

**THE STATE BAR OF CALIFORNIA  
STANDING COMMITTEE ON  
PROFESSIONAL RESPONSIBILITY AND CONDUCT  
FORMAL OPINION NO. 2005-169**

- ISSUES:**
1. Does an attorney commit an ethical violation merely by obtaining or using overdraft protection on a Client Trust Account?
  2. What are an attorney's ethical obligations when a check is issued against a Client Trust Account with insufficient funds to cover the amount of the check?
  3. Must an attorney immediately withdraw earned fees once funds deposited into a Client Trust Account have become fixed in order to comply with the attorney's ethical obligations?

- DIGEST:**
1. An attorney does not commit an ethical violation merely by obtaining or using overdraft protection on a Client Trust Account, so long as the protection in question does not entail the commingling of the attorney's funds with the funds of a client. Overdraft protection that compensates exactly for the amount that the overdraft exceeds the funds on deposit (plus funds reasonably sufficient to cover bank charges) is permissible, whereas overdraft protection that automatically deposits an amount leaving a residue after the overdraft is satisfied is not. In all cases, banks must report to the State Bar any presentment of a check against a Client Trust Account without sufficient funds, whether or not the check is honored. Although overdraft protection will not avoid State Bar notification, nor exculpate any unethical conduct that caused the overdraft, it may avoid negative consequences to a client resulting from a dishonored check.
  2. When a check is issued against a Client Trust Account with insufficient funds to cover the amount of the check, an attorney must deposit funds sufficient to clear the dishonored check or otherwise make payment, must take reasonably prompt action to ascertain the condition or event that caused the check to be dishonored, and must implement whatever measures are necessary to prevent its recurrence. In addition, if a client will experience negative consequences from the dishonoring of the check, the attorney may have to advise the client of the occurrence.
  3. An attorney must withdraw earned fees from a Client Trust Account at the earliest reasonable time after they become fixed in order to comply with the attorney's ethical obligations, but need not do so immediately.

**AUTHORITIES**

**INTERPRETED:** Rule 4-100 of the Rules of Professional Conduct of the State Bar of California.

**STATEMENT OF FACTS**

Attorney, a solo practitioner who is about to begin a three-month trial, has recently transferred accounts to Bank, which has just opened for business. The accounts transferred are the office business account and the Client Trust Account (CTA).<sup>1/</sup> Attorney arranges for overdraft protection for the CTA by linking it to the office business account.

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<sup>1/</sup> In addition to clients' funds, a client trust account may contain other funds that have client trust fund status, such as court-awarded fees belonging to the attorney, medical lien money, etc. For a discussion of client trust fund status, see *Handbook on Client Trust Accounting for California Attorneys* (State Bar of California 2003).

A month later, while Attorney is in the midst of trial, a settlement check arrives for Client. Attorney obtains Client's approval of disbursements and Client's signature on the settlement check, Attorney's fee becomes fixed, and Attorney deposits the settlement check into the CTA, but Bank misposts the check into the office business account. After making the deposit and waiting a sufficient period for the settlement check to clear, Attorney issues a check against the CTA for expenses related to Client's case. Because of its misposting of the settlement check, Bank determines that the expense check exceeds the amount on deposit. Bank honors the expense check by debiting the linked office business account and notifies the State Bar and Attorney that the check was paid against insufficient funds.

Three months after the arrival of the settlement check for Client, the trial having concluded, Attorney issues two checks on the CTA account: The first check is payable to Client for Client's portion of the settlement; the second check is payable to Attorney for fees, and is immediately deposited by Attorney into the office business account. Because of its not-yet-corrected misposting of the settlement check, Bank determines that the two disbursements exceed the amount on deposit, but makes inquiry of Attorney. As a result, Bank discovers, and corrects, its misposting, and honors the checks to the Client and to Attorney for fees.

## DISCUSSION

### 1. Overdraft protection is not prohibited by Rule 4-100.

When a bank is presented with a check that is greater in amount than the combination of cash in the account on which it is drawn and checks deposited but not collected, the bank has the option of honoring or dishonoring the check<sup>2/</sup>. If a bank elects to honor the check, the payment from its funds is an overdraft and is considered to be in the nature of a loan<sup>3/</sup>. An overdraft is not necessarily the result of negligence or wrongdoing by the depositor. For example, an overdraft can be the result of the bank's delay in crediting a deposit or as a result of the bank's dishonoring of a check submitted by the depositor in the good faith belief it would be paid<sup>4/</sup>, or by an inadvertent bank computer or accounting error<sup>5/</sup>.

In recent years, many banks have instituted overdraft protection to avoid the dishonoring of a depositor's checks. In order to cover checks written against insufficient funds, overdraft protection can entail the making of payments by the bank on a voluntary basis<sup>6/</sup> or as a result of a contract with the depositor for extensions of credit or for the linking of accounts.<sup>7/</sup>

Whether it is permissible to obtain and use overdraft protection for a CTA depends on whether the protection in question entails the commingling of the attorney's funds with the funds of a client. Rule 4-100 of the Rules of

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<sup>2/</sup> California Commercial Code section 4401, subdivision (a).

<sup>3/</sup> *Hoffman v. Security Pacific National Bank* (1981) 121 Cal.App.3d 964, 969 [176 Cal.Rptr. 14]. See 1 Brady on Bank Checks: The Law of Bank Checks (Sept. 2004) §19.01: "An overdraft is the payment by a bank from its funds of a check drawn on it by a depositor who does not have sufficient funds on deposit to pay the check."

<sup>4/</sup> *Perdue v. Crocker National Bank* (1985) 38 Cal.3d 913, 932, footnote 18 [216 Cal.Rptr. 345].

<sup>5/</sup> 12 C.F.R. § 225.52(c)(1).

<sup>6/</sup> Davis and Mabbit, *Checking Account Bounce Protection Programs* (2003) 57 Consumer Finance Law Quarterly Report 26.

<sup>7/</sup> *Interagency Guidance on Overdraft Protection Programs*, 70 Fed.Reg. 9127, 9128 (Feb. 24, 2005) (speaking of overdraft protection by means including "line[s] of credit" and "linked accounts").

Professional Conduct<sup>8/</sup> strictly limits the funds belonging to an attorney that may be deposited into a CTA to (1) funds reasonably sufficient to cover bank charges<sup>9/</sup> and (2) undifferentiated funds belonging in part to a client and in part to the attorney.<sup>10/</sup> The California Supreme Court has held that maintaining the personal funds of an attorney in a CTA as a cushion against overdrafts is not allowed by rule 4-100 and may therefore expose an attorney to discipline.<sup>11/</sup>

Although rule 4-100 does not define commingling, judicial decisions provide a definition. "[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."<sup>12/</sup> Employing an overdraft protection program, such as a line of credit or linkage to another account, that compensates exactly for the amount that the overdraft exceeds the funds on deposit in a CTA does not threaten the separate identity of a client's funds, does not subject the client's funds to claims of the attorney's creditors,<sup>13/</sup> and does not permit the attorney to use the client's funds.<sup>14/</sup> Furthermore, the California Supreme Court has held that an attorney's deposit of personal funds to restore funds that have been improperly withdrawn does not constitute a separate wrongful act of impermissible commingling.<sup>15/</sup>

A different situation is presented by an overdraft protection program that automatically deposits a fixed amount into a CTA leaving a residue after the overdraft is satisfied. The excess funds, which belong to the attorney, are not required to remedy an error. There is no meaningful distinction between depositing excess funds to cure an overdraft and maintaining a cushion of attorney funds in a CTA beyond an amount reasonably sufficient to cover bank charges, a practice that has been prohibited.<sup>16/</sup> Leaving excess funds belonging to the attorney in a CTA in order to avoid the negative effect of error, even if it causes no harm to a client or any other person or entity with an interest in the trust funds, may expose an attorney to discipline.<sup>17/</sup>

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<sup>8/</sup> Unless otherwise indicated, all rule references are to the Rules of Professional Conduct of the State Bar of California.

<sup>9/</sup> Rule 4-100(A)(1). See *In the Matter of Respondent F* (1992) 2 Cal. State Bar Ct. Rptr. 17.

<sup>10/</sup> Rule 4-100(A)(2)-with the caveat that "the portion belonging to the [attorney] must be withdrawn at the earliest reasonable time after the [attorney's] interest in that portion becomes fixed."

<sup>11/</sup> *Jackson v. State Bar* (1979) 25 Cal.3d 398, 404 [158 Cal.Rptr. 869]. See, e.g., L.A. County Bar Ass'n, Formal Opinion No. 485 (1996); Peck, *Managing Clients' Trust Accounts* (1994) 517 PLI/Lit 197, 207.

<sup>12/</sup> *Clark v. State Bar* (1952) 39 Cal.2d 161, 167 [246 P.2d 1].

<sup>13/</sup> A bank may not offset an attorney depositor's debt against his CTA. "The bank's right of offset . . . exists only if the depositor is indebted to the bank in the same capacity as he holds the account. Thus, a bank may not 'apply the trust funds to a personal indebtedness of the trustee.' [Citations omitted.]" (*Chazen v. Centennial Bank* (1998) 61 Cal.App.4th 532, 541 [71 Cal.Rptr.2d 462].)

<sup>14/</sup> Of course, if an attorney were to employ an overdraft protection program that compensates exactly for the amount that the overdraft exceeds the funds on deposit in a CTA as part of a scheme to siphon off a client's funds for the attorney's own use, the attorney would thereby misappropriate the client's funds.

<sup>15/</sup> *Guzzetta v. State Bar* (1987) 43 Cal.3d 962, 978-979 [239 Cal.Rptr. 675].

<sup>16/</sup> *Silver v. State Bar* (1974) 13 Cal.3d 134, 145, footnote 7 [117 Cal.Rptr. 821].

<sup>17/</sup> *Guzzetta v. State Bar, supra*, 43 Cal.3d at page 976: "However, as the State Bar Court correctly noted, 'good faith of an attorney is not a defense involving Rules of Professional Conduct 8-100(A)(B).' [Citation omitted.] Rule 8-101 is violated where the attorney commingles funds or fails to deposit or manage the funds in the manner designated by the rule, even if no person is injured. [Citation omitted.]"

Banks are required by law to report to the State Bar the presentment of any properly payable instrument against a CTA containing insufficient funds, whether or not the instrument is honored.<sup>18/</sup> Although overdraft protection will not avoid notification of the State Bar, nor exculpate any unethical conduct that caused the overdraft, it may avoid negative consequences to a client resulting from a dishonored check. Therefore, rather than violating an attorney's fiduciary duties to a client under rule 4-100, overdraft protection is a recognized method of protecting the client's funds from loss.<sup>19/</sup>

It follows that, under the facts presented, Bank was required to notify the State Bar that the expense check drawn on the CTA was paid against insufficient funds, even though subsequent events would reveal that its action resulted from its misposting. Attorney, however, should not be subject to discipline with respect to the triggering of overdraft protection for the expense check. Of course, an attorney has a "personal obligation of reasonable care to comply with the critically important rules for the safekeeping and disposition of client funds."<sup>20/</sup> That obligation is nondelegable<sup>21/</sup>. "[W]here fiduciary violations occur as a result of the serious and inexcusable lapses in office procedure, they may be deemed 'wilful' for disciplinary purposes, even if there was no deliberate wrongdoing."<sup>22/</sup> Moreover, if an attorney were to make use of overdraft protection for an impermissible purpose such as issuing checks prior to the availability of the funds against which they were to be paid, the attorney could be found culpable of failure to maintain the CTA in violation of rule 4-100. Under the facts presented, however, there was no violation by Attorney because there was no lapse in office procedure or repeated use of overdraft protection for an impermissible purpose.<sup>23/</sup> There were indeed mistakes and errors, but they were attributable to Bank and not to Attorney.<sup>24/</sup>

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<sup>18/</sup> "A financial institution . . . which is a depository for attorney trust accounts . . . shall report to the State Bar in the event any properly payable instrument is presented against an attorney trust account containing insufficient funds, irrespective of whether or not the instrument is honored." (Bus. & Prof. Code, § 6091.1.)

<sup>19/</sup> "Overdraft protection for your client trust account is a good idea. Client retainer checks may bounce, clerical errors may occur in drafting checks, and even banks sometimes make errors. At a minimum, overdraft protection ensures that clients will not be *harmed* by a drop in the client trust account." (Vapnek et al., *Cal. Practice Guide: Professional Responsibility* (The Rutter Group 2004) § 9:153 (italics in original).) As the foregoing quotation indicates, overdraft protection for a client trust account is a good idea not only against errors by banks and other third parties, but also against errors by the attorney's staff and the attorney him- or herself.

<sup>20/</sup> *Palomo v. State Bar* (1984) 36 Cal.3d 785, 795 [205 Cal.Rptr. 834]. See, e.g., *Tatlow v. State Bar* (1936) 5 Cal.2d 520, 524 [55 P.2d 214] (fundamental rule of ethics is common honesty, "without which the profession is worse than valueless in the place it holds in the administration of justice")

<sup>21/</sup> *Coppock v. State Bar* (1988) 44 Cal.3d 665, 680 [244 Cal.Rptr. 462].

<sup>22/</sup> *Palomo v. State Bar* (1984) 36 Cal.3d 785, 795 [205 Cal.Rptr. 834].

<sup>23/</sup> An attorney's personal, and nondelegable, obligation of reasonable care to protect client funds requires the attorney to supervise the attorney's employees. *In the Matter of Malek-Yonan* (2003) 4 Cal. State Bar Ct. Rptr. 627.

<sup>24/</sup> If Bank were to continue to make mistakes and errors with respect to the CTA, and if such mistakes and errors were to threaten the integrity of the client funds deposited, Attorney might be required to take appropriate action in response, which might include transferring the CTA to another financial institution.

It is recognized that, in its present version, the Handbook on *Client Trust Accounting for California Attorneys*, *supra*, pages 6 and 10, states that an attorney should not obtain or use overdraft protection on a CTA. But since its initial publication in 1992, the Handbook has been revised from time to time in response to developments in the law generally and in professional responsibility in particular.

2. **An attorney who issues a CTA check against insufficient funds is required to make any dishonored check good or otherwise make payment, take reasonably prompt action to ascertain what caused the problem, and correct or change whatever led to the occurrence.**

Since an attorney has an obligation that is both personal and nondelegable to take reasonable care to protect client funds, the attorney has attendant obligations: (1) to deposit funds sufficient to clear any check drawn on the CTA that is dishonored for insufficient funds<sup>25/</sup> depositing personal funds into a CTA to remedy an overdraft does not constitute impermissible commingling<sup>26/</sup> or to make payment by other means; (2) to take reasonably prompt action to ascertain the condition or event that caused the check to be dishonored; and (3) to implement whatever measures are necessary to prevent its recurrence.<sup>27/</sup> In addition, since an attorney has an obligation to keep clients advised of significant developments relating to the employment or representation, the attorney may also have an obligation to advise the affected client of the overdraft of the client's funds if the client will experience negative consequences.<sup>28/</sup>

Under the facts presented, the expense check drawn on the CTA was not dishonored. As a result, there was no check that Attorney had to make good or provide for payment otherwise; neither were there any practices or procedures Attorney had to change or any lapses Attorney had to correct. Likewise, there was no significant development about which Attorney had to advise Client. As its name declares, overdraft protection protected Client from experiencing any negative consequences from the dishonoring of the expense check by preventing dishonoring of the check. It follows that, under these circumstances, Attorney has no obligation to advise Client of this occurrence.

3. **Earned fees need not be withdrawn immediately from a CTA after they become fixed, but instead must be withdrawn at the earliest reasonable time.**

Rule 4-100(A)(2) provides: "In the case of funds belonging in part to a client and in part presently or potentially to the [attorney], the portion belonging to the [attorney] must be withdrawn at the earliest reasonable time after the [attorney's] interest in that portion becomes fixed."

Nothing in rule 4-100 or related judicial decisions defines "earliest reasonable time." But the rule does indeed give some indications in this regard. As noted, it provides that an attorney must withdraw from a CTA the portion of funds belonging to the attorney at the earliest reasonable time "after the [attorney's] interest in that portion becomes fixed."

In so providing, the plain language of rule 4-100 suggests that an attorney is not required to withdraw the attorney's fees from a CTA "immediately." But it also suggests that an attorney is not allowed to delay until he or she finds it "convenient" to make the withdrawal. If the attorney delays unreasonably, the client's funds may be "endanger[ed]," as by "attachment" in a case where the attorney's "creditors [are led] to believe the funds belong to the [attorney] rather than the client."<sup>29/</sup>

Although the phrase "earliest reasonable time" contains the word "reasonable" and therefore counsels that all relevant circumstances should be taken into account, including especially the risk to the client's interest, a rule of

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<sup>25/</sup> Cf. *Waysman v. State Bar* (1986) 41 Cal.3d 452, 458 [224 Cal.Rptr. 101] (attorney immediately notified client of misappropriation and assumed responsibility).

<sup>26/</sup> *Guzzetta v. State Bar, supra*, 43 Cal.3d at pages 978-979.

<sup>27/</sup> See *Greenbaum v. State Bar* (1976) 15 Cal.3d 893, 905 [126 Cal.Rptr. 785]; *Bradpiece v. State Bar* (1974) 10 Cal.3d 742, 748 [111 Cal.Rptr. 905].

<sup>28/</sup> See *Waysman v. State Bar, supra* 41 Cal.3d at page 458.

<sup>29/</sup> Vapnek et al., [*Cal. Practice Guide: Professional Responsibility*], *supra*, § 9:179 (citing *Vaughn v. State Bar* (1972) 6 Cal.3d 847, 852-853 [100 Cal.Rptr. 713] [CTA was attached as a result of actions brought against attorney for personal debts]).

thumb is suggested by the standards for preserving the identity of funds and property of a client adopted by the Board of Governors of the State Bar. Those standards require a monthly reconciliation of a CTA, which identifies the portion of the funds belonging to the attorney.<sup>30/</sup> It follows, therefore, that an attorney should withdraw the attorney's fees from the CTA at the time of the monthly reconciliation after that portion has become fixed.

Under the facts presented, Attorney appears not to have withdrawn Attorney's fees from the CTA at the "earliest reasonable time." Attorney's fees had become fixed about three months earlier. Attorney's preoccupation with trial may have made such a period of time seem reasonable. But a delay of this length of time might have proved harmful to Client-and Attorney's other clients-if, for example, Attorney's creditors had attached the funds in the CTA on the belief they belonged to Attorney.<sup>31/</sup>

This opinion is issued by the Standing Committee on Professional Responsibility and Conduct of the State Bar of California. It is advisory only. It is not binding upon the courts, the State Bar of California, its Board of Governors, any persons, or tribunals charged with regulatory responsibilities, or any member of the State Bar.

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<sup>30/</sup> Standards for Client Trust Account, Std.(1)(d) adopted by the Board of Governors of the State Bar, effective January 1, 1993, pursuant to rule 4-100(c).

<sup>31/</sup> Whether Attorney disbursed Client's portion from the CTA in timely fashion is beyond the scope of this opinion, and is accordingly neither addressed nor resolved herein.