been earned." As we observed in Opinion 570, this provision does not require that the advance be deposited in a client trust account until earned. This conclusion is supported by the language in DR 2-110(A), which still separately classifies fee advances and client property. DR 2-110(A)(2) requires a lawyer planning to withdraw from representing a client to "deliver to the client all papers and property to which the client is entitled" while DR 2-110(A)(3) separately provides for the refund of any unearned "fee paid in advance." In sum, the standards delineated in N.Y. State 570 for advance payment retainers are still valid today.

8. We note that advance payment retainer agreements, like any other fee agreement between a lawyer and client, must be "fair, reasonable, and fully know and understood by the client." [8] These agreements must also comply with other relevant provisions of the Code. In this respect, we construe DR 9-102 to require the lawyer to maintain complete records of any advance payment retainer received and to render appropriate account to the client regarding the retainer. [9] Although the advance payment retainer is not client property, the client retains an interest in that portion of the retainer that is not yet earned by the lawyer. Furthermore, at the conclusion of the representation the lawyer must promptly return any portion of the advance payment retainer that is not earned.[10]

Finally, it would be inappropriate for a lawyer to negotiate a nonrefundable advance payment retainer with the client.[11]

9. An advance payment retainer will obviously benefit the lawyer by helping to ensure that he or she will be paid for services rendered, at least to the extent of the advance. This form of arrangement

can also benefit the client, who may wish to hire counsel to defend the client from judgment creditors. If the lawyer deposited such a retainer in a client trust account, 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. [12]

Therefore, it is imperative for a lawyer at the outset of the representation to discuss the advantages and disadvantages of advance payment retainers and to reach an agreement about the treatment of any such advances. These agreements should be confirmed in writing in the engagement letter where one is required. [13]

10. We also conclude that an attorney may request an advance payment retainer for final fees that accrue at the very end of the relationship, with interim fees billed out as they are performed. While such an arrangement is permissible, it must comply with the standards outlined in Jacobson and our prior opinions. If the advance payment retainer is intended to be payable only once specific services use performed, it must describe the services that it is intended to cover. If the services outlined in the agreement are not provided, that portion of the advance payment retainer must be promptly returned to the client. [14]

CONCLUSION

11. A lawyer may ethically accept an advance payment retainer and need not place such funds in a client trust account. If the advance payment retainer is placed in the lawyer's account, the lawyer may retain any interest earned from such amount. A lawyer may request an advance payment retainer for final fees that accrue at the very end of the relationship.

(14-07)

[1] See N.Y. State 570 n. 1.

[2] See DR 2-110(A)(3) ("A lawyer who withdraws from employment shall refund promptly any part of a fee paid in advance that has not been earned.").

[3] See DR 9-102(A)(lawyer may not commingle client funds on property with his or her own).

[4] N.Y. State 570

[5] See, .e.g., N.Y. State 599 (1989) (discussing nonrefundable minimum fee provisions); N.Y. State 693 (1997); N.Y. State 764 (2003).

[6] See Matter of Aquilo, 162 A.D.2d 58, 560 N.Y.S.2d 583 (4th Dep't 1990) ("Moneys advanced by clients for disbursements need not, unless expressly agreed, but held in trust and may be placed in a general account."); N.Y. City 2002-2.

[7] Dowling v. Chicago Options Associates, Inc., ___ N.E.2d ___, 2007 WL 1288279, at *7 (Ill., May 3, 2007) ("we recognize advance payment retainers as one of three retainers available to lawyers and their clients").

[8] Jacobson v. Sassower, 66 N.Y.2d 991, 993, 489 N.E.2d 1283, 1284, 499 N.Y.S.2d 381, 382 (1985); see N.Y. State 599 ("The essence of the matter is clarity").

[9] DR 9-102(c)(3) requires a lawyer to "[m]aintain complete records of all funds, securities, and other properties of a client or third person coming into possession of the lawyer and render appropriate accounts to the client or third person regarding them."

[10] DR 9-102(c)(4) (requiring a lawyer to "pay or deliver to the client or third person as requested by the client or third person the funds, securities or other properties in the possession of the lawyer which the client or third person is entitled to receive").

[11] See DR 2-106(c)(2)(b) (prohibiting use of a nonrefundable fee clause in a domestic relations matter); Matter of Cooperman, 83 N.Y.2d 465, 633 N.E.2d 1069, 611 N.Y.S.2d (1994) (holding that the payment of a nonrefundable fee for specific services, in advance and irrespective of whether professional services are actually rendered, is per se violative of public policy).

[12] See, e. g., Dowling, ___ N.E.2d at ___, 2007 WL 1288279, at *8 ("Paying the lawyer a security retainer means the funds remain the property of the client and may therefore be subject to the claims of the client's creditors. This could make it difficult for the client to hire legal counsel. Similarly, a criminal defendant whose property may be subject to forfeiture may wish to use an advance payment retainer to ensure that he or she has sufficient funds to secure legal representation.").

[13] See 22 NYCRR Part 1215 (engagement letters are to include, among other things, an [e]xplanation of attorney's fees to be charged, expenses and billing practices").

[14] See DR 2-110(A)(3); DR 9-102(C)(4); N.Y. State 570.

**The Association of the Bar of the City of New York
Committee on Professional and Judicial Ethics**

Opinion No. 1986-5 (7/14/86)

Lawyer as Escrow Agent

Introduction

This opinion addresses certain ethical questions that arise when lawyers hold funds in escrow. Although the issues are, in many cases, similar to those involving trust funds or other funds held for clients or third parties, only escrow accounts are covered here.

We first discuss the general duties of escrow agents and the need for fully informed consent by all parties before the lawyer for one of them can act as escrow agent. We stress the importance of having a carefully drafted escrow agreement that covers, among other things, possible disputes over the escrowed funds. Our opinion then speaks to the possibility that the escrow agreement may involve a client confidence or secret and discusses the conflicts that may arise between the interests of the client and the interests of the other party to the escrow. We then turn to the conflicts that may arise between the interests of the lawyer and the interests of his own client with respect to the escrowed funds. Finally, our opinion discusses the permissible modes of investing the funds, the lawyer's entitlement to any income that may be earned thereon, participation in the New York IOLA (Interest on Lawyer Accounts) program, problems of commingling and recordkeeping requirements.

I. Escrow Accounts and Escrow Agents

An escrow agent is a custodian or stakeholder of funds designated for a special purpose, usually pursuant to a written agreement. The escrow agent has contractual and fiduciary duties to all parties to the escrow arrangement and may dispose of the escrowed funds only in accordance with the terms of the escrow agreement or with the consent of all parties. The duties of an escrow agent are thus

principally matters of contract and fiduciary law, rather than of ethics, and to that extent are beyond the jurisdiction of this Committee.

A lawyer serving as escrow agent has fiduciary duties and obligations, not only to his client, but to all parties to the escrow agreement. In addition, a lawyer's conduct with respect to escrow arrangements is governed by the Code of Professional Responsibility. As discussed more fully below, the requirements of Canon 9 pertaining to the preservation, safekeeping and use of client funds and trust property are applicable to escrowed funds held by a lawyer, although such funds are not literally "funds of clients." N.Y. City 82-8; N.Y. City 79-48 (1980); N.Y. State 532 (1981); In Re Hollendonner, No. D-1 (N.J. Sup. Ct., Oct. 17, 1985).

II. Consent and Escrow Agreements

As a general rule, it is ethically permissible for a lawyer to represent a client and to act as escrow agent in the same transaction if all interested parties have consented after full disclosure by the lawyer of the possible effect of his dual role on the interests of each party, and if it is obvious that the lawyer can adequately represent the interests of all parties. See DR 5-105(C); N.Y. County 573 (1969). Such consent must be fully informed. A consent based upon the contemplated discharge of routine escrow instructions, without taking into account potential disputes among the parties, is not sufficient to override a conflict of interest in the event of a dispute. N.Y. City 80-56.

It is advisable, therefore, to include in the escrow agreement carefully drafted provisions making clear that the non-client party agrees that, in the event of a dispute between the parties with respect to the escrow or the underlying transaction, the lawyer may represent his client in the dispute. Such a provision clarifies the scope of the non-client's consent and therefore lessens the likelihood of confusion and delay that might be

caused by the lawyer's attempting to obtain such consent after a dispute occurs, or having to resign as escrow agent or being disqualified from representing his client.

In order to give the lawyer-escrow agent an agreed-upon means of resolving any conflict of interest, the escrow agreement should also provide that the escrow agent may at his option pay the escrowed funds into court or submit the matter to arbitration in the event of a dispute over the funds. Such a provision should expedite the ability of the escrow agent to resign as such, but to continue to represent his client, in the event that he deems it necessary or desirable. If the escrow agent were to bring an interpleader action, however, the court might decide that, notwithstanding the fully informed consent of all interested parties, the lawyer-escrow agent cannot represent one of the claimants to the escrowed funds while at the same time he is seeking to be discharged by the court from any further liability with respect to the funds. It is also possible that the lawyer would be required to testify in such an action, thereby disqualifying him from representing his client. See DRs 5-101 and 5-102.

III. Escrow Agreement as Confidence or Secret

Whether the existence of an escrow account, or information pertaining to that account, is a confidence or secret of a client within the meaning of Canon 4 is a question that frequently arises, usually in the context of a request for such information by the Internal Revenue Service or other governmental authority. Under Canon 4, a lawyer is prohibited from knowingly revealing a confidence or secret of his client. A "confidence" refers to information protected by the attorney-client privilege under applicable law. DR 4-101(A). Whether information pertaining to an escrow account constitutes a confidence is thus a question of law beyond the jurisdiction of this Committee. A "secret" refers to other information gained in the professional relationship that the client has requested be held inviolate or the disclosure of which would be embarrassing or would likely be detrimental to the client. *Id.*

Whether the existence of, or information with respect to, an escrow account fits this definition requires a factual determination on a case-by-case basis.

A lawyer may reveal confidences or secrets with the consent of the clients affected, but only after full disclosure to them. A lawyer may also reveal confidences or secrets when permitted under the Disciplinary Rules or required by law or court order. DR 4-101(C). Thus, if presented with a request by a governmental authority for production of information pertaining to escrow accounts when a client is a target of an investigation, a lawyer must, unless the client has consented to disclosure, decline to furnish such information on the ground either that it is protected by the attorney-client privilege or that it has been gained in the course of a confidential relationship. Taking such a position (as in support of a motion to quash a subpoena) will usually result in a court order deciding the issue. If disclosure is compelled, it will not breach a lawyer's ethical obligation with respect to his client's confidences or secrets. If the records of the lawyer, rather than of the client, are the subject of the inquiry, the lawyer's response should be the same, unless he is certain that the requested information does not constitute a client confidence or secret. See *N.Y. County 413* (1953); *ABA 393* (1961); *N.Y. County 377* (1975); *N.Y. City 312* (1934); *Connecticut 81-3* (1980); *Oregon 440* (1980); *Michigan CI-1088* (1985); *Michigan CI-925* (1983); *Michigan CI-389* (1979); *Tennessee 81-F-20* (1981). Depending upon his client's interests, however, the lawyer may have a further duty under Canon 7 (a lawyer should represent his client zealously within the bounds of the law) to appeal a court order adverse to his client. See *Michigan CI-925* (1983); *Michigan CI-1088* (1985).

IV. Conflicts of Interest -- Client versus Third Party

Canon 5, which requires a lawyer to exercise independent professional judgment on behalf of his client, and in particular to avoid a stake in interests that might conflict with those of his

client, is applicable to the conduct of a lawyer who represents one party to a transaction and at the same time acts as escrow agent for both parties. See N.Y. City 80-56; N.Y. County 573 (1969); N.Y. County 477 (1959); ABA 923 (1966). The role of the escrow agent as a neutral stakeholder may conflict with the obligation of the lawyer to assert his client's position with respect to the transaction. See N.Y. City 82-8; N.Y. City 80-56; N.Y. County 357 (1940); Nassau County 80-7. In the event of a dispute over the disposition of the escrowed funds, the escrow agent, as a fiduciary for both sides, would be obligated to assume a neutral position, while, as the lawyer for one party, he would be ethically bound to represent his client zealously. See N.Y. County 357 (1940); Canon 7.

Another source of conflict between the simultaneous roles of lawyer and escrow agent may arise when the lawyer is put in a position of having to assert a lien on the escrowed funds on behalf of his client. On the one hand, the escrow agent has a duty to treat the escrowed funds neutrally and in accordance with the terms of the escrow agreement. See Nassau County 80-8. On the other hand, the lawyer has an ethical obligation to assert any claims his client may have in a dispute. This Committee has noted in the past that although the issue involves questions of law relating to the duties of an escrow agent, such a lien would nonetheless appear to be an encumbrance on escrowed funds, the imposition of which would seem incompatible with the stakeholder's role. N.Y. City 80-56. In the absence of knowing consent by the non-client to the lawyer's continuing to act in both capacities, the lawyer should either resign as escrow agent or decline to represent his client in the dispute. In any case, Canon 9 requires a lawyer to avoid even the appearance of impropriety. Depending upon the circumstances, it might appear improper for a lawyer to participate in the attachment of funds he is holding as escrow agent. *Id.*

Even in the absence of a dispute between the parties to the escrow agreement, the lawyer-escrow agent may face conflicts of interest. For example, in the course of the attorney-client relationship, the

lawyer may acquire information material to the escrow arrangement which should be disclosed to the parties in interest. If such information does not constitute a client confidence or secret, the lawyer should, if circumstances warrant, advise his client to take action to eliminate the need for disclosure. If the client is unwilling or unable to do so, the lawyer should disclose such information to the other parties to the escrow agreement. See N.Y. County 477 (1959). If the information does constitute a confidence or secret, the lawyer should probably resign as escrow agent to avoid even the appearance of conflict of interest or divided loyalty to his client.

V. Conflicts of Interest -- Lawyer versus Client

Lawyers sometimes wish to assert their own claims against funds they are holding in escrow, usually to recover unpaid legal fees. Such claims may arise in one of three situations: (1) funds which are payable in full to the parties to the escrow and the client is entitled to receive at least part; (2) funds which are immediately payable only in part; and (3) funds which are only potentially payable to the client. The question whether the lawyer-escrow agent may claim the funds in any of these situations principally involves legal issues. For example, the existence of an attorney's retaining or charging lien on the escrowed funds as well as the lawyer-escrow agent's contractual and fiduciary duties are all legal matters and, as previously noted, are thus beyond the jurisdiction of this Committee.

The ethical considerations come into play only to the extent the lawyer has legal rights to the escrowed funds. There are two provisions of the Code of Professional Responsibility with which a lawyer in this position should primarily be concerned. The first is DR 9-102(A)(2), which provides as follows:

Funds belonging in part to a client and in part presently or potentially to the lawyer or law firm must be deposited [in a separate account], 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 second is DR 9-102(B)(4), which states that a lawyer shall:

Promptly pay or deliver to the client as requested by a client the funds, securities, or other properties in the possession of the lawyer which the client is entitled to receive. See N.Y. City 82-22; N.Y. City 82-61; N.Y. City 82-65; N.Y. City 590 (1941); N.Y. City 229 (1932); ABA 859 (1965); Maryland 84-60 (1983); Kentucky E-292 (1984); Michigan CI-636 (1981).

When the entire amount in escrow is payable and at least a part is to be paid to the client against whom the lawyer has a claim, the lawyer must first determine whether the funds to be paid the client "presently" or "potentially" belong to the lawyer. This is a legal and not an ethical question. For example, the escrow agreement may provide that a portion of the escrowed funds is to be paid to the lawyer as legal fees. (In such cases, because of the potential conflict the lawyer may have, all parties to the escrow agreement should have the conflict explained to them at the outset and their consent should be obtained.) In such situations, as a matter of contract law, part of the funds would presently or potentially belong to the lawyer. The client would not be "entitled to receive" the funds and thus DR 9-102(B)(4) would not require that the funds be paid to the client. However, if the funds do not presently or potentially belong to the lawyer, they must be "promptly" turned over to the client.

Assuming the funds may legally belong to the lawyer, he should then notify the client of his claim to see if the client agrees or disagrees. If the claim is disputed, then, under DR 9-102(A)(2), the lawyer may not pay out the disputed portion to himself until the dispute is resolved, but may retain the funds until such time.¹ Again, this is because the client would not be "entitled to

receive" the funds and thus DR 9-102(B)(4) would not be applicable. Of course, if there is no dispute, the funds may be taken by the lawyer. If the lawyer has a claim to only part of the funds, the undisputed portion should promptly be paid to the client.

If the escrow agreement calls for only a portion of the escrowed funds to be paid out, or if the funds are only potentially payable to the client, a similar analysis to that described above should be followed. There may, however, be additional ethical considerations. The lawyer as escrow agent may be presented with a conflict of interest. To the extent that his disputed claim may only partially be satisfied by the funds payable, or is only to be satisfied from potentially payable funds, the lawyer will have a self-interest in interpreting the escrow agreement, if susceptible to interpretation, in such a manner that the funds not yet payable become so as soon as possible. This conflict would be greater if the escrow agent is, in certain circumstances, required to pay the funds to a third party. In such an instance, the lawyer-escrow agent will have an interest in interpreting the agreement so that the funds go to his client and thus may be obtained by the lawyer. If the funds payable would fully satisfy the disputed claim, the lawyer may have an interest in delaying further distributions to the client, if possible, as a means of forcing a settlement of the dispute. Because of the conflict, the lawyer should resign as escrow agent in these cases.

VI. Permissible Modes of Investing Escrowed Funds

All escrowed funds received by a lawyer must be deposited in one or more identifiable accounts, in which (with limited exceptions) no funds belonging to the lawyer may be deposited. DR 9-102(A).

We have previously opined that, although the rule by its terms refers only to "bank accounts," it allows the lawyer to deposit escrowed funds in other types of accounts which bear characteristics of safety and security similar to a bank account.

We express no opinion on the merits of any such alternative investment account. See N.Y. City 82-8; N.Y. City 81-15; N.Y. City 79-48 (1980); N.Y. City 79-22.

The propriety of using a particular investment mode is primarily a matter of the lawyer-escrow agent's authority under the escrow agreement and his obligations under applicable law. We urge that the lawyer obtain the consent of the parties to the escrow agreement before depositing escrowed funds in an account other than a bank account. N.Y. City 82-8; N.Y. City 79-22. Further, the lawyer should ensure that any pre-withdrawal notice and waiting periods that may apply are understood and approved. N.Y. State 90 (1968). If knowing consent of all parties is obtained, the limitation of DR 9-102(A) to bank accounts (or their equivalent) should not be applicable to escrow accounts.

VII. Commingling of Escrowed Funds

It is impermissible for a lawyer to commingle a client's funds with his own funds; however, since it is generally impractical to deposit each escrowed fund in a separate account (DR 9-102(A) and EC 9-5), lawyer-escrow agents often commingle several funds in one escrow account. This is permissible as long as proper records are maintained and other ethical requirements are fulfilled.

VIII. Interest-Bearing Accounts; Distribution of Interest

The typical escrow account -- containing several escrowed funds -- is often not an interest-bearing account because of the difficulty in calculating the interest attributable to each party. ABA 348 (1982); N.Y. State 554 (1983). Nonetheless, Canon 9 has been repeatedly interpreted to permit, but not require², the placement of escrowed funds in one or more interest-bearing accounts, as long as the requirements of DR 9-102 and other ethical rules are met. N.Y. City 81-15; N.Y. State 554 (1983); ABA 348 (1982); cf. N.Y. City 79-22.

Lawyers may not retain as compensation for their escrow services, or otherwise, any of the interest earned in interest-bearing escrow accounts unless they have obtained the prior knowing consent of their clients and the other parties to the escrow, and even with such consent, there are still serious risks of ethical impropriety.

In light of the fiduciary nature of the attorney-client relationship and the fact that the lawyer may be in a superior bargaining position, agreements purporting to grant consent to such arrangements present a clear danger of overreaching and could lead to a breach of Canon 5, which requires a lawyer to exercise independent professional judgment on the client's behalf. This is so because the lawyer would have a financial interest in delaying the event that terminates the escrow which might conflict with his duty to his client and other parties relating to the funds. See N.Y. City 81-68 (1982).

There is also the danger of violating DR 2-106(A), which prohibits a lawyer from collecting a clearly excessive fee. Since the expenses involved in an escrow account are generally nominal, the interest accrued would often substantially exceed any actual administrative costs. See N.Y. City 79-48 (1980). See also N.Y. City 181 (1931) (professionally improper for an attorney, "arbitrarily," to retain interest as compensation for his services as escrow agent where the escrow agreement is silent on the subject); N.Y. City 81-15 ("In the absence of an explicit agreement, any income realized on the client's funds by an attorney-escrow agent belongs to the client."); ABA 348 (1982) (reaffirming ABA 545 (1962)) and ABA 991 (1967), and stating that under present-day Canon 9, although depositing funds in statutory "IOLTA" or "IOLA" accounts is proper, it is unethical to use interest earned on client funds "to defray the lawyer's own operating expenses without the specific and informed consent of the client."); N.Y. State 554 (1983) (interest earned on "trust accounts," absent the client's consent, belongs to the client).

Some bar association ethics committees have gone farther and concluded that agreements permitting payments to lawyers from the interest earned on escrow accounts for the purpose of defraying their administrative costs are per se improper. See N.Y. State 532 (1981) (expressly rejecting N.Y. City 79-48 (1980)); N.Y. State 575 (1986); Nassau County 85-9; Nassau County 84-2. Our Committee does not agree with this view. We adhere to the position of our earlier opinions that it is not per se improper for a lawyer to pay himself interest earned on escrowed funds if he has obtained the prior knowing consent of the client and the other interested parties; however, we again caution that even with such consent, there are grave risks of ethical impropriety. These risks include overreaching, a conflict of financial interest between the lawyer and client in violation of Canon 5, overcharging the client in violation of DR 2-106(A), and commingling client funds with the lawyer's funds in violation of DR 9-102(A). Any agreement purporting to give such consent, if challenged, would be subject to strict scrutiny.

IX. IOLA

The New York IOLA (Interest on Lawyer Accounts) program, authorized by the legislature in Section 497 of the Judiciary Law,³ is a nonmandatory, state-supervised program under which lawyers may deposit and commingle in an interest-bearing account clients' funds (including escrowed funds) that are too small, or to be held for too short a period of time, to be worth investing in a separate interest-bearing account. The interest on the funds is automatically paid to legislatively approved organizations. The main purpose of the program is to help provide civil legal assistance to the poor.

It is ethically proper for lawyers to participate in IOLA. N.Y. State 554 (1983); see also ABA 348. Since the funds used in IOLA are not reasonably expected by the client to earn interest (because the sum is so small or to be held for so short a time), the client is not "entitled" to the interest earned by virtue of the program DR 9-102(B)(4); hence,

there is no violation if that interest is paid out under the program rather than to the client.

X. Recordkeeping

Pursuant to DR 9-102(B)(3), a lawyer must maintain complete records of all escrowed funds coming into his possession and render appropriate accounts to his client and the other interested parties regarding them. Lawyers in New York should also refer to the Uniform Rule for the Preservation of Client Funds, applicable in all four Departments of the Appellate Division (22 NYCRR §§§§ 603.15, 691.12, 806.18 and 1022.5), which sets forth detailed requirements regarding client-fund recordkeeping, including a seven-year retention rule.

¹ One committee has said that the only instance in which a lawyer may ethically withhold escrowed funds from a client is when the escrow agreement specifically so permits. Nassau County 80-7; Nassau County 85-7. We do not agree.

² Although there is generally no ethical obligation to place funds in an interest-bearing account, there may be a fiduciary obligation to do so under the law of trusts where the funds are sufficient to earn interest. See N.Y. State 554, citing 2 Scott, Law of Trusts, §§§§ 180.3, 181 (3d ed. 1967); N.Y. State 575 (1986); Judiciary Law §§ 497(4). Further, in ABA 348, it was indicated that where the amount and the holding period of particular funds make it obvious that the interest to be earned would exceed the cost of placing the funds in an interest-bearing account, the failure to seek the client's instructions as to how to invest the funds could be an "extreme violation" of the lawyer's fiduciary obligation, and thus violative of DR 6-101(A) and DR 7-101(A)(1). We agree with the ABA position.

³ Subdivision (5) of §§ 497 provides that "No attorney shall be liable in damages nor held to answer for a charge of professional misconduct because of a deposit of moneys to an IOLA account pursuant to a judgment in good faith that such moneys were qualified funds." The term

"qualified funds" is defined in subdivision (2) as "moneys received by an attorney in a fiduciary capacity from a client or beneficial owner and which, in the judgment of the attorney, are too small in amount or are reasonably expected to be held for too short a time to generate sufficient interest income to justify the expense of administering a segregated account for the benefit of the client or beneficial owner."

Opinion No. 1991-3 (5/16/91)

Opinion

The Committee has received several inquiries concerning the ethical propriety of "non-refundable retainers" for lawyers practicing in New York.

This Opinion addresses whether a lawyer may ethically enter into a fee agreement with a client providing for a fee paid in advance of the performance of the services that is to be "non-refundable". We conclude that (i) various types of fee agreements that may commonly be thought of or referred to as "non-refundable" are ethically permissible; however, (ii) no fee paid in advance can be literally "non-refundable" in all circumstances; and, therefore, (iii) a lawyer may not ethically represent or characterize to a client a fee being paid in advance as "non-refundable".

I. There has been controversy over the ethical appropriateness of "non-refundable retainers". For example, the Bar Association of Nassau County has opined that a lawyer may never enter into a fee agreement with a client that calls for a non-refundable retainer and that unearned advance fee payments must be refunded to a client upon discharge from employment. Opinion 85-5 (June 18, 1985). See also Bar Association of Greater Cleveland Opinion 84-1 (October 26, 1984) (a lawyer may not require a non-refundable retainer to secure his or her availability over a specified period of time without regard to a specified matter); Brickman and Cunningham, "Non-

refundable Retainers: Impermissible Under Fiduciary, Statutory and Contract Law", 57 Fordham L. Rev. 149 (1988).

At what might appear to be the other end of the spectrum, the Pennsylvania Bar Association Committee on Legal Ethics and Professional Responsibility has expressly disagreed with the Nassau County Bar. In Formal Opinion 85-120 (Jan. 29, 1987), the Pennsylvania Committee concluded that a non-refundable retainer places a lawyer on call so that the lawyer must forego other employment and that it is proper to compensate a lawyer for that factor. That Committee concluded, therefore, that Pennsylvania lawyers could enter into "non-refundable retainer" agreements with clients provided that the fee charged was reasonable and not excessive and that such agreements were fully explained to the clients and reduced to writing.

To some degree, these apparently differing views about "non-refundable retainers" result from differing uses of the term. For purposes of this Opinion, we distinguish among three types of fee arrangements, each of which may on occasion be referred to as a "non-refundable retainer", as follows:

(i) Minimum fee. A "minimum fee" is a stated minimum payment a lawyer receives for undertaking a representation regardless of the amount of work actually involved. Such a minimum fee may entitle the client to some amount of legal services, with additional charges for work beyond that amount, but the client would normally receive no refund if the actual services are less than the total covered by the minimum. Often, the minimum fee amount is collected in advance. Such a minimum fee might reflect the recovery of necessary start-up costs that are incurred with each new matter -- costs which alternatively, for example, could be recovered through a higher than normal charge for the first few hours of representation -- or compensation for the fact that other employment will be foreclosed as a result of taking on the new matter.

(ii) Flat fee. A "flat fee" is a stated amount for the representation contemplated, to be paid regardless of the actual hours that are ultimately required. The agreement might provide for an additional fee if the representation extends to an additional phase (e.g., the case goes to trial or there is an appeal). The flat fee reflects a sharing of risks between lawyer and client and generally provides the client with the security or comfort of a known cost for a particular service.

(iii) Retainer. A "retainer" is an amount paid for reserving the availability of a lawyer, generally with respect to a particular period of time. The retainer may also provide that the lawyer be on call to represent a specific client in connection with a particular event or transaction, if the client decides to use the lawyer. In the latter case, the retainer agreement may implicitly contemplate that the lawyer could not represent anyone else in connection with the event or transaction where such representation could interfere, by reason of a conflict of interest or otherwise, with the representation of the client who is reserving the services of the lawyer. Where the retainer is for a specified period of time, it is generally contemplated that the lawyer will limit his or her other commitments so as to be available for the client paying the retainer. Fees for actual legal services performed might be credited against the retainer amount (in which case the retainer would resemble a minimum bill) or they might be billed in addition to the retainer.

These distinctions reflect basic differences in the nature of fee arrangements both in terms of the client's expectations and the lawyer's justification. Any of these three types of arrangements might, under various circumstances, be called "non-refundable", since the client would not generally have an expectation of receiving a refund at the end whether as a consequence of the results obtained, the hours actually worked or the nature of the services actually performed.¹ Therefore, each of these fee arrangements is clearly distinguishable from a simple "advance" against future fees and expenses. In addition, each might be referred to as a "non-refundable retainer".

II. The principal ethical issue involving "non-refundable" fee arrangements is whether the lawyer is thereby charging a fee that is "excessive" within the prohibition of DR 2-106(A) of the Lawyer's Code of Professional Responsibility (the "Code").

DR 2-106(B) defines what is an excessive fee and lists a number of relevant factors to be considered in determining a fee's reasonableness. DR 2-106(B) states in full:

"A fee is excessive when, after a review of the facts, a lawyer of ordinary prudence would be left with a definite and firm conviction that the fee is in excess of a reasonable fee. Factors to be considered as guides in determining the reasonableness of a fee include the following:

1. The time and labor required, the novelty and difficulty of the questions involved and the skill requisite to perform the legal service properly.
2. The likelihood, if apparent or made known to the client, that the acceptance of the particular employment will preclude other employment by the lawyer.
3. The fee customarily charged in the locality for similar legal services.
4. The amount involved and the results obtained.
5. The time limitations imposed by the client or by circumstances.
6. The nature and length of the professional relationship with the client.
7. The experience, reputation and ability of the lawyer or lawyers performing the services.
8. Whether the fee is fixed or contingent."

The standard set forth in DR 2-106(B) is highly fact-specific, and the Committee does not express any opinion on its operation in the abstract. DR 2-106(A) provides that a "lawyer shall not enter into an agreement for, charge or collect an illegal or excessive fee". Thus, every fee agreement must be justifiable at the time it is entered into based upon the factors listed in DR 2-106(B). The Committee concludes that, in the case of fees agreed to and paid in advance of the time the services are performed, the point of termination of the

representation constitutes a time at which the fee is "charge[d]" or "collect[ed]" by the lawyer. Therefore, ethically, no fee or fee agreement can ever be absolutely "non-refundable" as that term may be literally understood, since it will always be subject to the proscription of DR 2-106(A), as explicated by DR 2-106(B).

At the same time, it is the opinion of this Committee that flat fees, minimum fees and traditional retainers can satisfy the criteria of reasonableness. In fact, one can argue that such fee arrangements are at least implicitly contemplated by DR 2-106(B). The relevant factors clearly include more than the number of hours of legal services actually performed, the lawyer's skill and experience, and the results obtained. For example, DR 2-106(B)(2) expressly lists the likelihood that the representation in question will preclude other employment if that likelihood is "apparent or made known to the client". The preclusion of other employment would appear to be a principal justification for a traditional "retainer" (although, not necessarily the lawyer's only motivation in seeking a "retainer") and may be relevant to "minimum fee" and "flat fee" arrangements as well.² Similarly, the factors set out in subparagraphs (3), (5), (6), (7) and (8) of DR 2-106(B) could be relevant to the reasonableness of and provide justification for flat fees, minimum fees and retainers. All of these factors could justify a fee that might otherwise appear, when viewed after the fact, to be high relative to the actual number of hours of service performed or the results obtained.

III. Additional issues arise where the lawyer withdraws from the representation or is discharged by the client prematurely.

The case of withdrawal is expressly addressed by DR 2-110(A)(3) -- "any part of a fee paid in advance that has not been earned" shall be "promptly" refunded. What it means for a fee to have been "earned" is not clear. Certainly, the factors relevant to the reasonableness of the fee would apply here as well, and any amounts in excess of a reasonable fee must be refunded. The

Committee believes, however, that the concepts of "reasonableness" and "earned" are not identical.

How much of the fee has been "earned" will depend upon the express terms of the fee arrangement and the parties' expectations, as a matter of contract interpretation, as well as the extent to which the lawyer satisfied the client's legitimate expectations, the benefits received by the client, what the lawyer actually did during the representation and the situation in which the client is left after withdrawal. The fee "earned" may be less than an amount that might otherwise be considered not to be "excessive".

The case of discharge is affected by significant legal issues. As a matter of law, the client's right to discharge a lawyer is essentially absolute, and well-established legal precedent dictates that a client should not be compelled to continue being represented by a lawyer in whom the client has lost confidence or trust. See, e.g., Martin v. Camp, 219 N.Y. 170, 114 N.E. 46 (1916). These policies can be jeopardized by fee arrangements that purport to be "non-refundable", especially where the lawyer is discharged before any meaningful services have been performed. Such an arrangement, if enforced, could effectively compel some clients to continue an unsatisfactory relationship with a lawyer because the client would otherwise be required to pay twice for the contemplated representation or be unable to afford new counsel. Therefore, courts have generally been reluctant to enforce such agreements and have, instead, based the compensation to a lawyer who has been discharged upon quantum meruit. See, e.g., Jacobson v. Sassower, 122 Misc. 2d 863, 474 N.Y.S. 2d 167 (1983), aff'd, 107 A.D. 2d 603, 483 N.Y.S. 2d 711 (1st Dept.), aff'd, 66 N.Y. 2d 991, 489 N.E. 2d 1283, 499 N.Y.S. 2d 381 (1985). See also Brickman and Cunningham, *supra*, at 153-170.

This Committee does not opine on legal questions; and, therefore, we express no view as to the legal enforceability of a "non-refundable" agreement where an attorney has been discharged or the prop-

er legal standard for determining the amount of the fee to which the lawyer is entitled.

As a matter of ethics, however, the Committee looks to the proscriptions and guidelines of DR 2-106. In the case of discharge where a fee has been agreed to and paid in advance, this Committee believes it appropriate to apply the analysis of DR 2-106(B), with the benefit of hindsight, to all the circumstances as they exist at the time of the discharge. That analysis would include consideration of the actual amount of work performed, the results achieved and the various other factors that could not have been known in advance when the agreement was entered into and the payment made. That analysis, therefore, could result in the conclusion that the amount of the fee already paid is unreasonable and that a refund is required.

IV. To this point, we have discussed the ethical issues concerning the substance of various types of fee agreements that could be loosely termed "non-refundable". We turn now to the matter of the actual usage in fee agreements of the word "non-refundable" or other language purporting to state that the fee paid will not be refunded under any circumstances, whether such agreements are oral or written.

Because we conclude that no agreement can make a fee literally non-refundable, being subject to (i) the reasonableness standard of DR 2-106(A) in all cases, (ii) the "not earned" standard of DR 2-110(A)(3) in the case of withdrawal, and (iii) potential legal limitations in the case of discharge, the Committee also concludes that the use of the word "non-refundable" or equivalent language in a fee agreement is necessarily misleading. At minimum, it may be likely to cause the client to reach mistaken conclusions as to his or her legal rights. In addition, we have already noted that the words "non-refundable retainer" as applied to fees appear to be subject to various meanings and interpretations within the profession so that the usage is ambiguous in fact.

Finally, if the issue of a possible refund arises, the lawyer will be in an obvious and untenable position of conflict. The lawyer's duty to the client would require that the lawyer advise the client that the "non-refundable" fee is not or may not actually be non-refundable under the particular circumstances as a matter of law, while at the same time the lawyer would presumably be desirous of retaining the amounts already paid pursuant to the fee agreement. We believe that these circumstances raise ethical problems under EC 2-19, EC 5-2, DR 5-101(A), EC 7-8, EC 7-9, DR 7-101(A), EC 9-1 and EC 9-2.

Therefore, we conclude that a lawyer may not properly denominate or characterize a fee as "non-refundable" or otherwise use words that could reasonably be expected to convey to the client the understanding that a fee paid before the services are performed will not be subject to refund or adjustment under any possible circumstance.

¹ We discuss separately below the issue of refund where the lawyer withdraws or is discharged by the client.

² If that factor is a basis for the fee arrangement, then that circumstance should normally be explained to the client in order to fall clearly with DR 2-106(B)(2).

Opinion No. 1995-6 - (4/5/95)

Topic: Client Funds; Incompetent Client; Interest on Trust Accounts.

Digest: A lawyer who has (a) successfully negotiated a settlement of a lawsuit on behalf of an incompetent client, (b) received the settlement proceeds and (c) is holding those proceeds in a trust account, but who cannot release the proceeds to the client without delivering a general release to the defendant should take steps necessary to obtain a valid release or measures that would permit him to dispense with the requirement that a release be

delivered. Although the Code does not specifically require that lawyers hold client funds in interest-bearing accounts, the failure to invest client funds, taking into account the amount of funds held for a specific client and the expected holding period, may in some circumstances constitute neglect.

Code: DRs 6-101(A), 9-102, 9-102(F).

Question

What are the ethical obligations of a lawyer who has (a) successfully negotiated a settlement of a lawsuit on behalf of an incompetent client, (b) received the settlement proceeds and (c) is holding those proceeds in a trust account, but who cannot release the proceeds to the client without delivering a general release to the defendant?

Opinion

The inquirer is counsel for an individual who has been institutionalized in a mental facility. The client is mentally incompetent, has not granted a power of attorney to anyone and does not have a legal guardian. The inquirer has successfully negotiated the settlement of a law suit on behalf of the client and is holding the \$4,000 settlement proceeds in an attorney trust account. The client, however, did not execute a general release prior to his incapacity, and the inquirer is not authorized to release the settlement proceeds without first obtaining an executed general release and delivering it to the defendant. We have been asked to opine on the inquirer's ethical responsibilities in these circumstances.

The inquirer is ethically obligated to maintain the funds in an appropriate escrow account until one of the following four conditions has occurred:

- (1) The client recovers sufficient mental capacity to sign a general release.
- (2) A guardian is appointed who signs the general release, or, should the client die, the release is

executed on behalf of the client's estate by the administrator or executor of the client's estate.

(3) In view of the circumstances, the inquirer reaches an agreement with the defendant under which it authorizes the release of the settlement proceeds in the absence of a general release.

(4) An application is granted by the appropriate court for permission to deposit the funds in court following a procedure similar to that set forth in DR 9-102(F).

So long as the inquirer continues to hold the funds, depending on the prognosis of the client's continued incompetence and his life expectancy, it may be incumbent upon the inquirer to transfer the settlement proceeds from an "interest on lawyer account" ("IOLA") (designed to hold small amounts of money where the amount and the time the funds will be in escrow are not sufficient to justify opening an individual escrow account) to an individual escrow account.

Both the Lawyer's Code of Professional Responsibility (DR 9-102) and the Model Rules of Professional Conduct (Rule 1.15) require that property of clients and third parties be kept separate from a lawyer's own property. However, these rules say nothing concerning whether such funds must be maintained in an interest-bearing account. N.Y. State 90 (1968) advanced the view that whether a client's funds may be put in an interest-bearing savings account is "largely a question of law rather than ethics," and suggested that whether such a deposit was proper depended on the circumstances.

The opinion focused on the notice and waiting period technically applicable to savings accounts. See also N.Y. State 575 (1986) and 554 (1983); ABA, Annotated Model Rules of Professional Conduct 254 (2d ed. 1992) ("[g]enerally, a lawyer need not deposit client funds in an interest-bearing account"). * See generally ABA/BNA Lawyers' Manual on Professional Conduct at 45:201 (1994)

("Traditionally, lawyers at their discretion have been able to deposit client funds in interest-bearing accounts. . . . Neither the Model Code nor the Model Rules impose an obligation on a lawyer to invest funds for the benefit of a client or third person. Instead, they leave the matter to laws governing the general obligations of a fiduciary."); Charles W. Wolfram, *Modern Legal Ethics* §§ 4.8, at 183 (1986) ("[t]rust accounts are typically non-interest bearing").

Judiciary Law §§ 497, enacted in 1983, provides rules with respect to interest on lawyer accounts and specifically states: "An attorney shall have discretion, in accordance with the Code of Professional Responsibility, to determine whether money received by an attorney in a fiduciary capacity from a client or beneficial owner shall be deposited in non-interest or in interest bearing accounts." ABA 348 (1982), which provides a lengthy examination of the rules with respect to placing client's funds in interest bearing accounts, noted that the focus of the ethical rules on client funds was safekeeping, accounting and delivery, not investment. However, the opinion stated that when the amount of funds held for a specific client and the expected holding period make it obvious that the interest to be earned would exceed the lawyer's administrative charges, "the lawyer should consult the client and follow the client's instructions as to investing." It also stated that in the case of an extreme violation of a lawyer's duty to invest a client's funds amounting to gross neglect, see DR 6-101(A), there would be a basis for professional discipline.

It is not clear whether the opinion refers to a failure to follow a client's instructions or to a situation that demanded investment where the lawyer failed to invest. See also N.Y. City 1986-5 n.2.

It is the view of this Committee that, given the size of the fund and available interest rates, if the fund is likely to be retained in escrow for a period of a year or more, a separate interest-bearing trust account for the client may be ethically required.

Conclusion

A lawyer who has (a) successfully negotiated a settlement of a lawsuit on behalf of an incompetent client, (b) received the settlement proceeds and (c) is holding those proceeds in a trust account, but who cannot release the proceeds to the client without delivering a general release to the defendant should take steps necessary to obtain a valid release or dispense with the requirement that a release be delivered. If it is likely that the settlement proceeds will be retained by the lawyer for a period of a year or more, the lawyer should establish a separate interest-bearing trust account for the client.

Opinion No. 1997-1 (3/97)

Topic: Interest charges on unreimbursed expenses

Digest: A lawyer may enter into a fee agreement under which the client will be charged interest on unreimbursed expenses of litigation to cover interest paid to the bank from which the lawyer borrows to pay the expenses

Code: DRs 2-106(D), 5-103(B)(1), 5-104(A)

Question

A lawyer represents plaintiffs in personal injury actions on a contingent fee basis. The lawyer advances funds to pay expenses of litigation (e.g., court costs, expert witness fees and other disbursements). The lawyer borrows from a bank to finance these disbursements. May the lawyer charge clients interest on funds advanced to pay litigation expenses at the rate charged by the bank?

Opinion

Loans from a lawyer to a client are generally restricted, see DR 5-104(A), and in litigation, loans for most purposes are flatly forbidden. As an

exception, however, DR 5-103(B)(1) provides that "[a] lawyer may advance or guarantee the expenses of litigation" Although the exception does not explicitly address whether a lawyer may charge interest on funds advanced for this purpose, other ethics committees have uniformly concluded that, subject to limitations, a lawyer may do so. See Ala. RO-88-88 (1988); Fla. Op. 86-2 (1986); Ga. Op. 92-1 (1992); Haw. Op. 32 (1992); Ill. 94-6 (1994); Iowa Op. 81-7 (1981); Md. Op. 94-24 (1994); N.J. Op. 603 (1987); Va. Op. 1595 (1994).

We agree, subject to limitations recognized in the above-cited opinions. First, the interest charged may not exceed the interest charges actually incurred by the lawyer. Second, the provision must be explained clearly to the client in advance and agreed upon by the client. Finally, the method by which the rate of interest will be determined must be stated in a writing provided to the client. See DR 2-106(D) ("Promptly after a lawyer has been employed in a contingent fee matter, the lawyer shall provide the client with a writing stating the method by which the fee is to be determined, including . . . expenses to be deducted from the recovery [ILLEGIBLE WORD]"): see also N.Y. City Bar Op. 1993-2 (1993).

Although this Committee does not address issues of substantive law, we note that Rules of Court adopted by the Appellate Divisions of the Supreme Court of the State of New York may further restrict the proposed practice of charging interest on disbursements in personal injury actions. Rules of Court governing contingent-fee representation in personal injury actions require the filing of retainer statements and prescribe their contents. Among other things, the Rules provide that the lawyer's percentage of the amount recovered "shall be computed on the net sum recovered after deducting from the amount recovered expenses and disbursements for expert medical testimony and investigative or other services properly chargeable to the enforcement of the claim or prosecution of the action." McKinney's 1996 Rules of Court, sec. 691.20 (22 NYCRR sec. 691.20). The lawyer should consider whether the proposed conduct is permissible under these Rules.

Conclusion

Subject to the limitations identified above and any applicable legal restrictions, the Committee answers the question in the affirmative. We conclude that a lawyer may charge clients interest on funds loaned to cover expenses of litigation.

Formal Opinion 2002-2: Duty to Pay Interest on Client Funds Deposited in an Interest-Bearing Account

TOPIC: Duty to pay interest on client funds deposited in an interest-bearing account where retainer agreement does not require attorney to pay interest to client.

DIGEST: Where a lawyer has placed client funds in an interest-bearing escrow account, and the lawyer's retainer agreement does not address whether the lawyer must pay interest on client funds to the client, the lawyer must pay any interest earned on the funds to the client. If the lawyer cannot locate the client, the lawyer should deposit the client's funds with the Lawyers' Fund for Client Protection.

CODE: DR 9-102

QUESTION

If a lawyer has deposited client escrow funds in an interest-bearing account, and the retainer agreement does not address the lawyer's duty to pay interest to the client on such funds, may the lawyer retain the interest earned on these deposits?

OPINION:

A lawyer has submitted an inquiry indicating that she has several Client Fund Accounts in JP Morgan Chase that involved cases that have been closed. The funds were escrowed in connection with the purchase and sale of real estate. The

moneys remaining in escrow represent interest earned prior to the closing of the transaction. The real estate contracts did not require funds to be placed in interest bearing accounts, and her engagements with the clients are silent on the issue. The aggregate dollar amount of the interest is around \$3,000. The interest arises from approximately sixteen separate client transactions, dating back up to ten years. Some of the former clients may be difficult to locate. She has asked for guidance as to how to dispose of the interest residue.

DR 9-102(A) [22 N.Y.C.R.R. § 1200.46] strictly prohibits commingling of client funds with the funds of a fiduciary, and DR 9-102(B)(2) requires that a lawyer in possession of funds belonging to another, incident to her practice of law, maintain those funds in special bank accounts. These rules, taken together with general trust principals, mandate that interest on separated client funds belongs to the client. See N.Y. State 582 (1987) ("it is ethically improper for a lawyer to receive interest earned on funds held in an escrow account as compensation for serving as the escrow agent," citing N.Y. State 532 (1981)); N.Y. State 554 (1983) ("where a lawyer holds a sum for a client which is sufficient to earn interest, the lawyer has a fiduciary obligation to invest that sum, and an ethical obligation to notify the client of receipt of the funds, and any interest thereon, maintain adequate records to and make prompt payment of both principal and interest" (citations omitted)); N.Y. State 90 (1968) (lawyer's duty as to escrowed funds is "to treat the funds in all respects as the client's property and if any income is realized on the funds, it would, of course, belong to the client"); Nassau County 84-2 (1984) (attorney may not retain interest earned on funds during escrow); N.Y. City 81-68 (1981) ("[s]ince the funds deposited in the lawyer's trust account are, by definition, client's funds, it follows that any interest earned on those funds belongs to the client"); N.Y. City 79-48 (1980) ("in the absence of an explicit agreement, any income realized on the client's funds by an attorney-escrow agent belongs to the client"); see also N.Y. State 570 (1985) (the client is entitled to interest on funds

deposited into escrow even where they are not strictly client's funds).

Although some opinions have suggested in dictum that "it might be permissible for an attorney subject to the client's consent to retain interest on client funds which are to be promptly and routinely disbursed," e.g., N.Y. State 532 (1981), this possible exception to the stringent requirements of DR 9-102 would apply, if at all, only to situations where the lawyer had obtained express consent to retain the interest and the amount of interest was so small as to be de minimus. N.Y. State 582 (1987); N.Y. City 81-68 (1981). Neither of these conditions exists on the facts presented. In any case, the better practice in those situations where the amount of interest will be negligible and the funds must be promptly and routinely disbursed is to use an IOLA account. N.Y. State 554 (1983) (where the funds are held for a short period of time and the amount of interest is expected to be nominal, the funds may be deposited into an IOLA account and the interest paid to tax-exempt organizations for the support of legal services or other purposes as defined by the legislature). "The decision as to which funds may be appropriately placed in the IOLA program is left to the discretion of the lawyer to whom the funds are entrusted." *Id.* A client may also agree to donate interest to a charity of the client's choice. N.Y. City 84-15 (1981).

Thus, on the facts provided, any interest on the funds belongs to the clients and should be paid to them, if they may be located.

If a lawyer cannot locate a client or another person who is owed funds from the attorney trust account, the lawyer is required to seek a judicial order to fix the lawyer's fees and disbursements, and to deposit the missing client's share with the Lawyers' Fund for Client Protection. DR 9-102(F) [22 N.Y.C.R.R. § 1200.46(f)]. Forms for such an application are available online at the website for the Lawyers' Fund for Client Protection, www.nylawfund.org.

1 Because DR 9-102(F) requires that monies owed to missing clients be deposited with the Lawyers' Fund for Client Protection, the lawyer's may not exercise discretion to deposit funds in an IOLA account under the circumstances presented here. Issued: March, 2002

Formal Opinion 2008-1: A Lawyer's Ethical Obligations to Retain and to Provide a Client with Electronic Documents Relating to a Representation

QUESTIONS

What ethical obligations does a lawyer have to retain e-mails and other electronic documents relating to a representation? Does a lawyer need client permission before deleting e-mails or other electronic documents relating to the representation? When a client requests that a lawyer provide documents relating to the representation, may the lawyer charge the client for the costs associated with retrieving e-mails and other electronic documents from accessible and inaccessible storage media?

OPINION

I. Background

We live in the digital era. Lawyers routinely use e-mail to formally convey important information and documents to clients, colleagues, and other counsel. Just as routinely, lawyers use e-mail to conduct informal conversations. In many law practices, lawyers are as likely to send an e-mail as to pick up the telephone or walk down the hall to a colleague's office.

The growing reliance by lawyers on digital technology, of course, is not limited to e-mails. Virtually all correspondence, transactional documents, and court filings originate as electronic documents. Many of these electronic documents are never converted into paper format, and lawyers

have become increasingly comfortable in drafting, editing, and commenting on these documents. Emblematic of the growing reliance on electronic documents, courts and administrative agencies now increasingly insist that lawyers make filings electronically. In addition, many lawyers and law firms, taking advantage of widely available document imaging technology, convert their paper records into electronic documents for organizational and storage purposes.

Given this reality, we believe that it would be useful to address some of the ethical issues implicated by a lawyer's reliance on e-mails and other electronic documents. Specifically, this Opinion addresses (i) a lawyer's ethical obligation to retain e-mails and other electronic documents relating to a representation; (ii) the ethical limitations on a lawyer's ability to delete e-mails and other electronic documents; (iii) the extent to which a client has a presumptive right to e-mails and other electronic documents in a lawyer's possession; and (iv) the extent to which a lawyer may charge a client for producing e-mails and other electronic documents at the client's request.¹

II. A Lawyer's Obligation to Retain E-mails and Other Electronic Documents

A lawyer's file relating to a representation includes both paper and electronic documents.² The ABA Model Rules of Professional Conduct (the "Model Rules") define a "writing" as "a tangible or electronic record of a communication or representation" Rule 1.0(n), Terminology.

The Code of Professional Responsibility (the "Code") does not explicitly identify the full panoply of documents that a lawyer should retain relating to a representation. The only Code provision that specifically requires a lawyer to retain client records is DR 9-102. That disciplinary rule imposes mandatory record-retention requirements with respect to a small number of discrete documents, such as retainer agreements, bills to clients, bank statements, and records of transactions in escrow accounts. See DR 9-102(D)(1)-(10).

The Code, however, contains several provisions that implicitly impose on lawyers an obligation to retain documents. For instance, under DR 6-101, a lawyer has an obligation to represent a client competently. See also EC 6-1 ("Because of the lawyer's vital role in the legal process, the lawyer should act with competence and proper care in representing clients."). Similarly, DR 7-101(A)(3) states that "[a] lawyer shall not intentionally . . . [p]rejudice or damage the client during the course of the professional relationship," subject to certain defined exceptions in DR 2-110 and DR 7-102.

In 1986, before the explosive growth in electronic documents, this Committee addressed a lawyer's obligations regarding the retention and disposition of documents in the lawyer's file at the end of a representation. Endorsing several guidelines adopted by the American Bar Association,³ we recognized as a starting point that certain documents in a lawyer's file might belong to the client and should be returned at the client's request.⁴ ABCNY Formal Op. 1986-4. This Committee further opined, without significant elaboration, that before destroying any documents that belong to the client, the lawyer should contact the client and ask whether the client wants delivery of those documents.⁵

As to documents "that belong to the lawyer" or "as to which no clear ownership decision can be made," this Committee opined that the questions whether and how long to retain these documents were "primarily a matter of good judgment." *Id.* We noted that with respect to these documents, the lawyer should use care not to destroy or discard documents (i) that the lawyer knows or should know may still be necessary or useful in the assertion or defense of the client's position in a matter for which the applicable statutory limitations period has not expired; or (ii) that the client has not previously been given but which the client may need and may reasonably expect that the lawyer will preserve. *Id.*

In any given representation, a number of documents will likely fall into one of these two

categories. Among those documents are legal pleadings, transactional documents, and substantive correspondence. Other documents regularly generated during a representation, such as draft memoranda or internal e-mails that do not address substantive issues, are unlikely to fall into these categories. Often a lawyer will need to exercise good judgment, document by document, to determine whether specific documents should be retained.

To be sure, our 1986 Opinion does not require a lawyer to retain every paper document that bears any relationship, no matter how attenuated, to a representation. For instance, consistently with the guidelines described above, a lawyer does not have an ethical obligation to keep every handwritten note of every conversation relating to a representation. The same conclusion will often be reached with respect to drafts of correspondence, of pleadings, and of legal memoranda, among other types of paper documents.

Because many e-mails and other electronic documents now serve the same function that paper documents have served in the representation of a client, we believe that the retention guidelines articulated in our 1986 Opinion should also apply to e-mails and other electronic documents.

As is the case with paper documents, which e-mails and other electronic documents a lawyer has a duty to retain will depend on the facts and circumstances of each representation. Many e-mails generated during a representation are formal, carefully drafted communications intended to transmit information, or other electronic documents, necessary to effectively represent a client, or are otherwise documents that the client may reasonably expect the lawyer to preserve. These e-mails and other electronic documents should be retained. On the other hand, in many representations a lawyer will send or receive casual e-mails that fall well outside the guidelines in our 1986 Opinion. No ethical rule prevents a lawyer from deleting those e-mails.⁶

We also expect that many lawyers may retain e-mails and other electronic documents beyond those required to be retained under our 1986 Opinion. For example, some lawyers and law firms may retain all paper and electronic documents, including e-mails, relating in any way to a representation, as a measure to protect against a malpractice claim. Such a broad approach to document retention may at times be prudent, but it is not required by the Code.

III. A Lawyer's Obligations to Organize and Store E-mails and Other Electronic Documents

We next consider whether a lawyer has any ethical obligation to organize in any particular manner those e-mails and other electronic documents that the lawyer retains, or to store those documents in any particular storage medium.

We do not believe, as a general matter, that a lawyer has any ethical obligation to organize electronic documents in any particular manner, or to store those documents in any particular storage medium. In determining how to organize and store electronic documents, a lawyer should take into consideration the nature, scope, and length of the representation, and the client's likely need for ready access to particular documents. From an ethical standpoint, a lawyer should ensure that the manner of organization and storage does not (a) detract from the competence of the representation or (b) result in the loss of documents that the client may later need and may reasonably expect the lawyer to preserve.

This is more of an issue for e-mails than for other electronic documents. Law firms frequently store electronic documents other than e-mails, such as transactional documents and court filings, in a document management system. In such a system, electronic documents are typically coded with several identifying characteristics, including by client and matter. Many document management systems permit documents to be located by using those identifying characteristics, making it much easier to assemble them.

E-mails raise more difficult organizational and storage issues. Some e-mail systems automatically delete e-mails after a period of time. With such a system, a lawyer will have to take affirmative steps to preserve those e-mails that the lawyer decides to save. Furthermore, unless a lawyer organizes the saved e-mails to facilitate their later retrieval, it may be exceedingly difficult and expensive for the lawyer to retrieve those e-mails, and, as explained in Part V below, the lawyer must not charge the client for retrieval costs that could reasonably have been avoided.

Thus, a practice with much to commend it is to organize saved e-mails to facilitate their later retrieval, for example, by moving those e-mails to an electronic file devoted to a specific representation, or by coding those e-mails with specific identifying characteristics, such as a client and matter number, when the e-mails are first sent or received.

IV. A Lawyer's Obligation to Provide the Client with E-mails and Other Electronic Documents in the Lawyer's Possession

A related, but distinct, issue is the scope of a lawyer's obligation to provide the client with e-mails and other electronic documents retained by the lawyer. Put differently, once a lawyer decides to retain an e-mail or other electronic document — even when that electronic document does not have to be retained under our 1986 Opinion — does the lawyer have an obligation to provide the client with that electronic document upon request?

The Code does not explicitly address this issue. The Code recognizes that a client has a right to certain "papers and property" in the possession of the lawyer, but does not spell out what those "papers and property" consist of. See, e.g., DR 2-110(2) (providing that, upon withdrawing from a representation, a lawyer shall "deliver[] to the client all papers and property to which the client is entitled"); DR 9-102(C)(4) (providing that lawyer shall "[p]romptly pay or deliver to the client or third person as requested by the client or third person the funds, securities, or other properties in

the possession of the lawyer which the client or third person is entitled to receive").⁷

The leading New York case discussing this issue is the Court of Appeals' 1997 decision in *Sage Realty Corp. v. Proskauer Rose Goetz & Mendelsohn LLP*, 91 N.Y.2d 30, 37 (1997). Abandoning the distinction adopted by some courts "between documents representing the 'end product' of an attorney's services, which belong to the client, and the attorney's 'work product' leading to the creation of those end product documents, which remains the property of the attorney," *id.* at 35, the Court of Appeals adopted what it termed the "majority view." It held that "upon termination of the attorney-client relationship, where no claim for unpaid legal fees is outstanding," the client is "presumptively accord[ed]... full access" to the lawyer's file on a represented matter. *Id.* at 34.8

Sage Realty recognized two principal exceptions to the general rule of presumptive right of full access. The Court of Appeals held that a client is not entitled to the disclosure of (i) "documents which might violate a duty of nondisclosure owed to a third party, or otherwise imposed by law", or (ii) certain "firm documents intended for internal law office review and use" that are "unlikely to be of any significant usefulness to the client or to a successor attorney." *Id.* at 37-38. The Court of Appeals elaborated that this second category might include "documents containing a firm attorney's general or other assessment of the client, or tentative preliminary impressions of the legal or factual issues presented in the representation, recorded primarily for the purpose of giving internal direction to facilitate performance of the legal services entailed in that representation." *Id.*⁹

Consistently with the exceptions recognized by *Sage Realty*, a client does not have a presumptive right of access to e-mail communications between lawyers of the same law firm that are "intended for internal law office review and use" and are "unlikely to be of any significant usefulness to the client or to a successor attorney." Although it would be impossible to construct a list of the types of e-mails that would fall within the *Sage Realty*

exceptions, those e-mails might include an instruction to another lawyer or employee of the firm to perform a particular task; a preliminary analysis by a lawyer of a factual or legal issue in the representation; or a communication by a lawyer addressing an administrative issue.

The *Sage Realty* Court did not address whether a lawyer would need to provide client access to otherwise inconsequential documents similar to those intended for "internal law office review and use," but sent instead to or from a third party not employed by the lawyer's firm. Common examples of these documents are an e-mail sent to opposing counsel confirming the starting time of a deposition, or an e-mail sent to a testifying expert asking for transcripts of recent testimony. A lawyer is not under an ethical obligation to provide a client with electronic documents of this sort.

V. A Lawyer's Entitlement to Reimbursement for Providing the Client with Electronic Documents in the Lawyer's File

The burden associated with retrieving and producing e-mails and other electronic documents is mitigated by the lawyer's ability, under *Sage Realty*, to charge the client based on the lawyer's "customary fee schedules" for gathering and producing documents to a client. *Sage Realty*, 91 N.Y.2d at 38. Although the Court of Appeals' *Sage Realty* decision principally related to paper documents, we do not see any principled reason why a lawyer's fees may not reflect the reasonable costs of retrieving electronic documents from their storage media and reviewing those documents to determine the client's right of access. See DR 2-106.10 The reasonableness of that fee will often depend on the circumstances. On the one hand, it may be reasonable for a lawyer to charge a client for hiring an outside vendor to assist in the retrieval of electronic documents that a lawyer has stored on a less accessible storage medium that was widely in use at the time of retention. On the other hand, it may not be reasonable for a lawyer, who chooses not to use widely available and cost-effective technology to organize or code

electronic documents, to then charge the client the additional costs resulting from the lawyer's choice.

In some situations, a client might request a copy of the electronic documents in the lawyer's file, but decline to pay the lawyer's reasonable fee associated with the retrieval and review of those documents. As a general matter, a lawyer is not obligated to shoulder the costs of retrieving electronic documents in order to return those documents to the client. As the Court of Appeals held in *Sage Realty*: "[A]s a general proposition, unless a law firm has already been paid for assemblage and delivery of documents to the client, performing that function is properly chargeable to the client under customary fee schedules of the firm, or pursuant to the terms of any governing retainer agreement." 91 N.Y.2d at 38. We are reluctant, however, to articulate a bright-line rule. There may be some circumstances under which a client reasonably expects its lawyer to manage the client's e-mails and other electronic documents to allow for those materials to be sent to the client without either the lawyer or the client incurring substantial additional expense.¹¹ A lawyer should also consider whether to insist on the advance payment of fees associated with the retrieval and review of electronic documents when it is reasonably foreseeable that the client would suffer immediate harm as a result of any delay in the delivery of the requested documents.

VI. At the Outset of the Engagement Lawyer and Client Should Consider Discussing the Retention, Storage, and Retrieval of E-mails and Other Electronic Documents

In light of the exponential growth in e-mails and other electronic documents, and the pace of technological change involving the organization and storage of electronic documents, it may be prudent for a lawyer and client to discuss the retention, storage, and retrieval of electronic documents at the outset of an engagement. Lawyer and client may find it worthwhile to discuss and reach agreement at the outset on issues such as (i) the types of e-mail and other electronic documents that the lawyer intends to retain, given the nature

of the engagement; (ii) how the lawyer will organize those documents; (iii) the types of storage media the lawyer intends to employ; (iv) the steps the lawyer will take to make e-mail and other electronic documents available to the client, upon request, during or at the conclusion of the representation; and (v) any additional fees and expenses in connection with the foregoing. Consistently with the holding of *Sage Realty* and DR 2-106, those costs should accord with the lawyer's customary fee schedule and must not be excessive. By raising these issues at the outset of the representation, perhaps as part of the engagement letter, a lawyer and a client will be able to make informed decisions about the appropriate manner of retention, storage, and retrieval of electronic documents to which a client has a presumptive right of access.

CONCLUSION

In ABCNY Formal Op. 1986-4, we addressed a lawyer's obligations to retain paper documents relating to a representation. We now conclude that the guidelines articulated in ABCNY Formal Op. 1986-4 should also apply to a lawyer's obligations to retain e-mails and other electronic documents. With respect to the electronic documents that the lawyer retains, the lawyer is not under an ethical obligation to organize those documents in any particular manner, or to store those documents in any particular storage medium, so long as the lawyer ensures that the manner of organization and storage does not (a) detract from the competence of the representation or (b) result in the loss of documents that the client may later need and may reasonably expect the lawyer to preserve. To those ends, electronic documents other than e-mails present less difficulty because they are frequently stored in document management systems in which they are typically coded with several identifying characteristics, making it easier to locate and assemble them later. E-mails raise more difficult organizational and storage issues. Some e-mail systems automatically delete e-mails after a period of time, so the lawyer must take affirmative steps to preserve those e-mails that the lawyer decides to save. In addition, e-mails generally are not coded,

or otherwise organized, to facilitate their later retrieval. Thus, a practice with much to commend it is to organize saved e-mails to facilitate their later retrieval, for example, by coding them or saving them to dedicated electronic files.

Otherwise, it may be exceedingly difficult and expensive for the lawyer to retrieve those e-mails, and, as discussed in this Opinion, the lawyer must not charge the client for retrieval costs that could reasonably have been avoided.

In New York, a client has a presumptive right to the lawyer's entire file in connection with a representation, subject to narrow exceptions. The lawyer may charge the client a reasonable fee, based on the lawyer's customary schedule, for gathering and producing electronic documents. That fee may reflect the reasonable costs of retrieving electronic documents from their storage media and reviewing those documents to determine the client's right of access. It is prudent for lawyer and client to discuss the retention, storage, and retrieval of electronic documents at the outset of the engagement and to consider memorializing their agreement in a retention letter.

July 2008

1 This Opinion does not purport to address issues relating to the duty of a lawyer and client to preserve evidence, including electronic documents, that arise when a party has notice that the evidence is relevant to litigation or reasonably should know that the evidence may be relevant to anticipated litigation. See, e.g., *Zubulake v. UBS Warburg LLC*, 220 F.R.D. 212 (S.D.N.Y. 2003); *Delta Fin. Corp. v. Morrison*, 819 N.Y.S.2d 908 (Sup. Ct. Nassau County 2006).

2 The term "lawyer's file" is fast becoming a throwback to an earlier era, connoting as it does a collection of sorted physical documents. In this Opinion, "lawyer's file" means the collection of documents relating to a representation, regardless of the (electronic or paper) form or character (sorted or unsorted) of the documents.

3 Formal Opinion 1986-4 of the Committee on Professional and Judicial Ethics stated in pertinent part:

With respect to papers that belong to the lawyer, or papers as to which no clear ownership decision can be made, the answer to the questions whether and how long to retain such files is primarily a matter of good judgment, in the exercise of which the lawyer should bear in mind the possible need for the files in the future. See ABA Inf. Op. 1384 (1977); N.Y. State 460 (1977). The ABA guidelines, which follow, are particularly helpful:

- Unless the client consents, a lawyer should not destroy or discard items that . . . probably belong to the client. . . .
- A lawyer should use care not to destroy or discard information that the lawyer knows or should know may still be necessary or useful in the assertion or defense of the client's position in a matter for which the applicable statutory limitations period has not expired.
- A lawyer should use care not to destroy or discard information that the client may need, has not previously been given to the client, and is not otherwise readily available to the client, and which the client may reasonably expect will be preserved by the lawyer.
- In determining the length of time for retention or disposition of a file, a lawyer should exercise discretion. The nature and contents of some files may indicate a need for longer retention than do the nature and contents of other files, based upon their obvious relevance and materiality to matters that can be expected to arise.
- A lawyer should take special care to preserve, indefinitely, accurate and complete records of the lawyer's receipt and disbursement of trust funds.
- In disposing of a file, a lawyer should protect the confidentiality of the contents.
- A lawyer should not destroy or dispose of a file without screening it in order to determine that consideration has been given to the matters discussed above.
- A lawyer should [consider preserving], perhaps for an extended time, an index or identification of the files that the lawyer has destroyed or disposed of.

ABCNY Formal Op. 1986-4.

4 Although the 1986 Opinion recognized the distinction between documents that are the client's property and documents that are the lawyer's, it did not articulate any rules for drawing that distinction. This is understandable because the distinction is a question of law, and is therefore beyond the Committee's jurisdiction. See, e.g., N.Y. State 623 (1991) ("Which documents may be deemed to belong to the lawyer is not always easy to ascertain; in certain instances, the lawyer's ownership of such documents may be a complex issue of both law and fact."); ABCNY Formal Op. 1986-4 ("Initially, it must be determined whether the papers in question, including work product, belong to the client or to the attorney. This is a legal question beyond our jurisdiction.").

5But cf. ABA Informal Op. 1384 (1977) ("A lawyer does not have a general duty to preserve all of his files permanently. Mounting and substantial storage costs can affect the cost of legal services, and the public interest is not served by unnecessary and avoidable additions to the cost of legal services.").

6 On a related subject, the Committee on Professional Ethics for the New York State Bar Association has set forth procedures for the disposal of an attorney's file at the conclusion of the representation. See N.Y. State 623. With respect to documents belonging to a client, the New York State opinion calls for the lawyer, in the first instance, to make the documents available to the client and, depending on the nature of the client's response, to take steps designed to give the client a full opportunity to take possession of those documents. With respect to documents belonging to the lawyer, the New York State opinion provides that a lawyer may destroy all those documents without consultation or notice to the client, (i) except to the extent that the law may otherwise require, and (ii) in the absence of extraordinary circumstances showing a client's "clear and present need for such documents." N.Y.

State 623 (citing N.Y. State 398 (1975) and ABCNY Formal Op. 1986-4).

7See Cal. State Bar Formal Op. 2007-174 (construing e-mail and certain other electronic documents to fall within the scope of California Rule of Professional Conduct 3-700(D)(a), which provides that when a client requests the return of the "[c]lient papers and property," they include any items that are "reasonably necessary to the client's representation").

8 The Sage Realty Court agreed with those lower courts that "refused to recognize a property right of the attorney in the file superior to that of the client." 91 N.Y.2d at 36. For this proposition, Sage Realty relied upon the New York Supreme Court's decision in *Bronx Jewish Boys v. Uniglobe, Inc.*, which held that:

Under New York Law, an attorney has a general possessory retaining lien which allows an attorney to keep a client's file until his/her legal fee is paid. Implied in this is the rule that attorneys have no possessory rights in the client files other than to protect their fee. In other words, the file belongs to the client.

Bronx Jewish Boys v. Uniglobe, Inc., 166 Misc. 2d 347, 350, 633 N.Y.S.2d 711, 713 (Sup. Ct. 1995)(internal citation omitted).

9 The exceptions identified by Sage Realty to the presumption of client access to the documents in the lawyer's file are consistent with Comment (c) to Section 46 of the Restatement (Third) of the Law Governing Lawyers, which also recognizes circumstances under which a lawyer may refuse to provide certain documents in the lawyer's file to the client:

A lawyer may refuse to disclose to the client certain law-firm documents reasonably intended only for internal review, such as a memorandum discussing which lawyers in the firm should be assigned to a case, whether a lawyer must withdraw because of the client's misconduct, or the firm's possible malpractice liability to the client. The need for lawyers to be able to set down their thoughts privately in order to assure effective and

appropriate representation warrants keeping such documents secret from the client involved

10 In those instances when a lawyer's electronic documents have not been coded, or saved to a specific file, a lawyer will need to take steps to ensure that in returning electronic documents to a client, the lawyer does not inadvertently reveal the confidences and secrets of another client. See DR 4-101(B)(1).

11 See Model Rule 1.16(d) ("Upon termination of representation, a lawyer shall take steps to the extent reasonably practicable to protect a client's interests, such as giving reasonable notice to the client, allowing time for employment of other counsel, surrendering papers and property to which the client is entitled and refunding any advance payment of fee or expense that has not been earned or incurred. The lawyer may retain papers relating to the client to the extent permitted by other law."). The lawyer may retain copies of the client file at the lawyer's expense. See N.Y. State 780 (2004).