



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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New York Lawyers' Fund, Sixteenth Annual Report

Fiduciary and Law Office Record Keeping Rule

Disciplinary Rule 9-102 of the New York Lawyer's Code of Professional Responsibility 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. DR 9-102 is published at 22 NYCRR 1200.46.

DR 9-102 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.

Disciplinary Rule 9-102:

1200.46. 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 the State of New York which agrees to provide dishonored check reports in accordance with the provisions of Part 1300 of the joint rules of the Appellate Divisions. "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 he or she is a member, or in the name of the lawyer or firm of lawyers by whom he or she 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 which the lawyer may maintain as executor, guardian, trustee or re-

ceiver, or in any other fiduciary capacity, into which 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 the State of New York if such banking institution complies with such Part 1300, and the lawyer has obtained the prior written approval of the person to whom such funds belong which specifies 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 section 1200.46 (b)(1) of this Part as an "Attorney Special Account," or "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 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 presently 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.

(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 which the client or third person is entitled to receive.

(d) Required Bookkeeping Records. A lawyer shall maintain for seven years after the events which they record:

(1) The records of all deposits in and withdrawals from the accounts specified in section 1200.46(b) of this Part and of any other bank account which 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.

(2) 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.

(3) Copies of all retainer and compensation agreements with clients.

(4) Copies of all statements to clients or other persons showing the disbursement of funds to them or on their behalf.

(5) Copies of all bills rendered to clients.

(6) Copies of all records showing payments to lawyers, investigators or other persons, not in the lawyer's regular employ, for services rendered or performed.

(7) Copies of all retainer and closing statements filed with the Office of Court Administration.

(8) All checkbooks and check stubs, bank statements, prenumbered canceled checks and duplicate deposit slips with respect to the special accounts specified in DR 9-102(B)(subdivision [b] of this section) and other bank account which records the operations of the lawyer's practice of law. (**Note: citation should probably read: "section 1200.46(b) of this Part".**)

(9) 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.

(10) For purposes of section 1200.46(d) of this Part, 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 an attorney 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 section 1200.46 (d) of this Part. In the absence of agreement on such arrangements, any partner or former partner or member of a firm in dissolution may apply to the Appellate Division in which the principal office of the law firm is located or its designee for direction and such direction shall be binding upon all partners, former partners or members.

(i) Availability of Bookkeeping Records; Records Subject to Production in Disciplinary Investigations and Proceedings. The financial records required by this disciplinary 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 subdivision 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 lawyer-client privilege.

(j) Disciplinary Action. A lawyer who does not maintain and keep the accounts and records as specified and required by this Disciplinary 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
Accounts
and
Recordkeeping**



New York Lawyers' Fund for Client Protection

October 1999

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 disciplinary and court rules, statutes and bar association ethics opinions relating to attorney trust accounts, and accounting standards for law offices.

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 changes in court rules and statutes.

Like all practical guides, it is intended to provide a straightforward summary of the applicable rules and standards when a lawyer holds client money and escrow funds. It is not, of course, a substitute for the black-letter provisions of the New York Lawyer's Code of Professional Responsibility.

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We hope you find *A Practical Guide* to be informative and helpful in your practice.

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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 check notices" pursuant to statewide court rules.²

¹ Disciplinary Rule 9-102 of the Lawyer's Code of Professional Responsibility, 22 NYCRR 1200.46. The Appellate Divisions' Disciplinary Rules are published in 22 NYCRR Part 1200; *McKinney's Judiciary Law* (Appendix); and *McKinney's New York Rules of Court*.

² DR-9-102(b)(1), 22NYCRR1200.46(b)(1). The Dishonored Check Reporting Rules, effective January 1, 1993, are reported at 22 NYCRR Part 1300.

These rules also require that lawyers designate these 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.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. And only members of the New York bar can be signatories on the bank account.

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.⁴

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,

³ DR 9-102(b) (2); 22 NYCRR 1200.46(b)(2).

⁴ Judiciary Law, §497.

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.⁵ IOLA is a state agency which uses interest on attorney trust accounts to fund non-profit organizations 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: a sum of money, for example, that would not generate more than \$150 in interest for the client-owner.

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 bank service charges and fees on the account.

IOLA's offices are at 36 West 44th St., Suite 711, New York, New York 10036. Telephone (212) 944-9640, or 1-800-222-IOLA.

How should large trust deposits be handled?

When a client's funds and the anticipated holding period are sufficient to generate meaningful interest, a lawyer may have a fiduciary obligation to invest the client's funds in an interest-bearing bank account.⁶

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.

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.

⁵ State Finance Law, §97-v; Judiciary Law, §497.

⁶ See, NYSBA, Comm. on Prof. Ethics, Ops. 554 (1983), 575 (1986); Assoc. Bar, NYC, Comm. on Prof. & Jud. Ethics, Op. 86-5 (1986).

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.⁷

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; for referral 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 Reporting Rules.⁸ 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.

The Lawyers' Fund holds each dishonored check notice for 10 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.

⁷ NYSBA, Ops. 532 (1981), 582 (1987); NYC, Op. 81-68 (1981).

⁸ DR 9-102(b)(1), 22 NYCRR 1200.46(b)(1). The Dishonored Check Reporting Rules, effective January 1, 1993, are reported at 22 NYCRR Part 1300.

The purchase contract should make provision 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.⁹

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.¹⁰

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. If the advance fee becomes the lawyer's property when it is paid by the client, the fee should be deposited in the business account, and not in the attorney trust account.

If, on the other hand, 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.¹¹

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.¹²

⁹ General Business Law, Article 36-C, §§778,778-a.

¹⁰ See, General Business Law, §352-e(2-b).

¹¹ See, NYSBA, Op. 570 (1985).

¹² DR 2-110(a)(3); 22 NYCRR 1200.15(a)(3).

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 Protection.¹³

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 1994.¹⁴

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.¹⁵ There are also computer software packages for law office trust accounting.

¹³ DR 9-102(f); 22 NYCRR 1200.46(f) .

¹⁴ DR 9-102(g); 22 NYCRR 1200.46(g) .

¹⁵ Vendors include Eastern Systems, Inc., Safeguard Business Systems, Inc., and McBee One-Write Bookkeeping Systems.

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 preserve,¹⁶ for seven years after the events they record:

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

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.

In the event a law firm dissolves, appropriate arrangements must be made for the maintenance of the firm's records, either by a former partner or the successor law firm. In the absence of an agreement, the local Appellate Division has the authority to impose an arrangement.¹⁷

How are these rules enforced?

A violation of a Disciplinary Rule constitutes grounds for professional discipline under section

¹⁶ DR 9-102(d); 22 NYCRR 1200.46(d).

¹⁷ DR 9-102(h); 22 NYCRR 1200.46(h).

90 of the Judiciary Law. Also, the accounts and records required of lawyers and law firms by court rule may be subpoenaed in disciplinary proceedings.

Lawyers are also required to certify their familiarity and compliance with Disciplinary Rule 9-102 in the biennial 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 (previously the Clients' Security Fund) is financed by a \$100 share of each lawyer's \$300 biennial registration fee. The Lawyers' Fund receives no money from the IOLA program.

The Lawyers' Fund, established in 1982, is ministered *pro bono publico* by a Board of Trustees appointed by the State Court of Appeals.¹⁸ The Trustees provide upwards of \$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 \$200,000 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. Visit our Internet site at www.nylawfund.org.

¹⁸ Judiciary Law, §468-b; State Finance Law, §97-t.

Attorney Trust Accounts and Law Office Record Keeping

What follows is the text of a pamphlet guide published by the New York Lawyers' Fund and the New York State Bar Association in connection with a video presentation -- "Attorney Trust Accounts and Law Office Record Keeping" -- which outlines the fiduciary, banking and record keeping standards of Disciplinary Rule 9-102. The 15-minute video, with pamphlet guide, is available from the New York State Bar Association's Law Office Economics and Management Department. Call: (800) 699-5636.

Introduction

A successful law practice requires office systems and accounting controls to effectively serve clients. On any given day, lawyers in New York State are entrusted with millions of dollars in client funds. It's the lawyer's responsibility to preserve and safeguard those funds, in conformity with court rules, statutes and accepted business practices.

What follows is a guide to Attorney Trust Accounts and Law Office Record Keeping, a public-service video for the legal profession in New York State produced jointly by the New York State Bar Association and The Lawyers' Fund for Client Protection.

This 15-minute presentation focuses on current court rules, statutes and procedures that govern the fiduciary obligations of lawyers to maintain escrow and client trust accounts, IOLA bank accounts, and law office record systems. The video also covers the Appellate Divisions' new rules for bounced checks, missing clients and signatories for attorney trust accounts.

Attorney Trust Accounts and Law Office Record Keeping is designed for a broad audience — including members of the bar, law office employees, law students preparing for admission to the bar, accounting firms, and banks and other businesses that have banking and escrow transactions with New York lawyers and law firms.

This concise, plain-English overview of fiduciary, accounting, and record keeping standards will refresh every lawyer's knowledge of this important

aspect of the practice of law. Observing these standards will also guard against complaints of professional misconduct and malpractice for the loss of client and escrow funds.

Disciplinary Rule 9-102

Disciplinary Rule 9-102 of the Lawyer's Code of Professional Responsibility is the controlling court rule for lawyers handling clients' money and property, and for the maintenance of law office records. The rule applies to every lawyer and law firm in New York State. See 22 NYCRR 1200.46.

The Appellate Divisions of the Supreme Court have designated 9-102 as a "Disciplinary Rule." That means that a lawyer or law firm that violates DR 9-102 is exposed to charges of professional misconduct and discipline by an Appellate Division of the Supreme Court.

Fiduciary Responsibility

The key word in DR 9-102 is "fiduciary." Once a lawyer is entrusted with another person's money or property in the practice of law — and it need not be a law client — the lawyer assumes the additional responsibility of becoming a fiduciary. As every lawyer knows, a fiduciary is a trustee with scrupulous obligations of trust, good faith, and candor.

The role of fiduciary has several basic ethical obligations attached to it in financial transactions. The general principles:

- A trustee must segregate a client's assets from the trustee's own business and personal funds. Clients' money, in particular, must be deposited in bank accounts completely separate from the trustee's own accounts. Property other than money must be clearly identified as trust property and secured in a safe or safe deposit box.
- A trustee must notify a client or escrow beneficiary in writing whenever the trustee receives any funds or property on their behalf.
- A trustee must provide timely and complete accountings of trust money or property in the custody or control of the trustee.
- A trustee must promptly disburse all funds and property to trust and escrow clients and beneficiaries.

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

For example, it is not uncommon in the purchase and sale of a residence for the seller's lawyer to hold the purchaser's down payment in escrow until the closing, or transfer of title. The fiduciary rules of DR 9-102 apply to the seller's lawyer, notwithstanding that the purchaser is not the law client.

Engagement Letters

At the outset of a legal representation, it is good business practice to provide the client with an engagement letter, particularly where the fee to be charged is expected to be \$1,000 or more. The letter serves as a permanent record of the understanding between the parties.

Law Practice Bank Accounts

To comply with the fiduciary and banking obligations of DR 9-102, lawyers and law firms need at least two kinds of bank accounts. The first is an operating or business account for the deposit of daily receipts, such as legal fees, and the disbursement of money to pay the operating expenses of the law practice. The second is the attorney trust account — a separate account to be used exclusively for entrusted client funds or escrow money.

Attorney Trust Accounts

When a lawyer is entrusted with client or escrow funds, DR 9-102 requires that the funds be deposited in a special bank account, usually a checking account. The account can be used only for the management of client and escrow funds.

These accounts must have a special designation:

- Attorney Trust Account, or
- Attorney Escrow Account, or
- Attorney Special Account.

Checks on these special client accounts must be pre-numbered, and checks and deposit slips must be imprinted with the title of the account.

A lawyer or law firm may maintain a single account for all clients or individual accounts for specific clients or escrow beneficiaries. The point is that these must be separate accounts, and that there can be no commingling of client and escrow funds with the lawyer's personal or business funds.

All signatories on these accounts must be lawyers licensed to practice in New York State. And these special client accounts must be maintained in approved banking institutions located within New York State. Out-of-state banks may be used only with the prior written consent of the client or escrow beneficiary.

Deposits and Withdrawals

When a lawyer receives funds, in the form of a check or draft, that will be paid to a client or escrow beneficiary, the check or draft must be deposited into an attorney trust, escrow or special account. Before disbursing funds from that deposit, the lawyer or law firm should make certain that the deposit has cleared the payor's bank.

If a bank charges service fees to maintain an attorney trust, escrow or special account, DR 9-102 permits a lawyer or law firm to deposit money into the account to cover those charges. This is an obvious exception to the ethical ban on "commingling".

Funds in which the lawyer and the client have a present or potential shared interest — such as the proceeds of a personal injury settlement — are also required to be deposited in the attorney trust, escrow or special account.

The lawyer's share should be withdrawn from the account by the lawyer or law firm as soon as it's earned or due, unless the client disputes the withdrawal. In that event, the disputed portion of the funds should be left intact until the dispute is resolved.

All withdrawals from an attorney trust, escrow or special account must be payable to named payees and never to "cash." And as noted previously, only members of the bar can be signatories on these special accounts.

Advance Legal Fees

It is good business practice to deposit all fees paid in advance into the attorney trust, escrow or special account, to be withdrawn from the account as earned by the lawyer or law firm.

If, on the other hand, the lawyer and client agree that the advance fee becomes the property of the lawyer when paid by the client, the fee should be

deposited in the lawyer's operating or business account.

In either event, it is important to understand that Disciplinary Rule 2-110 (a) (3) of the Lawyer's Code of Professional Responsibility requires a lawyer to refund to a law client all unearned fees (and unused disbursements) at the conclusion of a legal representation.

Interest on Attorney Trust Accounts

Because a lawyer is a fiduciary when entrusted with client funds and escrow property, the lawyer may have a fiduciary obligation to make those funds productive by depositing them in interest-bearing bank accounts.

If a client's funds are substantial and can earn significant interest, the lawyer and client should consider establishing a special interest-bearing attorney trust, escrow or special account for that client or escrow beneficiary. The lawyer should make sure that the bank understands the arrangement. The lawyer should also use the client's social security or federal tax identification number so that interest is properly reported as being paid to the client, not to the lawyer.

IOLA Bank Accounts

In many legal engagements, the attorney trust, escrow or special account will be used for short-term deposits of client funds. If the term is a matter of days, it would not be economical to set up a special interest-bearing account for that client. The same would be true if only nominal amounts of client money are involved.

For short-term and nominal deposits, New York law encourages the establishment of so-called IOLA attorney trust accounts. IOLA is the acronym for the "Interest On Lawyer Account" program that is authorized by state statute.

Pursuant to section 497 of the Judiciary Law, the bank interest that's earned on these special accounts statewide is pooled and distributed in grants to fund civil legal services for the poor, and projects to improve the administration of justice in New York State.

IOLA accounts can be established at most banks in New York State. With respect to the interest generated by these accounts, there are no income tax consequences for law clients or lawyers. Moreover, IOLA pays the bank service fees to maintain these special trust accounts.

Master Attorney Trust Accounts

The IOLA statute permits members of the bar to use new banking programs that provide a segregated "sub-account" structure for lawyers and law firms. These sub-account programs generate interest for the law client or escrow beneficiary. With these new programs, lawyers can manage funds of numerous clients through one master attorney trust, escrow or special account. Banks maintain unique and segregated accounts for law clients and escrow beneficiaries, and their accounts are allocated their respective shares of bank interest.

Lawyers May Not Profit With Bank Interest

Being a fiduciary means that a lawyer or law firm cannot profit on the administration of an attorney trust, escrow or special account. While a lawyer is permitted to charge a reasonable fee for administering a client's special bank account, all earned interest belongs to the client or other person whose money generated the interest. In no case can a lawyer charge or calculate a legal fee based on the interest being earned on a client's trust account.

Bounced Checks

A bounced check on an attorney trust, escrow or special account is a signal that client funds may be in jeopardy. Pursuant to statewide court rules, banks in New York State now report bounced checks on these accounts to the Lawyers' Fund for Client Protection. See 22 NYCRR 1200.46, 1300.1.

The Lawyers' Fund holds each bounced check notice for 10 days to permit the filing bank to withdraw a report that was sent in error. If the notice is not withdrawn, the Lawyers' Fund forwards the bounced check notice to the appropriate attorney grievance committee for investigation, which includes an audit of the firm's law client accounts.

Unclaimed Client Funds

There are times when a lawyer or law firm cannot locate a client or other person who is owed funds from the attorney trust account. If this happens, Disciplinary Rule 9-102 (F-1) requires a judicial order fixing and allowing legal fees and disbursements owed to the lawyer. The court's order will provide that the balance be paid to the Lawyers' Fund for safeguarding and payment to its owner.

Death of a Lawyer/Sole Signatory

Disciplinary Rule 9-102 (F-2) provides that when a sole signatory on an attorney trust, escrow or special account dies, the Supreme Court in the local judicial district has authority to appoint a successor signatory for the account.

Dissolution of a Law Firm

In the event your law firm dissolves, arrangements must be made for the maintenance of the firm's records, either by a former partner or the successor law firm. In the absence of an agreement, the local Appellate Division of the Supreme Court can impose an arrangement.

Law Firm Accounting Systems

Disciplinary Rule 9-102 does not mandate the use of a specific accounting system for a law practice. However, a basic system for a law firm consists of a cash received and fees charged journal, a cash disbursements journal, and a trust ledger “book” which contains the individual ledger accounts for recording each financial transaction affecting each client’s funds.

Client Ledger Accounts

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” manual system provides an efficient and economical method of trust accounting for their law practices. Of course, computer software packages are becoming increasingly available. When using a computer, a lawyer should make periodic and routine back-up copies of accounting files, and make and preserve printed “hard” copies of those accounts.

Maintain each client’s account daily and, as a matter of good business practice, 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.

Maintaining Office and Banking Records

Every lawyer and law firm in New York State must preserve, for seven years after the events they record:

- copies of all accounting books for attorney trust and office operating accounts
- checkbooks and check stubs, bank statements, pre-numbered canceled checks and duplicate deposit slips

- 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
- retainer and closing statements filed with the Office of Court Administration.

Conclusion

The lawyer who serves as a fiduciary fulfills a vital role in preserving public confidence in the honesty and integrity of lawyers when entrusted with client and escrow money. Lawyers earn that trust daily by keeping their fiduciary accounts in true balance.

On another level, the lawyers of New York State protect clients when a colleague abuses that trust. Lawyers finance, with a share of their biennial registration fee, a program to reimburse clients for the misuse of their money in the practice of law. It’s called the New York Lawyers’ Fund for Client Protection.

The New York State Bar Association and the Lawyers’ Fund hope that the procedures and guidelines presented in this video will help you understand and maintain the fiduciary standards that are required of a profession that’s committed to public service.

Know Your Escrow Rights

The Lawyer's Edition

by Frederick Miller

Foreword

Since 1982, New York State's legal profession, through its Lawyers' Fund for Client Protection, has restored more than \$75 million to law clients and beneficiaries of escrow transactions for money and property that was misused in the practice of law. Each year the Trustees of the fund budget \$8 million to provide reimbursement to eligible victims of lawyer dishonesty.

Escrow losses coming to the Lawyers' Fund typically involve escrows in real property transactions, usually residential sales and down payments. Other escrow losses include bulk sales and special deposits created in the course of litigation.

Because the New York Lawyers' Fund provides clients with coverage of \$200,000 per loss, most escrow thefts qualify for full reimbursement if, of course, the dishonest (and disbarred or dead) practitioner is unable to make restitution. In a typical year, losses are attributable to less than 50 dishonest lawyers. At the close of 1998, there were more than 177,000 licensed lawyers in the Empire State.

There's an old and solid principle of common law that law clients can rightfully trust in the integrity of their attorneys. That being said, no law client is excused from exercising common sense, or an informed judgment. In the field of escrow, clients (and lawyers) have practical means to prevent losses and, in some cases, to promptly detect and remedy them.

Toward those ends, the Trustees of the Lawyers' Fund have published a pamphlet called, *Know Your Escrow Rights*. It's a plain-English guide to the rights of consumers and law clients, and the fiduciary obligations of escrow agents. It's available from the Lawyers' Fund without charge.

The practical suggestions in *Know Your Escrow Rights* are based upon New York laws, rules and court decisions. Observing

them will help consumers avoid disagreements in escrow transactions, and prevent the misuse or loss of escrow money and property. For the Lawyers' Fund, every dollar saved from loss is a dollar that will be used to help other law clients in need of reimbursement.

What follows is the plain-English text of the consumer pamphlet, annotated as a public service for members of the New York bar. The preface to the consumer edition includes the important admonition:

Because escrow agreements are legal contracts that involve important rights and obligations, the careful consumer will consult an attorney before entrusting money or property with an escrow agent.

What's an escrow?

An escrow is a legal arrangement to help parties perform their contracts and avoid disagreements. The escrow agreement has three parties: a "depositor", an "escrow agent" and a "beneficiary".¹

In the typical escrow, the depositor is required to entrust money or property with an escrow agent. The escrow agent holds the escrow deposit until it can be released to the beneficiary upon the happening of some future event, or the performance of some condition.²

A common example involves the down payment in the purchase and sale of a residence, condominium or cooperative. The contract frequently requires that the buyer's down payment be paid to the seller's lawyer, in escrow, or to a real estate broker, pending the title closing.³

In this escrow example, the buyer is the depositor, and the seller is the beneficiary. The seller's lawyer or real estate broker is the escrow agent who undertakes to safeguard the down payment in a special bank account until the contract has been

performed, or is canceled by the buyer and seller.⁴

If the purchase goes forward as planned, the escrow agent will release the down payment to the seller at the title closing. If the buyer and seller agree to cancel their contract, the escrow agent is usually required to return the down payment to the buyer.

The escrow will terminate when the contract has been performed;⁵ abandoned;⁶ or the escrow fund depleted.⁷

What are other examples of escrows?

Other escrows include settlements in personal injury and other court cases; agreements to distribute property in matrimonial actions; and, in the bulk sale of business assets, escrows to insure that taxes and business debts will be paid.

There are also consumer escrows that are regulated by special state laws. Examples include escrow accounts for rent security deposits;⁸ real property tax escrow accounts required by mortgage lenders;⁹ deposits paid to builders constructing new homes;¹⁰ down payments for homeowners associations and time-share projects;¹¹ advance fees paid to automobile brokers;¹² membership fees paid to health clubs and licensed campsgrounds;¹³ and entrance fees and deposits paid on life-care community contracts.¹⁴

Are written escrow agreements required?

Not in all cases. However, someone considering an escrow transaction should insist that the escrow agreement be in writing, and be reviewed by a lawyer. Every escrow agreement should contain provisions which set forth:

- the names and addresses of the depositor, the escrow agent and the beneficiary;
- the amount of the escrow deposit;



- the name and address of the bank where escrow money will be deposited, and the title and number of the bank account;

- whether the escrow agent is required to use an interest-bearing account, and how the interest earned on the deposit will be distributed;

- the conditions that must occur or be performed before the escrow agent can release the escrow fund;

- time limits for the performance of these conditions;

- the names and addresses of all persons who will be paid the escrow fund; and

- the duties of the escrow agent in the event the conditions of the escrow agreement cannot be met.¹⁵

It's also a good practice for the parties, or their attorneys, to require a copy of the written agreement, and a periodic status report from the escrow agent regarding the current balance in the escrow account, if any, and its location.

Who does an escrow agent work for?

The escrow agent's authority is defined and controlled by the escrow agreement.¹⁶ It is beyond an escrow agent's authority to amend or reform an inadequate or ambiguous escrow agreement.¹⁷

A person who serves as an escrow agent is a fiduciary, with duties to all parties who have an interest in the escrow property.¹⁸ The most important duty is to safeguard the escrow property.¹⁹ If it's money, it must be deposited in a special bank account that's separate from the escrow agent's personal and business accounts.²⁰

An escrow agent should provide the parties with a receipt for the escrow property, a copy of the escrow agreement and keep complete and accurate records.²¹ Depositors and beneficiaries have a right to a full accounting of the escrow agent's management of the escrow property.²²

An escrow agent has the legal duty to comply strictly with the terms and conditions of the escrow agreement.²³ Escrow property cannot be delivered to anyone, except in accordance with the provisions of the escrow agreement.²⁴

An escrow agent who releases escrow property in violation of an escrow agreement is subject to money damages in a civil court action brought by any

party who has suffered economic loss because of the agent's breach of duty.²⁵

A law firm commits a conversion when it withdraws a legal fee from a settlement escrow and prejudices the superior rights of an escrow beneficiary.²⁶

Are escrow agents paid for their services?

Escrow agents can serve with or without compensation. If an escrow agent expects to be paid for administering an escrow account or property, the matter of fees and reimbursement of expenses should be clearly set forth in the escrow agreement.

Can escrow agents assert liens against escrow property?

No. An escrow agent can have no claim or lien on the escrow deposit for services rendered,²⁷ unless the escrow agreement provides otherwise.²⁸

The escrow agent is simply a custodian of the escrow property,²⁹ which must be paid out as the escrow agreement provides.³⁰

Are interest-bearing accounts required for escrow deposits?

Not in all cases,³¹ but escrow agreements should require interest-bearing accounts when escrow funds can generate significant interest for one or more of the parties. For small and short-term escrow deposits, lawyers are permitted by state law to use so-called "IOLA" bank accounts³². Interest earned on these IOLA accounts is pooled and used to finance civil legal services for the poor.³³

If you arrange for an interest-bearing bank account, the escrow agent and bank may require a Social Security or Federal Tax Identification number for federal and state income tax purposes.

Can escrow agents keep bank interest?

No. All interest that's earned on an escrow deposit should be paid out in accordance with the escrow agreement, or to the party whose money generated the

interest. It would be a conflict of interest for an escrow agent, as a fiduciary,³⁴ to require that bank interest be treated as compensation for services rendered.³⁵

If an escrow deposit is stolen, who bears the loss?

Unless an escrow agreement provides otherwise, the loss generally falls on the party who owned the escrow property at the time of its theft.³⁶ In the case of a stolen down payment, that's usually the buyer, who may be asked by the seller to replace the down payment before title closes. Of course, an injured party will have the right to seek money damages from the dishonest escrow agent.³⁷

Are there danger signals to watch for?

Yes, and consumers can protect themselves against losses. A deposit of money with an escrow agent should be made by check, for example, and not with cash. The check should be promptly deposited in a special bank account identified in the escrow agreement. The depositor should review the endorsement on the check to make sure that the escrow agent has made the proper bank deposit. The beneficiary of an escrow agreement should be wary if an escrow agent delays in releasing escrow property. And a bounced check from an escrow agent is a signal that escrow money might have been misused. In these situations, the careful consumer will promptly consult a lawyer.

How to handle disputes.

The escrow agent must make an independent determination whether the parties have complied with the escrow agreement.³⁸ A party who claims a right to an escrow deposit must show a clear right to the deposit.³⁹ An escrow agent who is uncertain as to which claimant is entitled to possession of the escrow deposit, or whether the agreed condition in the escrow agreement has been performed, has the remedy of interpleader,⁴⁰ in which the escrow agent deposits the escrow with a court and seeks a judicial determination as to its rightful owner.⁴¹

What's the Lawyers' Fund for Client Protection?

The New York Lawyers' Fund is a state agency that the legal profession finances to



protect law clients from dishonest conduct in the practice of law.⁴²

The Lawyers' Fund is administered by a Board of Trustees composed of lawyers and non-lawyers.⁴³ The Trustees are permitted to reimburse law clients when a lawyer misuses or steals client money and property in the practice of law.⁴⁴

The fund's coverage is \$200,000 per client loss.⁴⁵ To qualify, the loss must occur in the practice of law, and an attorney-client relationship.⁴⁶

Reimbursement procedures are simple and cost-free. In addition, lawyers who help clients seek reimbursement cannot charge legal fees for this professional service.⁴⁷

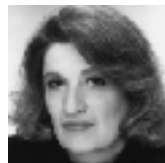
Losses reimbursed by the fund include the theft of down payments in real property transactions, estate and trust assets, personal injury settlements and money embezzled from clients in investment transactions. The fund cannot settle fee disputes, or compensate for a lawyer's malpractice or neglect.⁴⁸

A law client seeking reimbursement must also file a complaint with the appropriate Attorney Grievance (Disciplinary) Committee in the locality where the lawyer practices, and cooperate fully with the Committee's investigation.⁴⁹ Awards from the fund are generally made after a lawyer's disbarment, and where the lawyer is unable to make restitution.

Application forms, information and other help is available from the offices of the New York Lawyers' Fund in Albany. Telephone 518-434-1935 or 800-442-FUND (3863). Internet: www.nylawfund.org



Frederick Miller, Executive Director and Counsel, New York Lawyers' Fund for Client Protection.



Eleanor Breitel Alter of Manhattan has served as Chairman of the Board of Trustees since 1985. She is a partner in the Manhattan law firm of Kasowitz, Benson, Torres & Friedman.



Theodore D. Hoffmann of Hicksville, Nassau County, is Vice-Chairman of the Board. Mr. Hoffmann is Counsel to the Garden City law firm of Albanese, Albanese & Fiore.



Charles Joseph Hynes of Brooklyn is the District Attorney of Kings County.



Ray W. Manuszewski of Cheektowaga, Erie County, is the fund's Treasurer. A graduate of Canisius College (1951), Mr. Manuszewski is a former Regional President of Manufacturers Hanover Trust Company N.A. in Buffalo.



Eric A. Seiff lives in the Bronx and is a partner in the Manhattan law firm of Seiff Kretz & Maffeo.



Bernard F. Ashe of Delmar, Albany County, is a former General Counsel to New York State United Teachers.



Shirley B. Waters of Rome, Oneida County, is Vice President of the Rome Sentinel Company, which publishes the *Daily Sentinel* newspaper.

The Trustees of the New York Lawyers' Fund

Section 468-b of the Judiciary Law provides for the administration of the fund; and section 97-t of the State Finance Law governs the management of its assets as a special trust account on deposit in the State Treasury. Both statutes vest management authority in the fund's Board of Trustees.

They serve renewable terms of three years, and without compensation for their services. Since 1981, the Court of Appeals has preserved the mix of five members of the bar and two business and community leaders.

The Board's officers are a Chairman, Vice-chairman, and Treasurer. The fund's Executive Director serves as the Board's Secretary and its Counsel.

Statutes and judicial precedent give the Board sole discretion to determine the merits of claims, and the amount of reimbursement to be awarded.

Distinguished former members of the Board of Trustees include Chief Judge Judith S. Kaye (1981-1983); Joseph Kelner, Esq. (1981-1982); Anthony R. Palermo, Esq. (1981-1990); and John F.X. Mannion (1981-1992).

Special thanks to Stefanie R. DiLallo, a student at Albany Law School, for her research help.

Annotations

¹ *Silberstein v. Murdoch*, 216 App. Div. 665, 216 N.Y.S. 657 (1st Dep't 1926).

² 55 N.Y. Jur.2d Escrow § 1; see, *Animalfeeds Internat'l, Inc. v. Banco Espirito Santo E Commercial De Lisboa*, 101 Misc. 2d 379, 420 N.Y.S.2d 954 (New York Co. Sup. Ct. 1979); *National Union Fire Ins. Co. v. Proskauer Rose, N.Y.L.J.*, August 16, 1994, at 22 (New York Co. Sup. Ct.).

³ See, N.Y. Gen. Bus. Law §§ 778, 778-a.

⁴ *New York Lawyer's Code of Professional Responsibility DR 9-102(A)*; 22 NYCRR 1200.46(a); see generally, *Assoc. Bar, NYC, Comm. on Prof. & Jud. Ethics, Op. 86-5 (1986)*; *Assoc. Bar, NYC, Comm. on Prof. Disc., Other People's Money: Procedures and Pitfalls in Handling Client Funds; New York Lawyers' Fund for Client Protection, A Practical Guide to Attorney Trust Accounts and Recordkeeping (1992)*.

⁵ 55 N.Y. Jur. 2d Escrow § 1; see *Id.*; *National Union Fire Ins. Co. v. Proskauer Rose, N.Y.L.J.*, August 16, 1994, at 22 (New York Co. Sup. Ct.).

⁶ *Kosinski v. Gallt* 58 Misc. 2d 124, 294 N.Y.S.2d 602 (Nassau Co. Sup. Ct. 1968).

⁷ *Re Estate of Reece* 122 Misc.2d 517, 470 N.Y.S.2d 974 (1983)

⁸ N.Y. Gen. Oblig. Law § 7-103 (*McKinney's* 1989).

⁹ N.Y. Gen. Oblig. Law §§ 5-601 et seq. (*McKinney's* 1989).

¹⁰ N.Y. Gen. Bus. Law §§ 779 et seq. (*McKinney's* 1984).

¹¹ N.Y. Gen. Bus. Law § 352-e(2)(b) (*McKinney's* 1984 & Supp. 1994).

¹² N.Y. Gen. Bus. Law §§ 740 et seq. (*McKinney's* 1984 & Supp. 1994).

¹³ N.Y. Gen. Bus. Law §§ 687 et seq. (*McKinney's* 1984 & Supp. 1994).

¹⁴ N.Y. Pub. Health Law § 4611 (*McKinney's* 1985 & Supp. 1994).

¹⁵ See, *Animalfeeds*, 101 Misc. 2d at 383, 420 N.Y.S.2d at 957; for drafting considerations, see 8 Am. Jur. Legal Forms 2d §§ 100.11 et seq.; 19 West Legal Forms 2d §§ 13.1 et seq.

¹⁶ 55 N.Y. Jur.2d Escrow §15; see *Gershen v. Gersten* 6 A.D.2d 862, 175 N.Y.S.2d 841 (1st Dep't 1958); *Entertainment & Amusements of Ohio, Inc. v. Barnes* 49 Misc. 2d 316, 267 N.Y.S.2d 359 (Onondaga Co. Sup. Ct. 1966).

¹⁷ N.Y.S. Comm. On Professional Ethics, *Op. 710 (1998)*; see 22 N.Y. Jur.2d Escrow § 15; see also, *Stein v. Rand Constr. Co.* 400 F. Supp 944, 16 UCCRS 1150 (S.D.N.Y. 1975).

¹⁸ *Oppenheim v. Simon*, 57 A.D.2d 1006, 394 N.Y.S.2d 500 (3d Dep't 1977); see, *Assoc. Bar, NYC, Comm. on Prof. & Jud. Ethics, Op. 86-5 § 1 (1986)*.

¹⁹ *Matter of Neuhoff's Will*, 107 Misc. 2d 589, 435 N.Y.S.2d 632 (Nassau Co. Surr. Ct. 1980), *aff'd* 107 A.D.2d 417, 486 N.Y.S.2d 956 (2d Dep't 1985).

²⁰ See, *New York Lawyer's Code of Professional Responsibility DR 9-102(A)*; 22 NYCRR 1200.46(a).

²¹ See, *New York Lawyer's Code of Professional Responsibility DR 9-102(B)(3)*; 22 NYCRR. 1200.46(b)(3).

²² See, *New York Lawyer's Code of Professional Responsibility DR 9-102(B)(3)*; 22 NYCRR 1220.46(b)(3); *Assoc. Bar, NYC, Comm. on Prof. & Jud. Ethics, Op. 86-5 § 10 (1986)*.

²³ *Farago v. Burke*, 262 N.Y. 229, 186 N.E. at 685 (1933); see, *Matter of Bigman*, 178 A.D.2d 90 (2d Dep't 1992); *National Union Fire Ins. Co.*, supra note 2, at 22.

²⁴ *Farago*, 262 N.Y. at 133, 186 N.E. at 685

²⁵ *Grinblat v. Taubenblat*, 107 A.D.2d 735, 484 N.Y.S.2d 96 (2d Dep't 1985); see *National Union Fire Ins. Co.*, supra note 2, at 22; see also *Takayama v. Schaefer* 240 A.D.2d 21, 669 N.Y.S.2d 656 (2nd Dep't 1998).

²⁶ See *Bank of India v. Weg and Myers*, 1999 N.Y. App. Div. LEXIS 6487 (1st Dep't June 8, 1999)

²⁷ *Entertainment & Amusements of Ohio, Inc. v. Barnes*, 49 Misc. 2d 316, 267 N.Y.S.2d 359 (Onondaga Co. Sup. Ct. 1966); *National Union Fire Ins. Co.*, supra note 2, at 22; see, *Nassau Bar Opinion 85-7 (1985)*. See also *Gala Enters. v. Hewlett Packard Co.*, 970 F. Supp. 212, (D.N.Y. 1997) (an escrow fund may be subject to attachment if the depositor retains sufficient control or interest over the funds); *Lang v. State No. 1528-1528A*, 1999 N.Y. App. Div. LEXIS 8929 (1st Dep't 9/2/99) (defendant's attorney could not assert a claim for legal fees against an escrowed restitution fund); *Koroleski v. Badler*, 32 A.D.2d 810, 303 N.Y.S.2d 221 (2nd Dep't 1969).

²⁸ *Entertainment & Amusements of Ohio, Inc. v. Barnes*, 49 Misc. 2d 316, 267 N.Y.S.2d 359 (Onondaga Co. Sup. Ct. 1966); See, *Heyward v. Maynard*, 119 App. Div. 66, 103 N.Y.S. 1028 (where attorney was entitled to be paid out of escrowed property because the parties had agreed to it); see also *Mayeri Corp v. Shea and Gould*, 112 Misc. 2d 734, 447 N.Y.S.2d 413 (N.Y. Co. Sup. Ct. 1982) (where law firm held escrow deposit as escrow agent in landlord-tenant dispute, not as attorney for parties, the firm was not entitled to claim charging or retaining liens).

²⁹ *Entertainment & Amusements*, 49 Misc.2d at 318-19, 267 N.Y.S.2d at 363.

³⁰ *Farago*, 262 N.Y. at 233, 186 N.E. at 685. See *Lang v. State No. 1528-1528A*, 1999 N.Y. App. Div. LEXIS 8929 (1st Dep't September 2, 1999) (defendant's attorney could not assert a claim for legal fees against an escrowed restitution fund). See also *Gala Enters. v. Hewlett Packard Co.*, 970 F. Supp. 212, (D.N.Y. 1997) (an escrow fund may be subject to attachment if the depositor retains sufficient control or interest over the funds); *Koroleski v. Badler*, 32 A.D.2d 810, 303 N.Y.S.2d 221 (2nd Dep't 1969).

³¹ See, *Assoc. Bar, NYC, Comm. on Prof. & Jud. Ethics, Op. 86-5 § 8 (1986)*.

³² N.Y. Jud. Law § 497 (*McKinney's* 1983 & Supp. 1994); N.Y. State Fin. Law § 97-v(4) (*McKinney's* 1989).

³³ N.Y. State Fin. Law § 97-v(3) (*McKinney's* 1989).

³⁴ See, generally, *Matter of Neuhoff's Will*, 107 Misc.2d 589, 435 N.Y.S.2d 632 (Nassau Co. Surr. Ct. 1980), *aff'd* 107 A.D.2d 417, 486 N.Y.S.2d 956 (2d Dep't 1985).

³⁵ NYSBA, *Ops. 532 (1981)*, 582 (1987); but cf. *Assoc. Bar, NYC, Op. 81-68 (1981)*.

³⁶ *Asher v. Herman*, 49 Misc.2d 475, 267 N.Y.S.2d 932 (Queens Co. Sup. Ct. 1966).

³⁷ *Grinblat*, 107 A.D.2d at 736, 484 N.Y.S.2d at 97.

³⁸ *Aktivis v. Brecher* 128 Misc. 2d 965, 492 N.Y.S.2d 316 (Kings Co. Sup. Ct. 1985); see 55 NY Jur 2d Supp § Escrow 16.

³⁹ *Takayama v. Schaefer* 240 A.D.2d 21, 669 N.Y.S.2d 656 (2nd Dep't 1998); see *Falk v. Goodman* 7 N.Y.2d 87, 195 N.Y.S.2d 645; see also *Falk v. Goodman* 7 A.D.2d 1014, 185 N.Y.S.2d 231 (2nd Dep't 1959)

⁴⁰ NY CPLR 1006 (*McKinney's* 1997); see 55 N.Y. Jur.2d Escrow § 40.

⁴¹ *Casolaro v. Blau* 4 Misc. 2d 206, 158 N.Y.S.2d 589 (Queens Co. Sup. Ct. 1956); *Lindley v. Robillard* 208 Misc. 532, 144 N.Y.S.2d 33 (Onondaga Co. Sup. Ct. 1955); see 55 N.Y. Jur.2d Escrow § 41.

⁴² 22 NYCRR 7200.1.

⁴³ 22 NYCRR 7200.2(a),(b).

⁴⁴ 22 NYCRR 7200.4(g), 7200.8(a)(2).

⁴⁵ 22 NYCRR 7200.13(a).

⁴⁶ 22 NYCRR 7200.8(a)(1),(2).

⁴⁷ 22 NYCRR 7200.14(b).

⁴⁸ 22 NYCRR 7200.8(d),(e)(3).

⁴⁹ 22 NYCRR 7200.8(a)(5).



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 \$300 biennial registration fee which is split between the New York Lawyers' Fund for Client Protection and 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 the 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 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 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 \$100 share of the \$300 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 engaging in frivolous conduct in the course of civil litigation (see 22 NYCRR Parts 130 and 131-a). 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. 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 client 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, and IOLA's Trustees have determined that a deposit of client funds is "qualified", for purposes of the statute, if the escrow deposit would not generate \$150 in interest.

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.

The constitutionality of IOLA-type programs is the subject of pending litigation in the federal courts. See, Phillips v. Washington Legal Foundation, Inc., 118 S. Ct. 1925 (1998).

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.

**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 administering [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 con-

tract 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 book-keeping 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 certi-

fied 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 simi-

lar 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.

**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 proper 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.

Highlights from the Trustees' Sixteenth Annual Report

Business in 1998 was brisk. The year opened with 562 pending claims seeking reimbursement. They alleged losses of \$47 million resulting from dishonest conduct in the practice of law. The fund's liability on those claims amounted to \$17 million.

There were 812 new claims filed in 1998. They alleged losses totaling \$24 million. During the course of 1998, the Trustees approved awards to 415 victims of lawyer dishonesty. Another 522 claims were rejected as ineligible for reimbursement. Awards to eligible victims totaled \$6 million.

All claims processed to final disposition in 1998 involved alleged losses of \$42 million. At the close of 1998, there were 337 claims pending. They alleged losses of \$18 million. The fund's liability on those claims is \$11 million. The Trustees have budgeted \$8 million in registration fee revenues for the payment of reimbursement claims in 1999.

Since the fund's creation in 1981, the legal profession in New York State has contributed \$73 million to reimburse law clients and escrow beneficiaries for losses resulting from a lawyer's breach of trust.

This is a unique protection that the legal profession provides the public. It's also a genuine protection: last year 99 percent of all eligible victims received 100 percent reimbursement of their losses.

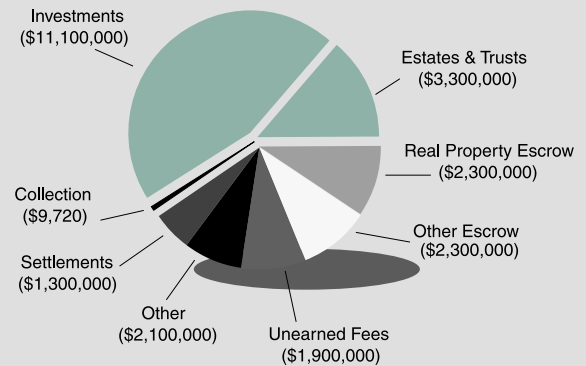
There are currently 177,000 licensed lawyers in the Empire State. Reimbursement awards over a 16-year period involve dishonest conduct by only 578 lawyers. That's less than one percent of the bar's total membership.

The Lawyers' Fund is a trust independently administered by a Board of Trustees appointed by the Judges of the Court of Appeals. The Court's support of a new budgeting structure for the fund, and its approval by the Legislature in 1998, has paved the way for even greater economic protection for New Yorkers.

On March 10, 1999, the Trustees doubled the fund's maximum limit on awards: from \$100,000 to \$200,000, applicable to awards approved after January 1, 1999.

Reported Losses in 1998

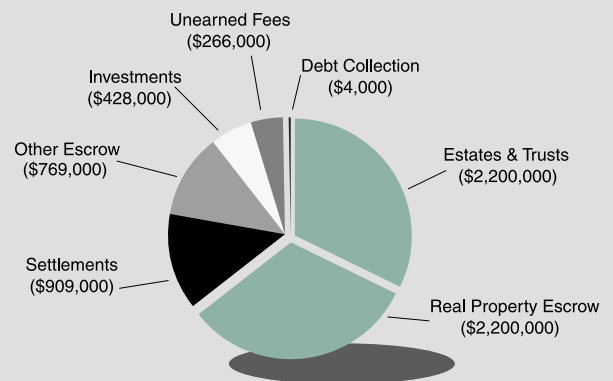
There were 812 reimbursement claims filed in 1998. The bulk of reported losses (68%) involve alleged embezzlements in investment transactions, thefts from estates and trusts, and thefts in real property transactions.



Losses in 1998 Awards

The Trustees approved 415 reimbursement awards in 1998. Awards totaled \$5.9 million, and reimbursed actual client losses of \$6.7 million.

Thefts from estates and trusts and the proceeds of real estate transactions accounted for the bulk of client losses (65%).



The New York Lawyers' Fund was created by the State Legislature in 1981 at the urging of the NYS Bar Association. The law provides for the reimbursement of losses caused by a lawyer's "dishonest conduct", which is defined as the "misappropriation or wilful misapplication" of client property in the practice of law.

Examples of eligible losses include the theft of estate assets, real property escrows, litigation settlements, debt-collection proceeds, and embezzled investments. The fund requires the lawyer's removal from practice, and evidence that the lawyer is unable to make restitution. The fund's Trustees budget \$8 million annually for awards to eligible victims.

The fund has no jurisdiction in fee disputes, and will only reimburse legal fees where there's evidence of deceit or larceny by false promise. In investment frauds, the client must show that "but for" dishonest conduct in an attorney-client relationship, the loss would not have occurred.

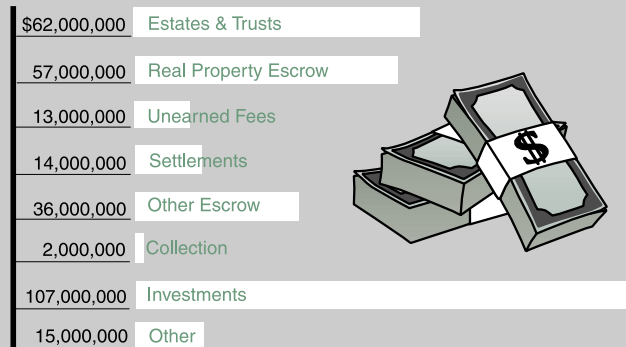
The fund does not reimburse losses of government agencies, financial institutions, or business organizations with 20 or more employees.

Claim investigations are coordinated with Attorney Grievance Committees and District Attorneys to avoid duplication of effort and unnecessary expense.

Claim filings in 1998 reached 812, with alleged losses of \$24 million. The largest number (397) sought reimbursement of legal fees. The largest reported losses (\$11 million) involved investment transactions with lawyers, followed by \$3 million in alleged losses involving the administration of estates and trusts.

Reported Losses Since 1982

All reimbursement claims since 1982 total 9353. The claims allege losses of \$306 million.



The Trustees meet quarterly to evaluate the merits of claims. Claim reports are readied for the Trustees promptly following a lawyer's disbarment. Awards are paid by the NYS Comptroller from the fund's trust account.

The Trustees approved 415 awards in 1998, with documented losses of \$9 million. Awards totaled \$6 million, and ranged between \$9 and \$100,000. Median loss and award: \$2,717.

Only two claimants since 1982 have challenged Trustees' determinations which denied awards. Both involved investment transactions with lawyers. The courts upheld both determinations in Article 78 proceedings.

Since 1982, final determinations have been reached in 9,353 claims. 4,715 claims have been approved (53%) and 4,361 (47%) have been rejected. Losses alleged in rejected claims now exceed \$170 million.

All awards since 1982 involve actual client and escrow losses of \$105 million. Most losses involve thefts from estates and trusts (\$39 million), followed by thefts in real property transactions, typically residential purchases (\$26 million).

Reported Losses Since 1989

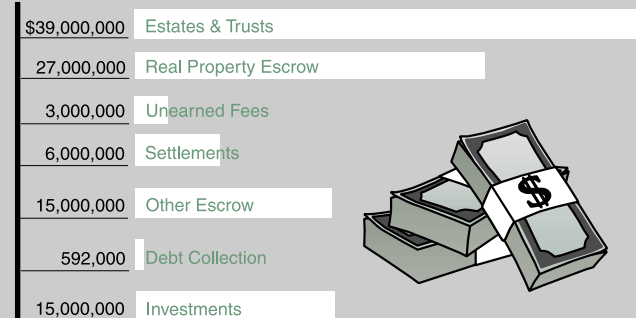
Alleged losses in filed claims since 1989 have ranged from \$14 million in 1989 to \$41 million in 1997.

| | |
|------|--------------|
| 1998 | \$24,000,000 |
| 1997 | 41,000,000 |
| 1996 | 30,000,000 |
| 1995 | 37,000,000 |
| 1994 | 26,000,000 |
| 1993 | 25,000,000 |
| 1992 | 25,000,000 |
| 1991 | 28,000,000 |
| 1990 | 16,000,000 |
| 1989 | 14,000,000 |



Actual Losses in all Awards

The Trustees have approved 4715 reimbursement awards since 1982. Actual losses of law clients and escrow beneficiaries total \$105.6 million.



Lawyers Involved in all Awards

The Trustees' awards since 1982 involve 578 former lawyers. Their law offices were located in these judicial departments of New York State.

| | |
|-------------------|-----|
| First Department | 180 |
| Second Department | 258 |
| Third Department | 49 |
| Fourth Department | 91 |



Awards since 1982 involve dishonest conduct by 578 former members of the bar. The national experience (and there are now client protection funds in every state) is that most losses involve sole practitioners. Very few losses in New York State have involved female lawyers.

A large percentage of losses that come to the fund involve a lawyer's medical and professional problems, and alcohol, gambling and drug abuse.

The NYS Attorney General represents the fund, on a 22% contingent-fee basis, in its subrogation litigation.

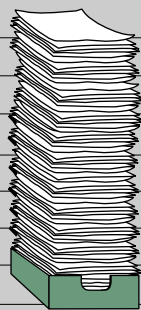
Orders of restitution, including money judgments imposed in disbarment proceedings, safeguard the fund's creditor rights. One order permitted the seizure of a \$1 million lottery jackpot to satisfy the fund's \$100,000 restitution claim. The fund's recovery included interest and legal fees.

The theft of a personal injury settlement, by forgery of the client's endorsement, has been nearly eliminated in New York, thanks to an Insurance Department procedure, proposed by the fund, that requires notice to a client when an insurer mails the settlement check to the client's attorney. The ABA has crafted this procedure into a Model Rule for the states.

Claim Filings Since 1989

Annual filings have increased 67% since 1989.

| | |
|------|------|
| 1998 | 812 |
| 1997 | 1128 |
| 1996 | 730 |
| 1995 | 909 |
| 1994 | 598 |
| 1993 | 636 |
| 1992 | 627 |
| 1991 | 515 |
| 1990 | 438 |
| 1989 | 486 |

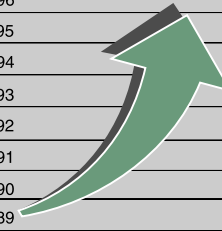


Lawyers in New York assist claimants pursue their claims at the fund without legal fee. They do it in great numbers; indeed, nearly half of all claimants have counsel assisting them. Many are standing volunteers ready to help clients in trouble.

Awards of Reimbursement Since 1989

The annual number of awards approved by the Trustees has more than doubled since 1989.

| | |
|------|-----|
| 1998 | 415 |
| 1997 | 625 |
| 1996 | 381 |
| 1995 | 383 |
| 1994 | 362 |
| 1993 | 318 |
| 1992 | 288 |
| 1991 | 200 |
| 1990 | 219 |
| 1989 | 177 |



The fund's site on the Internet — www.nylawfund.org — was financed by a testamentary gift from a Justice of the Supreme Court. The site contains complete information about the fund, helpful advice for consumers and the legal community including, *A Practical Guide to Attorney Trust Accounts and Recordkeeping*; *Know Your Escrow Rights*; *What's A Power of Attorney?*; and *Avoiding Grief with a Lawyer — A Practical Guide*. There are hypertext links to other Internet legal sites, and the Trustees' annual reports.

The Lawyers' Fund acts as a statewide clearing house for reports of bounced checks on attorney trust and escrow accounts. In five years, the fund has processed 2,500 bank reports involving bounced checks on trust accounts totaling \$44 million. The reports have identified upwards of 35 lawyers who had misused escrow funds. Most have clients who have claims pending with the fund.

Court rules designate the Lawyers' Fund as a depository for funds that belong to missing law clients and escrow beneficiaries. 22 NYCRR 1200.46 (f-1). The rules and sample pleading forms are posted on the fund's Internet site.

Distribution of Awards Since 1982

The Trustees' awards since 1982 were paid to law clients and escrow beneficiaries of lawyers who had offices in these judicial departments of New York State.



| | |
|-------------------|------|
| First Department | 939 |
| Second Department | 2825 |
| Third Department | 430 |
| Fourth Department | 521 |

Section 468-b of the Judiciary Law provides for the administration of the fund; and section 97-t of the State Finance Law governs the management of its assets as a special government trust.

Both statutes vest full administrative responsibility in a seven-member Board of Trustees appointed by the Court of Appeals. The Trustees serve *pro bono publico*. Their regulations are published at 22 NYCRR Part 7200.

They are assisted by a staff of seven persons headquartered in Albany. The fund's Executive Director serves also as the Board's Counsel and Secretary.

The fund's main source of revenue is a \$100 share of the biennial registration fee, augmented by interest; financial sanctions for frivolous conduct; restitution receipts; and contributions.

The fund gets no money from the IOLA program, or from general tax revenues.



Eleanor Breitel Alter has served as Chairman of the Board of Trustees since 1985. She is a partner in the Manhattan law firm of Kasowitz, Benson & Torres.



Theodore D. Hoffmann of Nassau County, is Vice-chairman. He is Of Counsel to the Garden City law firm of Albanese, Albanese & Fiore.



Ray W. Manuszewski of Erie County, serves as Treasurer. A graduate of Canisius College (1951), He is a former President of Manufacturers Hanover in Buffalo.



Bernard F. Ashe of Albany County, is a former General Counsel to New York State United Teachers.



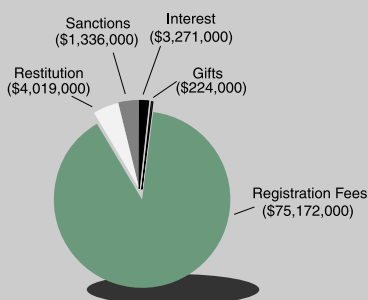
Charles Joseph Hynes of Brooklyn is the District Attorney of Kings County.



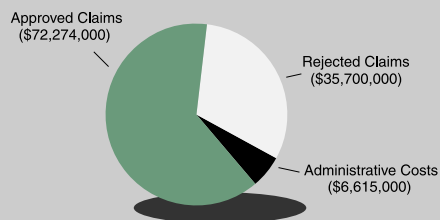
Eric A. Seiff lives in the Bronx and is a partner in the Manhattan law firm of Seiff & Kretz.

The Fund's Finances Since 1982

Revenue Sources



Claims and Operations



Shirley B. Waters of Oneida County, is Vice President of the Rome Sentinel Company, which publishes the *Daily Sentinel* newspaper.

Former Trustees

Chief Judge Judith S. Kaye (1981-83)

Joseph Kelner, Esq. of Manhattan (1981-82)

Anthony R. Palermo, Esq. of Rochester (1981-90)

John F. X. Mannion of Syracuse (1981-92)



Frederick Miller, a graduate of Siena College and the Albany Law School, has served as the fund's Executive Director since 1982.



The Lawyers' Fund for Client Protection

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