



1987

The Regulation of Attorney Escrow Accounts ... Boon or Overkill?

William I. Weston

Follow this and additional works at: <http://scholarworks.law.ubalt.edu/lf>



Part of the [Law Commons](#)

Recommended Citation

Weston, William I. (1987) "The Regulation of Attorney Escrow Accounts ... Boon or Overkill?," *University of Baltimore Law Forum*: Vol. 17 : No. 3 , Article 3.

Available at: <http://scholarworks.law.ubalt.edu/lf/vol17/iss3/3>

This Article is brought to you for free and open access by ScholarWorks@University of Baltimore School of Law. It has been accepted for inclusion in University of Baltimore Law Forum by an authorized editor of ScholarWorks@University of Baltimore School of Law. For more information, please contact snolan@ubalt.edu.

The Regulation of Attorney Escrow Accounts . . . Boon or Overkill?

by Professor William I. Weston

According to the American Bar Association Center for Professional Responsibility and the National Discipline Data Bank, there were more than 800 disbarments and suspensions nationally between the years 1980 and 1985 as a result of violations of attorney trust accounts. More than twenty of them occurred in Maryland. Such violations include misappropriation of client funds, poor or inadequate record-keeping, embezzlement or theft of client funds, conversion of client property, comingling and poor accounting of client funds.

When such violations occur, the client looks to the state Client Security Trust Fund (CSTF) for compensation. The Client Security Trust Fund is a non-profit agency established under the auspices of the Court of Appeals of Maryland to satisfy reasonable and legitimate claims by clients against their attorneys for mishandling or theft of their moneys. There is some evidence that a large percentage of the claims by such trusts are for violations of trust accounts. According to a recent report by Isaac Hecht, Esquire, member of the ABA Standing Committee on Lawyers' Responsibility for Client Protection and also Treasurer of the Maryland CSTF, "most, if not all, of the valid claims[against CSTFs nationally] are against attorneys who either did not have an escrow account or who did not use one even if it existed."

The authority to regulate attorney conduct with regard to client funds and client property is found in DR 9-102 of the Code of Professional Responsibility and Model Rule 1.15 in the new Model Rules of Professional Conduct. Both provide that an attorney is obligated to maintain client funds in a separate account, to refrain from comingling the funds and to account to the client for the funds.

The majority of states go no further than these rules in regulating attorney trust or fiduciary accounts. A number of states, however, have implemented new rules which provide further regulation of these

accounts. Citing lack of specificity in the ethical rules, state bars and the governing courts in these states have approached the development rules along several different lines.

Some states such as Maine, Massachusetts and Hawaii have no specific rules insuring an attorney's compliance with the rules governing escrow accounts (other than the ethical rules). Some states such as Iowa, Arizona and Delaware provide for the filing of annual statements of an attorney's compliance with DR 9-102 or its successor Model Rule. Finally, some states like New Jersey and Virginia have adopted sweeping regulations insuring compliance with the rules governing attorney trust accounts. Such rules are currently under consideration by the court of appeals for adoption in Maryland.

For the general practitioner, the adoption of detailed and sweeping rules has serious economic consequences. For the large firm, maintaining detailed records poses little or no logistical problem and is likely to be built into the current accounting system; although the rendering of individual reports to each client would be administratively difficult and expensive. For the solo practitioner or the small firm, such accounting and reporting will be onerous.

There are several major provisions which are consistent in each of the states which have adopted or are considering the new stricter regulations. First, the only financial institution which can be used by an attorney for an escrow or fiduciary account is an "approved financial institution." Such an institution is one which is approved by the Bar Association or other regulatory agency and which is willing to file an approved agreement with the regulatory agency which requires the financial institution to notify an attorney or law firm of a bounced check/overdraft and cooperate with the attorney or law firm in determining whether the dishonor or overdraft was due to a bookkeeping error. The institution must also notify the Bar Counsel or

regulatory agency in writing of a dishonored check if not corrected within ten days *for any reason*. Finally, the institution must provide reasonable access to all records of any attorney or law firm which is subject to an audit ordered by an appropriate court without regard to consent by the client or by the attorney.

The institution must also designate the account as a trust or fiduciary account irrespective of the nomination given the bank by the attorney.

Although these requirements *appear reasonable*, the record keeping and reporting provisions may be very difficult administratively for a small savings and loan institution or may result in high charges to the attorney because the approved institution can charge whatever it wants for the services rendered. The net result may be the abrogation of attorney accounts to larger financial institutions. For the general practitioner and especially the solo or small firm, the inability to place trust, escrow or fiduciary accounts at the neighborhood thrift would mean a loss of contact with the institution and the loss of an important source of client business. The adoption of a list of "approved financial institutions" by the Bar Association represents a serious limitation on the freedom of the attorney and the client to select an institution—for whatever reason—with which to do business. No matter how competent the institution is, no matter how much the client wants his or her money to be deposited in a particular institution, absent approval by the Bar Association or similar agency, the institution cannot be "approved."

If an attorney in a small town places his escrow account in the thrift from the courthouse, he or she may have easy access to the funds. He or she may be supporting a local institution and thereby supporting future clients, and may be building future business. If the only choice for these accounts is an approved institution which may not have a branch in that town, the attorney is faced with a serious intrusion in

his method of practice. The balance of business relationships for 15,000 attorneys in Maryland would be upset in order to deal with a problem which involves about twenty errant attorneys over the past five years.

Perhaps most troubling about the use of "approved" institutions is the absence of any method for the client to exercise any influence on the selection of a financial institution in order to maximize the interest earned on the moneys deposited. This restriction may also limit the attorney's selection process as the institution which pays the highest interest is likely to be one giving less service and hence not on the list of approved institutions. Under the terms of the rules, the attorney is duty bound to select an approved institution primarily on the basis that they are approved and without consultation with the client. In fact, the client has no right of rejection of the institution.

The second area of concern in the rules is the absence of a threshold or *de minimus* provision. At times an attorney receives a small amount of money (for example, through Lawyer Referral) which he holds for distribution to an agency. To require extensive accounting for \$25 to \$50 and to require that the money be placed in an approved institution is both ridiculous and unreasonable. There is no reason to require reporting, bookkeeping and administrative costs when the amount of money involved is purely nominal.

All interest which is paid on the money in the attorney trust account, less a deduction for service charges and fees, belongs to the client. This is true irrespective of the amount of the client's money actually in the account. The attorney is specifically prohibited from accepting or claiming the interest, irrespective of the existence of an agreement with the client. The client is not permitted to waive his or her right to the interest. It has to be paid. Furthermore, the attorney cannot draw a check on such an account made payable to cash or to the bearer for any reason, even with the client's approval.

In addition to the foregoing rules governing the establishment of the account(s) and the type of institutions which are "approved," the attorney is required annually to file a certification of compliance listing all attorney trust accounts, the name and number of every trust or fiduciary account and where such accounts are located. All of this documentation is to be filed with the office of the Bar Association and will be reviewed by the Bar Association, which is supposed to review all of these accounts. It is difficult to comprehend how—even with significant expenditures for new staff-

ing—the Bar Counsel could review the trust accounts of 15,000 members of the Bar, especially for the larger firms with hundreds of accounts.

Attorneys are required to maintain records of all funds to be deposited in trust or fiduciary accounts. This, of course, is not new. However, the rules go on to require a separate ledger or schedule containing a separate record for each client who has funds deposited in the trust account. The attorney, not an agent, is obligated to reconcile the checkbook for each account monthly and reconcile the separate ledger at least quarterly. Then the attorney is to provide each client, in writing, an accounting of the receipts and disbursements of the client's funds. That accounting is to be provided to the client at least once a year, unless the funds are fully disbursed.

These rules provide for thorough regulation of the handling of trust accounts by attorneys. However, for the general practitioner, they represent required record keeping which is onerous and expensive. The rendering of a detailed financial statement on an annual basis during an ongoing legal proceeding requires bookkeeping procedures. While no one would quarrel with the need to keep accounts accurate and up to date, the requirements of filing when there is no need for a report because the matter is on-going and there is no demand by the client to take the attorney's attention away from the conduct of legal services and significantly increase the cost of the operation of the law office for very little actual gain to the client is not practical.

Moneys are often deposited with an attorney for such reasons as a retainer agreement and as an advance against expenses and filing fees. There is no need or justification to require extensive accounting and reporting until the matter has been completed. Nor, does the statistical frequency of attorney theft justify draconian rules. The reporting rules are very much like killing an ant with a sledge hammer.

There is very little evidence to show that additional reporting requirements will do anything to prevent theft by an attorney. Very little clear evidence has been proffered to indicate widespread stealing from trust accounts exist. Moreover, the implementation of the most stringent of these rules will not prevent the less-than-honest attorney from theft. Also absent a large bureaucracy, there is no way the Bar Association will be able to catch that theft. If the problem is the failure of attorneys to maintain trust accounts, then a certificate of compliance together with a bank account number ought to be sufficient. There is no need for an "approved institution list."

There may be some anti-trust consequences for the Bar Association issuing such a list.

If the problem is the failure of attorneys to render an accounting to the client for receipts and expenditures, there is no need for these rules. An accounting is mandated by the new Model Rules of Professional Conduct. If the problem is simply compliance, then the use of a random audit would create the required incentive to comply with the statute (*see e.g.*, Maryland's and Nebraska's). Again, there is no need for bureaucratic system established by these rules and no need for the use of an approved list of banks. A number of states employ the random or have authority for such an audit in their court rules. A number of states also require the certificate of compliance (*e.g.*, Arizona, Delaware, Florida).

Despite the existence of very specific ethical constraints towards client funds, record keeping for those funds, the requirement to report to the client, and the existence of specific procedures of enforcement, there is a concerted effort to develop strict rules of enforcement for these accounts. It is doubtful that these rules will result in more effective enforcement of trust accounts or prevent theft by attorneys. What will result is a much more complex system for attorney law-office management, a serious restriction as to the type of institution in which funds can be deposited and enhanced operating costs which will be very difficult to pass on the client.

The special committee of the Maryland State Bar Association appointed to review the new "BU" rules has recommended the deletion of several of the more restrictive rules governing approved institutions and reporting requirements. However, the ultimate determination as to the rules lies with the court of appeals which may choose to follow New Jersey and Virginia by adopting unwarranted and highly restrictive rules governing escrow accounts. Whether more states will elect to adopt these new rules is unclear at the present time, but there is clear evidence of pressure from the state appellate courts for adoption of these rules.

Professor Weston is a faculty member at University of Baltimore Law School. He is a member of the Maryland and D.C. Bars. Prior to joining the faculty he served as Bar Grievance Administrative and Executive Director of the Bar Association of Baltimore City. Currently he writes the ethics column for the American Bar Association, General Practice Section magazine, *The Compleat Lawyer*. He teaches Torts, Domestic Relations and Professional Responsibility.