Handbook on Client Trust Accounting for California Attorneys

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Foreword

This handbook is intended as a tool to help every California attorney fulfill their statutory and ethical obligations to clients whose money and other properties they hold in trust. Even if you never hold money or other properties for clients, it's imperative that you understand these obligations. Your license may depend on it.

This handbook assumes that you know very little about client trust accounting and is devoted to teaching you the basics necessary for you to properly account for your client's money. It will explain the rules governing your client trust accounting duties, the concepts behind client trust accounting, and a simple step-by-step system for accounting for your clients' money. To keep from distracting you from basic accounting, the citations have been kept to a minimum. The text of the relevant authorities, as well as an index of applicable cases, are attached as Appendices 2 and 3.

This handbook is not intended to address all the complex legal issues related to handling client funds and other trust money or property. To help you find answers for these and other questions about your professional responsibilities, the State Bar of California has a variety of resources available:

- The State Bar publishes a booklet called The California State Bar Act and Rules of Professional Conduct that contains the provisions of the Business and Professions Code and California Rules of Court relevant to attorneys, the Rules of Professional Conduct and other statutes contained in other codes relevant to your professional responsibilities, including the Evidence Code and the Civil Code. This booklet is available from the State Bar for a fee. To order a copy, call (415) 538-2112.

- The State Bar offers a toll-free, confidential Ethics Hotline, which you can call to discuss ethics issues with staff who are specially trained to refer you to relevant authorities. Attorneys may request a call by completing the online Ethics Hotline Research Assistance Request Form (https://apps.calbar.ca.gov/forms/EthicsHotline) or by calling 1-800-2-ETHICS or 1-800-238-4427.

- The State Bar publishes a multi-volume desk reference called the California Compendium on Professional Responsibility, which contains ethics opinions issued by the State Bar, the Los Angeles, San Francisco and San Diego county bar association ethics committees, the authorities in The California State Bar Act and Rules of Professional Conduct, the American Bar Association Rules and Code, the Code of Judicial Conduct, and a detailed subject matter index that will direct you to the relevant authorities. The Compendium, which costs $145.00 (plus tax), is updated annually for an additional $50 per year. To order a copy, call (415) 538-2148.

- The State Bar publishes the California State Bar Court Reporter, which includes the full text of published opinions of the State Bar Court Review Department, comprehensive headnotes, case summaries and a detailed index and digest.

- The Office of Access & Inclusion works with lawyers and financial institutions to make California's IOLTA program a success. Staff is available to answer questions and to help financial institutions and lawyers with their IOLTA accounts. Additional copies of the relevant statutes, State Bar Rules, and IOLTA forms are available upon request, or may be downloaded from www.calbar.ca.gov. For assistance or additional information, please contact the Office of Access & Inclusion, State Bar of California, 180 Howard Street, San Francisco, CA 94105-1639, or email iolta@calbar.ca.gov.

SECTION I: THE IMPORTANCE OF CLIENT TRUST ACCOUNTING

If you died suddenly, would your clients—or the executors who have to answer to your clients—be able to tell how much of the money in your various professional accounts belonged to each client? If a State Bar investigator asked you to account for a particular client's money, would you be able to do so? Would they find complete, systematic, up-to-date records showing what's been received and paid out for each client, or would they find a random assortment of cancelled checks, unopened bank statements, and checkbook registers full of cryptic notations and rounded-off figures? In these situations, the fact that you "have it all in your head" isn't going to help your clients find their money or satisfy the State Bar.

There are two completely mistaken ideas about client trust accounting. One idea is that client trust accounting is a mysterious, complicated process that requires years of training and innate mathematical ability. The other is that "maintaining a client trust account" simply means opening a bank account and depositing clients' funds into it.

The truth is that client trust accounting is a simple set of procedures that is easy to learn and easy to practice. It doesn't require financial wizardry or mathematical genius; all it requires is consistent, careful application. But as simple as it is, client trust accounting still means more than keeping money in the bank. A bank account is something you have; client trust accounting is something you do in order to know—and to show your clients that you know—how much of the money in your account belongs to each client. To clear up this confusion, in this handbook, we never say "client trust account." We say "client trust accounting"—when we mean what you have to do to account for your clients' money—or "client trust bank account"—when we mean the bank account where you keep your clients' money.

Whether you find it easy or difficult, the fact is that if you agree to hold money in trust, you take on a non-delegable, personal fiduciary responsibility to account for every penny as long as the funds remain in your possession. Whomever you hire to do your books or fill out your deposit slips, you have full responsibility for his or her actions when you receive money in trust. This responsibility can't be transferred, and it isn't excused by ignorance, inattention, incompetence or dishonesty by you, your employees or your associates. The legal and ethical obligation to account for those monies is yours and yours alone, regardless of how busy your practice is or how hopeless you are with numbers. You may employ others to help you fulfill this duty, but if you do you must provide adequate training and supervision. Failure to live up to this responsibility can result in personal monetary liability, fee disputes, loss of clients and public discipline.

The essence of client trust accounting is contained in these three words:

Client—These duties arise in the context of an attorney-client relationship, regardless of whether you are paid for your services, and are as inviolable as your duty to maintain client confidences. These duties may also be owed to third parties.

Trust—The willingness of people to trust a complete stranger with money just because the stranger is an attorney is a fundamental aspect of the attorney-client relationship, and maintaining that trust is the duty of every individual attorney and a matter of supreme public interest.

Accounting—The way to fulfill your clients' trust is to be able at any time to make a full and accurate accounting of all money you've received, held and paid out on their behalf.

That's all "client trust accounting" means. If you follow the simple procedures explained below, you will never have to worry about failing to live up to your duties as a fiduciary no matter how complex or busy your practice.

SECTION II: THE RULES

California's Rule of Professional Conduct 1.15 is called “Safekeeping Funds and Property of Clients and Other Persons.” The whole point of rule 1.15—and client trust accounting—is to make sure you know exactly how much of the money you are holding for clients belongs to each individual client.

Imagine how you'd feel if you asked your bank how much money was in your personal account, and they explained that they couldn't tell you because business was booming and keeping exact records of so much money for so many people would just take too much time. You'd probably feel that if knowing how much of your money they have is too much trouble, the bank shouldn't be holding your money. That's exactly how your clients feel about you. You keep records so you can give your clients an accounting of their money; failing to do so is a violation of your professional responsibilities.

Keeping track of exactly what's happening with a client's money is your personal, non-delegable ethical responsibility. The minute you *don't* keep track, you are in violation of the client trust accounting rules. The longer you don't know, the more violations you're likely to stumble into, and if you keep stumbling, sooner or later you're going to stumble into a State Bar investigation.

And don't think if you keep enough of your own money in the client trust bank account that everything's alright. Not only doesn't that satisfy your professional responsibility to your clients, it constitutes an additional violation known as “commingling.” In short, the only adequate way to fulfill your fiduciary responsibility to your clients is to keep track of, at all times, how much of their money you have in your client trust bank account.

Maintaining a common client trust bank account in which the funds of more than one client are held is fine, as long as you keep an accurate record of what belongs to each client. That's what client trust accounting is all about.

California Rule of Professional Conduct 1.15

In some states, rules and statutes spell out detailed recordkeeping requirements for attorneys. California’s approach is to set forth minimum standards under Rule 1.15(c). (See Appendix 2 for the text.)

Rule 1.15 only requires that you maintain sufficient records so that you keep track of how much money you are holding for each client at all times, and you can later prove that you knew it.

Rule 1.15 essentially comes down to this:

- All funds you receive from or hold for a client must be deposited into a bank account that is clearly labeled as a client trust bank account.
- When you receive other properties on behalf of a client, you have to identify what you've received in your written records, actually label the properties to identify the owner, and immediately put them into a safe deposit box or some other place of safe keeping.
- All client trust bank accounts must be maintained in California, unless it is more convenient for the client for the account to be located elsewhere. In that case, you have to get the client's consent in writing before you can deposit the client's funds outside of California.
- Whenever you receive money or other property on behalf of a client, you have to promptly notify that client of that fact.
- You can't *deposit* any money belonging to you or your law firm into any of your client trust bank accounts (except for the small amounts of money necessary to cover bank charges). This is known as commingling.

- You can't *keep* any money belonging to you or your law firm (other than money for bank charges) in any of your client trust bank accounts. This is also known as commingling. That means that when you're holding client money that includes your fees, you have to take those fees out of the client trust bank account *as you earn them*. It's not a matter of your convenience; you are ethically required to withdraw your money from that account as soon as you reasonably can. (In fact, it would be a good idea for you to withdraw your fees on a regular basis, perhaps when you do your monthly reconciliation. See **Reconciliation**. See also, State Bar Formal Op. No. 2005-169, Appendix 6.)

- Money held in a client trust bank account becomes yours and not the client's as soon as, in the words of rule 1.15(c)(2), your "interest in that portion becomes fixed." BUT—and this is a big but—you can't withdraw any fees that the client disputes. As far as you're concerned, from the moment a client disputes your fee, that money is frozen in the client trust bank account until the fee dispute is resolved. As soon as your interest becomes fixed and is not in dispute, you are obligated to withdraw that money promptly from the client trust bank account. (See Appendix 3 for references to disciplinary cases and Appendix 6 for State Bar Formal Opinion 2006-171 which discuss the issue of a redeposit of funds withdrawn from a trust account.)

- When your clients ask you for money or other properties that you're holding for them, you must deliver them promptly.

- When clients ask you how much money you're holding for them or what you've done with the money while you've had it, you must tell them.

- When the State Bar asks you how much money you're holding for the client or what you've done with it while you've had it, you must tell the State Bar.

- For at least five years after disbursement you have to keep complete records of all client money, securities or other properties that are entrusted to you.

What rule 1.15(d)(3) requires, as the mandatory minimum, is:

- **Client Ledger.** This is a written ledger for each client that details every monetary transaction on behalf of that client or other person. If you have a common client trust bank account in which the funds of more than one person are deposited, this is where you keep track of individual persons' money.

- **Account Journal.** This is a written journal for each client trust bank account. This is where you keep track of the money going in and out of a client trust bank account. When you have a bank account that's designated solely for one person's money, the account journal will be identical to the client ledger.

- **Bank Statements and Cancelled Checks.** You must keep all bank statements and cancelled checks or check imaging for each client trust bank account, individual or common. These records show that the entries in your client ledger and account journal are accurate.

- **Reconciliation.** You must keep a written record showing that every month you "reconciled" or balanced the account journals you keep for each client trust bank account against the client ledgers you keep for each person and the cancelled checks and bank statements for those accounts.

- **Journal of Other Properties.** You must keep a written journal of all securities or other properties you hold in trust for clients or other persons that explains what you are holding, who you are holding it for, when you received it, when you distributed it, and who you distributed it to.

Duties to Third Parties

Throughout rule 1.15, an attorney's duty is expressly stated as extending to a client or other person. As used in rule 1.15(a), this formulation of the rule language is intended to make clear that an attorney may have the same duties to a third-party as to his or her client. One instance is when there is a statutory lien applicable to the funds received by the attorney on behalf of the client. For example, an attorney may have a duty to the State Department of Health Services (DHS) to ensure that a statutory medical lien is honored. An attorney's obligations include, but is not limited to, notifying DHS when a matter has settled prior to the distribution of the settlement proceeds.

This means that an attorney's duty might not end with payment to the client of the client's ultimate share of the recovery. Where such liens are involved, the attorney might have an ongoing fiduciary duty to the client to hold in trust the remaining settlement funds subject to further directions from the client regarding disbursement.

Beyond the specific example of a statutory lien, generally where an attorney assumes the responsibility to disburse funds as agreed by the parties in an action, the attorney owes an obligation to the party who is not the attorney's client to ensure compliance with the terms of the agreement. If there is a dispute between the client and the third party, the attorney must retain the funds in trust until the resolution of the dispute.

Business and Professions Code Sections 6211-6213

When a client gives you a "nominal" amount of money, or money that you hold for too short a period of time to earn income in excess of the costs to hold the funds for the benefit of the client, you must hold the money in a common client trust bank account, called an "Interest on Lawyers' Trust Account" ("IOLTA account"). (See "IOLTA" Accounts.) That account is set up so that your bank pays the interest or dividends the account earns to the State Bar. By law, the State Bar distributes this money to programs that provide legal services in civil matters to indigent people, as defined by statute. Your responsibilities with respect to IOLTA accounts are governed by Business and Professions Code sections 6211-6213. (See Appendix 2 for the text of those sections and for the State Bar IOLTA rules, Title 2, Division 5 of the Rules of the State Bar of California.)

Other Regulations Relating to Clients and Money

There are other rules relating to clients and money that, while not directly related to client trust accounting, are so fundamental to the attorney-client relationship that we have to mention them in this handbook. These rules, which relate to setting fees, fee agreements, fee disputes, loans to and from clients, securing payment of fees and cash reporting requirements, are discussed in Appendix 1, and the text of these rules can be found in Appendix 2.

SECTION III: KEY CONCEPTS IN CLIENT TRUST ACCOUNTING

The following seven key concepts are all the background you need in order to understand your client trust accounting responsibilities.

Key Concept 1: Separate Clients Are Separate Accounts

Client A's money has nothing to do with Client B's money. Even when you keep them in a common client trust bank account (such as in an IOLTA account), each client's funds are completely separate from those of all your other clients. In other words, you are **NEVER** allowed to use one client's money to pay either another client's or your own obligations.

When you keep your clients' money in a common client trust bank account, the way to distinguish one client's money from another's is to keep a client ledger of each individual client's funds (as required by rule 1.15(d)(3) and the recordkeeping standards under rule 1.15(e)). The client ledger tells you how much money you've received on behalf of each client, how much money you've paid out on behalf of each client, and how much money each client has left in your common client trust bank account. If you are holding money in your common client trust bank account for 10 clients, you have to maintain 10 separate client ledgers. If you keep each client's ledger properly, you will always know exactly how much of the money in your common client trust bank account belongs to each client. If you don't, you will lose track of how much money each client has, and when you make payments out of your client trust bank account, you won't know which client's money you are using.

Also note, if your client's money can earn income in excess of the costs incurred to hold the account, either because the funds are large enough in amount or are held for a long period of time, then you cannot place the funds in an IOLTA account. (See **"IOLTA" Accounts** and **What MUST Be Held in Your IOLTA Account?**.)

Key Concept 2: You Can't Spend What You Don't Have

Each client has only his or her own funds available to cover their expenses, no matter how much money belonging to other clients is in your common client trust bank account. Your common client trust bank account might have a balance of $100,000, but if you are only holding $10.00 for a certain client, you can't write a check for $10.50 on behalf of that client without using some other client's money.

The following example graphically illustrates this concept. Assume you are holding a total of $5,000 for four clients in your common client trust bank account as follows:

Client A	$1,000
Client B	$2,000
Client C	$1,500
Client D	$ 500
Total	$5,000

If you write a check for $1,500 from the common client trust bank account for Client D, $1,000 of that check is going to be paid for by Clients A, B and C. The funds you are holding in trust for them are being used for Client D's expenses. You should have a total of $4,500 for Clients A, B and C, but you only have $3,500 left in the trust account. In State Bar disciplinary matters, a finding of a failure to maintain a sufficient client trust account balance will support a finding of misappropriation.

Key Concept 3: There's No Such Thing As a “Negative Balance”

It's not uncommon in personal checkbooks for people to write checks against money they haven't deposited yet or hasn't cleared yet, and show this as a “negative balance.” In client trust accounting, there's no such thing as a negative balance. A “negative balance” is at best a sign of negligence and, at worst, a sign of theft. (Don't think that because you have “automatic overdraft protection” on your client trust bank account and the check doesn't bounce, you have fulfilled your client trust account responsibilities. See “Automatic overdraft protection.”)

In client trust accounting, there are only three possibilities:

> You have a **positive** balance (while you are holding money for a client);
> You have a **zero** balance (when all the client's money has been paid out); or
> You have a balance of **less than zero** (a so-called “negative balance”) and a problem.

Key Concept 4: Timing Is Everything

It takes anywhere from a day to several weeks after you make a deposit before the money becomes “available for use.” A client's funds aren't “available” for you to use on the client's behalf until they have cleared the banking process and been credited by the bank to your client trust bank account. (This is especially true when you receive an insurance company's settlement draft —which cannot clear until the company actually receives the draft at its home office during the bank collection process and honors the draft. Thus, insurance company settlement drafts will take longer to clear your account.) If you write a check for a client at any time *before* that client's funds clear the banking process and are credited to your client trust bank account, ordinarily either the check will bounce or you will be using other clients' money to cover the check.

The time it takes for client trust account funds to become available after deposit depends on the form in which you deposit them. Every bank has different procedures, so when you open your client trust bank account, get the bank's schedule of when funds are available for withdrawal. Depending on the instrument, you may have to wait as many as 15 working days before you can be reasonably confident that the funds are available. For example, even if you make a cash deposit, the money may not be available for use until the following day. If you deposit a personal check from an out-of-state bank, the money will take longer to be available. Either way, until the bank has credited a client's deposit to your client trust bank account, you can't pay out any portion of that money for that client.

You also need to know what time your bank has set as the deadline for posting deposits to that day's business and for paying checks presented to it. Otherwise, even when you have deposited cash, you may end up drawing on uncollected funds. For example, let's say your bank credits any deposit made after 3 p.m. on the following day, but stays open for business until 5 p.m. Your client arrives at 3:30 and gives you $5,000 in cash which you immediately deposit. At 4 p.m., you write a client trust bank account check to an investigator against that money. If the investigator presents the check for payment at the bank before it closes at 5 p.m., the check will either bounce or be covered by other clients' money.

You may be tempted to do your client a favor by writing a check to the client for settlement proceeds before the settlement check has cleared because you know there's money belonging to other clients in your client trust bank account to cover this client's check. Depending on the circumstances, your client may insist that you do this. Don't. If you do, you'll end up writing a check to one client using another clients' money. You shouldn't help one client at the expense of your obligations to your other clients. In other words, no matter how expedient or kind or convenient it seems, don't make payments on your clients' behalf before their deposited funds have cleared. Otherwise, sooner or later, you'll end up spending money your clients don't have.

Some banks offer an “instant credit” arrangement where the bank agrees to immediately credit accounts for deposits while the bank waits for the funds from another financial institution. Beware of

this service because it is, in essence, a loan to the attorney that is deposited in the client trust bank account, and thus a commingling of funds. (An "instant credit" arrangement may also be offered as a form of overdraft protection. Refer to the discussion at page 10.)

Key Concept 5: You Can't Play the Game Unless You Know the Score

In client trust accounting, there are two kinds of balances: the "running balance" of the money you are holding for each *client*, and the "running balance" of each *client trust bank account.*

A "running balance" is the amount you have in an account after you add in all the deposits (including interest earned, etc.) and subtract all the money paid out (including bank charges for items like wire transfers, etc.). In other words, the running balance is what's in the account at any given time. The running balance for each *client* is kept on the client ledger, and the running balance for each *client trust bank account* is kept on the account journal. (A sample client ledger and a sample account journal are shown in Appendix 4.)

Maintaining a running balance for a client is simple. Every time you make a deposit on behalf of a client, you write the amount of the deposit in the client ledger and *add* it to the previous balance. Every time you make a payment on behalf of the client, you write the amount in the client ledger and *subtract* it from the previous balance. The result is the running balance. That's how much money the client has left to spend.

You figure out the running balance for the client trust bank account the same way. Every time you make a deposit to the client trust bank account, you write the amount of the deposit in the account journal and *add* it to the previous balance. Every time you make a payment from the client trust bank account, you write the amount in the account journal and *subtract* it from the previous balance. The result is the running balance. That's how much money is in the account.

Since "you can't spend what you don't have" (**Key Concept 2: You Can't Spend What You Don't Have**), you should check the running balance in each client's client ledger before you write any client trust bank account checks for that client. That way, if your records are accurate and up-to-date, it's almost impossible to pay out more money than the client has in the account.

Key Concept 6: The Final Score Is Always Zero

The goal in client trust accounting is to make sure that every dollar you receive on behalf of a client is ultimately paid out. What comes in for each client must equal what goes out for that client; no more, no less.

Many attorneys have small, inactive balances in their client trust bank accounts. Sometimes these balances are the result of a mathematical error, sometimes they are part of a fee you forgot to take, and sometimes a check you wrote never cleared or wasn't cashed.

Whatever the reason, as long as the money is in your client trust bank account, you are responsible for it. The longer these funds stay in the bank, the harder it is to account for them. Therefore, you should take care of those small, inactive balances as soon as possible, including, if necessary, following up with payees to find out why a check hasn't cleared.

If you take steps to take care of these small balances and are still unable to pay out the funds, you should consider whether the unclaimed monies escheat to the state pursuant to Code of Civil Procedure section 1518. (See Appendix 2 for the text.)

Key Concept 7: Always Maintain an Audit Trail

An "audit trail" is the series of bank-created records, like cancelled checks, bank statements, etc., that make it possible to trace what happened to the money you handled. An audit trail should start whenever you receive funds on behalf of a client and should continue through the final check you

issue against them. Without an audit trail, you have no way to show that you have taken proper care of your clients' money, or to explain what you did with the money if any questions come up. The audit trail is also an important tool for tracking down accounting errors. If you don't maintain an audit trail, you will find it hard to correct the small mistakes, like errors in addition or subtraction, and the big mistakes, like miscredited deposits, that are inevitable when you handle money.

The key to making a good audit trail is being descriptive. Let's say you are filling out a deposit slip for five checks relating to three separate clients. All the bank requires you to do is write in the bank identification code for each check and the check amounts. This doesn't identify which client the money belongs to. If you include the name of the client and keep a copy or make a duplicate, you will know which client the check was for, which is the purpose of an audit trail. That will make it easy to answer any questions that come up, even years later.

By the same token, every check you write from your client trust bank account should indicate which client it's being written for, so that it's easy to match up the money with the client. That means you should **NEVER** make out a client trust bank account check to cash, because there's no way to know later who actually cashed the check. If you are handling more than one case for the client, indicate which matter the payments and receipts relate to on your checks and deposit slips.

A good audit trail, one that will make it easy for you to explain what happened to each client's money and to correct accounting errors, requires that you keep more than just the minimum records required by rule 1.15(d)(3) and the recordkeeping standards under rule 1.15(e) In the following list of elements of a good audit trail, records that are required by rule 1.15 are in bold. (See **What Bank-Created Records Do You Have to Keep?**.) Records that aren't in bold are important for keeping track of your clients' money but are not specified in the recordkeeping standards under rule 1.15(e).

A good audit trail should include:

- The initial deposit slip (or a duplicate copy or bank receipt). This should show the date the deposit slip was filled out; the amount of the deposit; the name or file number of the client on whose behalf the money was received; who the money came from; and the bank's date stamp showing the day the deposit was actually received.

- **The bank statement** which shows *when the deposit was actually posted* by the bank.

- The checkbook stub, which should show when payments were made, how much the payments were, to whom they were made and in connection with which client matter they were made.

- **The cancelled check.** In a good audit trail, the check should show the date the check was drawn; the amount of payment; who the check was made out to; the purpose of the check (or the matter it relates to); the order in which the check was negotiated (from the endorsements); and the date it was deposited for collection. (Regarding check imaging as a substitute for cancelled checks, see Section VII Recordkeeping, What Bank-Created Records Do You Have to Keep?)

- **The bank statement** which shows *the date the trust account was actually charged* for the check.

- Copies of the front and back of any executed drafts, especially insurance settlement drafts, received on behalf of a client.

SECTION IV: OPENING A CLIENT TRUST BANK ACCOUNT

Rule of Professional Conduct 1.15(a) in part states:

> All funds received or held by a lawyer or law firm for the benefit of a client, or other person to whom the lawyer owes a contractual, statutory, or other legal duty, including advances for fees, costs and expenses, shall be deposited in one or more identifiable bank accounts labeled "Trust Account" or words of similar import . . . .

In other words, whenever you receive or hold money for clients—or any other persons with whom you have a fiduciary relationship—you have to deposit the money into a specifically labeled client trust bank account. As we detail below, client trust bank accounts are a special kind of bank account. Bankers who have experience with them can help you set up and administer your client trust bank account properly. When you first open the account, make sure the bankers you're dealing with know what a client trust bank account is; if they don't, ask to work with someone else.

General Dos and Don'ts

Client trust bank accounts:

- **Must** be identified as a client trust bank account. Rule 1.15(a) says that the name of any account where you keep your clients' money must clearly tell the bank, your clients, your employees, the State Bar, the people you pay out your clients' funds to and everyone else that it is a client trust bank account. Whatever name you choose, you can avoid all kinds of problems if the name of the account is prominently displayed on all your client trust bank account checks, deposit slips and other documents. Make sure that papers relating to your client trust bank account look different from those relating to your personal account or your general office account. For example, you can have your client trust bank account checks printed on paper that's a different color than your other checks.

- **Must** be maintained in California. Rule 1.15(a) says you are only allowed to keep client funds outside of California under certain circumstances, including a requirement to obtain the written consent of your client. Unless most of your clients are from out-of-state and you routinely get their written consent to keep their funds somewhere else, your common client trust bank account must be maintained in California.

- **Should** be maintained in a financially stable bank. Consider selecting a bank that is regulated by a federal or state agency and that carries deposit insurance from an agency of the federal government. As your client's fiduciary, you are responsible for protecting your client funds. Note that FDIC insurance coverage differs depending on the type of account that you use. If you use a non-IOLTA interest bearing trust account, the funds deposited may be subject to a $250,000 per client insurance coverage limit. The per-client limit includes all money the client has on deposit at that bank. In other words, if you are holding $150,000 for a client at a certain bank, and the client has another $150,000 on deposit at the same bank, only $250,000 of the $300,000 the client is holding in the bank may be covered. This is just an example. You should check with your bank or the FDIC to determine any applicable deposit insurance.

  Even if all your clients' money is covered by insurance, by the time the FDIC pays your clients their money, your clients could have, for example, missed a business opportunity. (As we will discuss later, if your bank goes under, you also may have a hard time getting copies of your client trust bank account records.) Like most client trust accounting problems, the answer requires thoughtful consideration of all relevant factors with the basic goal of keeping your client trust accounts in banks that you're reasonably sure are financially secure.

- **Should** limit accessibility of funds. Ideally, you should be the *only* person authorized to sign client trust bank account checks and otherwise pay out client funds. However, for practical reasons, many practitioners make their secretaries, bookkeepers or spouses authorized signatories. Since *you* are individually, personally accountable for all client funds you receive

or hold in trust, and since this accountability can't be delegated to anyone else, allowing other people access to your client trust bank account is risky. By the same token, you should never pre-sign client trust bank account checks and leave them for employees to issue.

- **Should NOT** have ATM access. Your fiduciary responsibility is to account for your clients' money. When you write a client trust bank account check, you create an audit trail that makes it easy to trace who the money came from and where it went. (See **Key Concept 7: Always Maintain an Audit Trail**.) A client trust bank account with ATM access makes it possible for you—or anyone who knows the account code—to withdraw your clients' money in cash, and it's very hard to account for cash. ATM withdrawals are an audit trail disaster. When you make an ATM withdrawal, the only record of what happened to the money is a little slip of paper that shows the date and the amount of the withdrawal; there's nothing that shows which client's money was withdrawn, who withdrew the money or who the money was paid to. This includes withdrawing your fees, since there's no indication of which client's fees you were paying. Even if you put all the descriptive information on an ATM receipt, it won't prove to your clients or a State Bar investigator what happened to the money. ATM access should be distinguished from "online" banking. Whether online banking is offered for common client trust bank accounts is the bank's prerogative in determining which financial products it will offer. If online banking is offered, it is your responsibility to ensure that the online banking mechanisms create an audit trail that complies with all of your obligations.

- **May** include "automatic overdraft protection," provided that the bank's terms do not result in a commingling violation. (Refer to the discussion of commingling at page 2.) Automatic overdraft protection can benefit your clients by assuring that the important checks you've written on a client's matter will not bounce if a bank error or delay causes an unanticipated shortfall in your client trust bank account. The State Bar's Committee on Professional Responsibility and Conduct ("COPRAC") has opined that: "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." (State Bar Formal Op. No. 2005-169. See Appendix 6 for the text.) Generally, "automatic overdraft protection" means that whenever you write a check for more money than is in your account, the bank will automatically make you a personal loan and apply those funds to your account to keep the check from bouncing. This optional account feature may also be offered as an "instant credit" arrangement where the bank agrees to immediately credit accounts for deposits while the bank waits for the funds from another financial institution. As discussed in the COPRAC opinion, a commingling problem does not arise if your bank's automatic overdraft protection operates according to terms that compensate exactly for the amount that the overdraft exceeds the funds on deposit. In contrast, overdraft protection that automatically deposits a set amount (i.e., a deposit or credit of $200 to cover a $155 overdraft) will leave a residual balance of funds after covering the amount of insufficient funds. This residue in your client trust bank account is money that belongs to you and not to any of your clients and creates the commingling problem.

There are additional considerations in deciding whether to use automatic overdraft protection. With the exception of bank errors, one important consideration is that you should never have insufficient funds in your client trust bank account in the first place; if you do, you're in violation of your professional responsibilities. Overdraft protection is not a substitute for the proper handling of clients' money. It can, however, help protect your clients from the effects of accounting errors by you or your bank. You should be aware that regardless of whether you have overdraft protection to keep a check from bouncing, the State Bar will find out about it. Business and Professions Code section 6091.1 requires financial institutions to report these transactions to the State Bar. (See Appendix 2 for the text.) This means that banks will report not only checks that are rejected for insufficient funds, but also checks that are paid against insufficient funds. The statute also requires financial institutions to notify the State Bar when a client trust bank account check is written against an account that is closed.

By the time you hear from the State Bar, several weeks may have passed since you had the problem with your client trust bank account. Do not assume that your bank has or will provide an explanation to the State Bar. When an overdraft of a client trust bank account occurs, it is possible that your bank made an error or is aware of funds not yet credited to your account. The bank may owe you, their customer, an explanation, but it is your responsibility to provide an explanation to the State Bar.

A report to the State Bar pursuant to Business and Professions Code section 6091.1 doesn't automatically mean that you are being investigated by the State Bar. However, if you fail to provide the State Bar with a satisfactory explanation or if the problem occurs more than once, an investigation may result. Remember, banks routinely charge for handling checks returned for insufficient funds, even if the bank pays them. The bank may also charge you for handling checks you deposit in your client trust bank account if the check is returned unpaid from the maker's bank. These charges should be handled like any other bank charges. (See **What MAY Go Into Your Client Trust Bank Account?**.)

Know Your Bank

From the moment you make the first deposit into your client trust bank account, handling your clients' money means dealing with your bank. Every bank has different procedures; not knowing those procedures can hurt you and your clients. For every bank in which you maintain a client trust bank account, make sure you get the answers to the questions in Key Concept 4, Timing is Everything—what is your bank's schedule for clearing deposits, what is your bank's daily deadline for crediting deposits and what is your bank's daily deadline for paying checks drawn on it—and the following:

- **When does the bank usually provide statements of account activity?** When account activity is occurring, banks provide periodic statements that show what deposits have been credited to and what payments have been withdrawn from each account. This might be in the form of mailed statements on a monthly basis or other interval or offered as electronic statements that can be viewed online, and downloaded or printed by the account holder. Rule 1-15(d)(3) and recordkeeping standard (1)(d) requires you to do monthly reconciliations of your client trust bank accounts to make sure that your records match the bank's records. (See **Reconcile the Account Journal with the Bank Statement**.) If you know your banks practice in providing or posting records of account activity, you can schedule a regular time every month to do the required reconciliations.

  In the case of mailed bank statements, knowing when to expect your statement can also help you guard against theft by an associate or an employee. If someone is stealing from your client trust bank account, the bank statement should help in uncovering that theft. An in-house thief may try to hide by concealing incriminating bank statements; if you're timely in looking for the mailed bank statement, the thief won't be able to hide for long. Be sure to review both the bank statements and cancelled checks to avoid potential problems. If you suspect that an employee or other person is maliciously manipulating mailed bank statements, then comparing those statements to online account records can help in investigating the suspected theft.

- **What does your bank charge for and how much will you have to pay?** As we've discussed, you need to know what bank charges to expect so that you can ensure that you or your clients always have money in the account to cover them. Ask your banker about bank fees and charges.

"IOLTA" Accounts

When a client gives you a "nominal" amount of money, or you will be holding a client's money for a "short period of time," Business and Professions Code section 6211 states that you must hold the money in a common client trust bank account which is set up so that the interest the account earns will be paid to the State Bar of California.

Since most attorneys at some time hold money for clients that is "nominal in amount" or will be held for a "short period of time," the chances are that you will need to set up a common client trust bank account, which for convenience we've referred to as an "IOLTA" account. ("IOLTA" stands for Interest On Lawyers Trust Accounts.) (For a discussion of how to decide which client funds should be held in an IOLTA account, see **What MUST Be Held in Your IOLTA Account?**.)

The idea behind the IOLTA statute is that attorneys often hold amounts of money for clients that are so small or will be held for such short periods of time that the interest the money could earn for the client if it were held in a separate interest-bearing account would be less than the costs involved in earning or accounting for the interest. However, when these amounts of money are held in a common client trust account, they collectively can generate substantial interest. The IOLTA statute requires that this aggregate interest, which would otherwise benefit only the bank, is used to ensure that indigent Californians have access to legal services.

Under Business and Professions Code section 6212, attorneys may hold IOLTA accounts only at eligible financial institutions. To be eligible, the rate of interest or dividends payable on an IOLTA account by the financial institution must be comparable to the interest or dividends paid to similarly situated non-IOLTA accounts. (See Appendix 7 for the State Bar's list of IOLTA-eligible institutions. This list is continuously updated so you should check the State Bar's Web site for the most current list of IOLTA-eligible institutions (http://www.calbar.org/IOLTA). If your financial institution is not already IOLTA-eligible, you should direct them to the Office of Access & Inclusion at (415) 538-2046 or iolta@calbar.ca.gov for information on becoming eligible.

When you open an "IOLTA" account, the bank will code the account with the State Bar's taxpayer identification number so you don't have to worry about paying tax on the interest. The bank automatically transmits the interest to the State Bar, and handles all the reporting requirements.

The State Bar must check to be sure that the bank sends the interest, so you must report to the State Bar when you open or close an IOLTA account. (See **Reporting IOLTA Compliance to the State Bar**.)

Under Business and Professions Code section 6212(C), reasonable fees may be deducted from the interest remitted on an IOLTA account. Reasonable service charges include per-check charges, per-deposit charges, monthly fees such as fees in lieu of minimum balance, federal deposit insurance fees, or sweep fees. However, the attorney is responsible for paying account expenses that are incurred in the ordinary course of business, such as charges for check printing, deposit stamps, collection charges, or insufficient fund charges. These fees may only be charged to the lawyer or law firm maintaining the IOLTA account and will not be deducted from the interest remitted on the account.

In the event that fees routinely exceed interest earned and are charged by the bank to the attorney, an attorney may apply to the Office of Access & Inclusion to convert the IOLTA account to a non-interest bearing trust checking account. In that case, the State Bar's taxpayer identification number will be removed from the account, and the attorney will be responsible for all fees and charges incurred to maintain the account. (See **Unproductive IOLTA Accounts**.)

In addition to an attorney's duties in client trust account management, your bank has obligations as well. For a more detailed outline of the guidelines applicable to a bank's administration of IOLTA accounts, please refer to the State Bar's Guidelines for Financial Institutions, available online at http://www.calbar.ca.gov/Portals/0/documents/iolta/IOLTAGuidelines-for-Financial-Institutions.pdf.

IOLTA Accounts and FDIC Insurance

Effective January 1, 2010, Business and Professions Code 6213 was amended to define "IOLTA account" to mean an account or investment product that is: 1) an interest-bearing checking account; 2) an investment sweep product that is a daily (overnight) financial institution repurchase agreement or an open-end money-market fund; or, 3) an investment product authorized by California Supreme Court rule or order. The legislation provides for strictly defined conservative safe investment sweep products, which are sometimes held on the investment side of the bank and therefore are not necessarily deposit accounts covered by the Federal Deposit Insurance Corporation (FDIC).

If your IOLTA is held in an interest-bearing checking account that is insured by the FDIC, the funds deposited by you on behalf of one or more principals are insured as the funds of the principal (the actual owner) to the same extent as if the funds were deposited directly by the principal, provided *all* of the following requirements are met:

- The fiduciary nature of the account must be disclosed in the account title.
- The identities and the interests of the principals for whom the fiduciary is acting must be ascertainable from either the deposit account records of the bank, or records maintained in good faith and in the regular course of business by the depositor or by some person or entity that had undertaken to maintain such records for the depositor."

An IOLTA account is subject to FDIC insurance limits. For more information, visit the FDIC website at: https://www.fdic.gov/consumers/consumer/news/cnwin1213/coverageupdate.html .

While the presence of FDIC insurance is important, a lawyer should note that even if all of a client's funds are covered, by the time the FDIC pays a client their money, that client's interests might be adversely impacted.

For example, the delay may result in a missed business opportunity. Similarly, FDIC coverage will not help with the problem that could arise if a bank goes under and copies of a client's trust bank account records need to be retrieved from that bank.

Reporting IOLTA Compliance to the State Bar

Rule 2.114 of the Rules of the State Bar of California requires attorneys to report compliance with the State Bar's IOLTA program. (See Appendix 2 for rules 2.100-2.118 of the Rules of the State Bar of California, which cover the duties of an attorney in trust account management.) Whenever you open or close an IOLTA account, you should promptly notify the State Bar.

The State Bar has made it easy to report compliance by logging on to your ***My State Bar Profile*** account on the State Bar's website and going to "Report my IOLTA status." Alternatively, you may send a deposit slip or a voided blank check for the account with your bar membership number written on it to the Office of Access & Inclusion, State Bar of California, 180 Howard Street, San Francisco, CA 94105-1639. (The fax number to the Office of Access & Inclusion is (415) 538-2552 and the e-mail address is iolta@calbar.ca.gov.)

If you'll be sharing the account with other attorneys, e.g., partners or associates in your firm, each attorney should update their ***My State Bar Profile.*** Alternatively, you may attach a list of the names and bar membership numbers of all the attorneys who will be using the account to the deposit slip or voided check.

Unproductive IOLTA Accounts

Normally, the bank will deduct reasonable service charges for holding an IOLTA account from the interest or dividends earned on the account. However, if service charges exceed the interest earned on an account during a remitting period, your bank has several options in determining how to deal with those excess fees. The bank may choose to maintain the account and write off or absorb any uncollected charges or offset the charges against future interest earnings on the account. However, the bank may instead choose to pass those service charges and costs to the lawyer. In the event that fees routinely exceed interest earned and the bank decides to charge the excess fees to the attorney, the attorney may apply to the Office of Access & Inclusion to convert the IOLTA account to a non-interest bearing trust checking account. The State Bar's taxpayer identification number will be removed from the account and the attorney will be responsible for the fees and charges incurred to maintain the account. (See **Bank Charges**.)

SECTION V: DEPOSITING MONEY INTO YOUR CLIENT TRUST BANK ACCOUNT

All funds and property held for the benefit of a client must be deposited into a client trust account. This includes advances for fees, costs, and expenses.

Your trust accounting duties require you to differentiate between the types of funds: funds that MUST go into your client trust account; funds that MUST NOT go into your client trust account; and funds that fall under certain limited exceptions. Failure to differentiate among these different types of funds may result in commingling or misappropriation.

What MUST Go into Your Client Trust Bank Account?

Any money received for the benefit of the client must be deposited into the client trust account and cleared before it can be paid out. This includes: money that belongs to the client outright (for example, funds from a sale of the client's property); money in which the attorney and the client have a joint interest (for example, settlement proceeds that includes the attorney's contingency fee or fees paid in advance that have not been earned); money in which the client and a third party have a joint interest (for example, funds from the sale of community property); and money that doesn't belong to the client at all but which the attorney is holding as part of carrying out the attorney's representation of the client (for example, when the attorney represents a client who is a fiduciary for funds owned by a beneficiary).

What MUST NOT Go into Your Client Trust Bank Account?

Funds that belong to an attorney or an attorney's law firm must never be deposited into your client trust account. You should never put your personal or office money, including funds like employee payroll taxes, into your client trust account.

Limited Exceptions for Certain Funds

You are required to hold advance fees in the client trust account, including a "flat fee" paid in advance. A "flat fee" is a fixed amount that constitutes complete payment for the performance of described services regardless of the amount of work ultimately involved, and which may be paid in whole or in part in advance of the lawyer providing those services. However, an attorney may deposit a flat fee into an attorney's or the firm's operating account provided the attorney complies with the requirements of rule 1.15, paragraph (b). These requirements include disclosing to the client in writing that the client is entitled to a refund of any unearned amount of the flat fee. Whenever any fees paid in advance are held in the client trust account, withdrawal of earned fees should be done on a regular basis perhaps when monthly reconciliation is performed.

Generally, money that belongs to an attorney or their firm should not be deposited into the client trust account. However, you may deposit attorney or law firm funds into the client trust account that are "reasonably sufficient to pay bank charges." This is permitted because you must prevent bank charges from being debited against your client's funds. Some attorneys arrange with the bank to have those charges assessed against their general office accounts instead of the client trust account. Remember that a deposit of your own money to cover bank charges, like every deposit you make to your client trust bank account, must be properly recorded in the account journal for your client trust bank account, and a special "bank charges" ledger. (See **What Records Do YOU Have to Create?**.)

What MUST Be Held in Your IOLTA Account?

As we've mentioned, Business and Professions Code section 6211 requires you to keep amounts of money that are "nominal in amount" or "on deposit or invested for a short period of time" in your IOLTA account. Client funds that can earn revenue for the client in excess of the costs to hold those

accounts must be deposited for the benefit of the client. Thus, you are required to make the practical determination of whether your clients' money must be held in your IOLTA account.

The constitutionality of California's IOLTA statute was upheld in *Carroll v. State Bar* (1985) 166 Cal.App.3d 1193 [213 Cal.Rptr. 305] (see generally, *Brown v. Legal Foundation of Washington* (March 26, 2003) 538 U.S. 216, 123 S.Ct. 1406, 155 L.Ed.2d 376). In Carroll, the court suggested a convenient rule of thumb for determining whether client funds must be placed in the IOLTA account: your clients' money is "nominal in amount" or being held "for a short period of time" if the cost of opening and administering a separate, individual client trust bank account or otherwise accounting for the funds separately is greater than the amount of interest the money would earn for your client.

Rule 2.110(A) of the Rules of the State Bar of California includes six factors that an attorney must consider in determining whether funds can earn income in excess of costs:

- the amount of the funds to be deposited;
- the expected duration of the deposit, including the likelihood of delay in resolving the matter for which the funds are held;
- the rates of interest or dividends at eligible institutions where the funds are to be deposited;
- the cost of establishing and administering non-IOLTA accounts for the client or third party's benefit, including service charges, the costs of the member's services, and the costs of preparing any tax reports required for income earned on the funds;
- the capability of eligible institutions or the member to calculate and pay income to individual clients or third parties;
- any other circumstances that affect the ability of the funds to earn a net return for the client or third party.

To help you make this determination, the following chart shows that if you're holding $5,000 for a client for 209 days—about seven months—that money will earn $50 in interest. (The chart assumes the current highest interest rate of 1¾%, compounded daily. Since interest rates change constantly, and most are now lower than this you shouldn't rely too heavily on this chart.) However, if your bank charges $8 a month to keep a separate account open, by the time your client earns $50, the bank will have charged your client about $56. Therefore, the $5,000 must be deposited into your IOLTA account because the actual transactional costs would prevent it from earning net income for your client.

Amount of Client Money You're Holding	Time Needed to Ear $50 Interest (At 1¾% Compounded Daily
$ 5,000	209 days
$10,000	106 days
$15,000	71 days
$20,000	54 days
$25,000	43 days

What if the money you are holding is not "nominal in amount" or not being held for "a short period of time"? While you are not required to earn interest for the client, in no case are you allowed to keep the interest your clients' money earns. In light of the fact that the funds would generate interest income for the client if held in a separate interest-bearing account and you are in a fiduciary

relationship with the client, you should ordinarily place the funds in an interest-bearing account for the benefit of the client. Tell the bank to code the account with your client's taxpayer identification number. In addition, make sure the type of account you choose doesn't limit access to your client's money in any way that will harm your client.

Your banker can help you figure out whether the amount of money a client has given you could generate net income for that client in a separate interest-bearing client trust bank account during the time you hold it, if you're having trouble deciding. Under rule 2.110(B), the State Bar will not bring disciplinary charges against an attorney for determining in good faith whether or not to place funds in an IOLTA account. However, rule 2.112 requires an attorney to review IOLTA accounts at reasonable intervals to determine whether changed circumstances warrant moving the funds out of the account.

SECTION VI: PAYING MONEY OUT OF YOUR CLIENT TRUST BANK ACCOUNT

Before you write your first client trust bank account check, there are five things you should know.

What Payments CAN You Make?

You can make any payments **on behalf of your client** out of your client trust bank account, including paying client costs and expenses (e.g., court filing fees or deposition transcript costs), disbursing settlement proceeds, paying yourself earned and undisputed legal fees, etc. You may also pay bank charges for the account. Those are the *only* payments you're allowed to make out of your client trust bank account.

Bank charges. For individual client trust bank accounts, paying bank charges is simple: since all of the charges are incurred for the client for whom you have the account, you can pay the charges out of that client's money.

For IOLTA accounts, paying bank charges is a little more complicated. Under amended Business and Professions Code section 6212(c), reasonable fees may be deducted from the interest remitted on an IOLTA account. Reasonable service charges include per-check charges, per-deposit charges, monthly fees such as fees in lieu of minimum balance, federal deposit insurance fees, or sweep fees. However, the attorney is responsible for paying account expenses that are incurred in the ordinary course of business, such as charges for check printing, deposit stamps, collection charges, or insufficient fund charges. These fees may only be charged to the lawyer or law firm maintaining the IOLTA account and will not be deducted from the interest remitted on the account. That's why rule 1.15(c)(1) allows you to keep a little of your own money–an amount "reasonably sufficient to cover bank charges"–in your client trust bank accounts without violating the rules against commingling. However, when the bank charges for a service (e.g., for wiring money) for a specific client, you can treat the charge as you would any other cost and pay for it out of money you are holding for that client in the IOLTA account.

What Payments CAN'T You Make?

You *can't* make payments out of your client trust bank account to cover your own expenses, personal or business, or for any other purpose that isn't directly related to carrying out your duties to an individual client. You also can't pay money out of your client trust bank account on behalf of a client if the client doesn't have money available in the account to cover those payments. (See **Key Concept 2: You Can't Spend What You Don't Have**.)

You should also remember that you can't pay yourself legal fees that your client is disputing, whether or not you feel you've earned them. The moment a client disputes your fees, the disputed amount is frozen in your client trust bank account until the dispute is settled. When the amount of your fees is no longer in dispute, you have an ethical obligation to take those fees out of the client trust bank account as soon as you reasonably can.

How Should You Make Payments?

You should always pay out money from your client trust bank account by using a check, a wire transfer or another instrument that specifies who is getting the money and who is paying it out. You should never pay out money in cash, or with checks or other instruments made out to cash because you have no evidence of payment. (See **Key Concept 7: Always Maintain an Audit Trail**.) If you do make a payment in cash (or another instrument that doesn't give you a record of the transaction), you *must* get a receipt, or you have violated your professional responsibilities.

Some attorneys carry blank client trust bank account checks around to pay client expenses that come up when they're out of the office. Don't. This is a bad practice which results in checks being written

out of numerical order (i.e., lower numbered checks being dated later than higher numbered checks), and, more often than not, a few checks disappearing altogether. That can make it hard to keep orderly records and reconcile your books. If you're out of the office and a client expense comes up, pay it out of your general office account and, when you get back to the office, write a client trust bank account check to reimburse yourself.

Who Should Make Payments?

As we've discussed, your clients have entrusted *you* with their money, and you are personally accountable for it. Giving other people access to your clients' money is even riskier than giving them access to your own money. If your money is stolen because you trusted the wrong person, all you lose is the money. If your clients' money is stolen because you trusted your employees or your spouse to sign client trust bank account checks, you can lose your clients' money, your professional reputation and even your license to practice law. *Don't* make a signature block or stamp for your client trust bank account checks; *don't* pre-sign blank client trust bank account checks. If you do, sooner or later some of your clients' money will be missing, and whether the cause is dishonesty or incompetence, you will bear responsibility for both the financial loss and the violation of your fiduciary responsibility.

When Can You Make Payments?

As we've discussed, you can only pay out money from your client trust bank account when the client you're making the payment for has money to cover the payment in the account. (See **Key Concept 2: You Can't Spend What You Don't Have** and **Key Concept 4: Timing Is Everything**.)

When MUST You Make Payments?

Rule 1.15(d)(7) says that you must "promptly distribute, as requested by the client or other person, any undisputed funds or property in the possession of the lawyer or law firm that the client or other person is entitled to receive." This means that if your client asks you to return money you are holding in trust for that client, you must deliver that money promptly. Often, a client request for payment is triggered by notice from you that certain money has been received for the client, such as settlement proceeds. Rule 1.15(d)(1) requires that you "promptly notify a client or other person of the receipt of funds, securities, or other property in which the lawyer knows or reasonably should know the client or other person has an interest." What is meant by "promptly" for purposes of both notifying clients about funds received and making payment as requested by clients will depend upon the specific circumstances of each client's matter.

Attorney fees. As we've discussed, when you're holding client money that includes your undisputed fees, you have to take those fees out of the client trust bank account promptly after you've earned them.

Third party claims. You also may have a duty to promptly pay expenses due to a third party incurred on behalf of a client. In some cases, the client may dispute a third party's claim to the money. This situation most often arises in connection with a medical lien which the attorney and client have both signed. After the recovery is received, the client instructs you not to pay the doctor. Since you signed the lien, turning the funds over to the client may expose you to potential civil liability and may violate your fiduciary duty to the doctor. On the other hand, paying the doctor against the express instructions of the client also presents difficulties. You should consider writing to the client and the doctor to inform them of the problem, and your intention to hold the disputed funds in your client trust bank account until the dispute is resolved. If the parties cannot resolve their dispute, you should advise them of your intent to file an interpleader action. In no case should you use the disputed funds, which would constitute misappropriation.

SECTION VII: RECORDKEEPING

The next two sections will describe a simple, effective system for accounting for your clients' money. Whenever something in this section is mandatory, we'll cite the applicable rule, statute or case. Otherwise, we're giving you practice pointers, not law.

Rule of Professional Conduct 1.15(e) does not mandate any particular client trust accounting system. (However, keep in mind that an absence of records can subject you to discipline.) You can hire consultants to set up a system, buy computer accounting software—whatever works for you—as long as you get the results and keep the records that the rules require. If your client trust accounting system will accomplish what our client trust accounting system does, then it's probably alright. However, the system described below will give you everything you need to do in order to account for your clients' funds.

Our client trust accounting system is designed for sole practitioners and attorneys in small law firms. It assumes that you will be directly involved in every aspect of handling your clients' money. However, whatever size firm you work in and whatever client trust accounting system you use, you still have full personal fiduciary responsibility for accounting for your clients' money.

Keeping records is the way you do the "accounting" part of client trust accounting. Recordkeeping must be done consistently and keeping incomplete records is just as great a breach of your professional responsibility as keeping no records at all.

As we've discussed, rule 1.15(d)(3) and (e) requires you to keep two kinds of records: records created by the *bank* that show what went into and out of your client trust bank accounts; and records created by *you* to explain the transactions reflected in the bank documents.

How Long Must You Keep Records?

Rule 1.15(d)(5) requires you to keep trust accounting records for five years after you pay out the money the records refer to. To be on the safe side, you should keep the records of all money you handled for a client for a minimum of five years after you closed that client's case, unless they relate to a matter under disciplinary investigation. In that case, you *must* retain the records until the investigation is concluded as part of your duty under Bus. & Prof. Code sec. 6068(I) to cooperate and participate in a State Bar investigation.

Where Can You Keep Your Records?

If you have a practice involving a lot of clients, you have to hold on to a lot of paper. Since office space is limited and expensive, you may find it makes more sense to keep some client trust accounting records off-site rather than in your office. That's OK, as long as you can produce the records within a reasonable time after receiving notice that you're the subject of a disciplinary inquiry. If you keep orderly files, label each box with the names of the client trust bank accounts the records apply to and the dates covered by the records, and keep an index listing the names of all the boxes you send into storage, this won't be a problem. If you don't, you're going to have to retrieve all the boxes from storage and sort through all the records they contain in order to respond to the disciplinary inquiry. This can be expensive, time-consuming, and, if you have to request a time extension, can create the wrong impression.

What If You Have a Computerized System?

A computerized accounting system is acceptable. However, you should consider generating and keeping hard copies of all the records required by the rule (including bank-created records). You can use computer printouts instead of hand-written ledgers for the records you are responsible for creating, but just having the data on a disk is risky. (It's a good idea to have these printouts dated and signed by the preparer to show when and by whom they were generated.)

If you're using a computerized accounting system, you should remember that computer data can be lost through natural disaster (like earthquake or fire), power or equipment failure and human error. For your own protection, make hard copies regularly and have all of your computer records regularly backed up onto disks. In addition, if you use computerized records, remember that if the records are offered as evidence, they must be authenticated as business records pursuant to Evidence Code sections 1270-1272. (See Appendix 2 for the text for those sections and Evidence Code sections 1552 and 1553.)

Beyond preservation of the computer data, you also should be very careful when changing or upgrading your specific accounting software application, your overall computer operating system, and the computer hardware itself. Different software applications and newer versions of your same software application may not be fully compatible with the data generated by your current software application. Similarly, changing computers or operating systems can cause difficult compatibility problems. These days, it is not unusual for computer technology to advance dramatically in a five year time period, rendering some application data obsolete and problematic to use.

What Bank-Created Records Do You Have to Keep?

Rule 1.15(d)(3) and (e) requires you to keep two kinds of bank-created records: client trust bank account statements and cancelled checks. Some attorneys don't take their duty to keep bank-created records seriously because they can always get copies from their bank. This is a clear violation of rule 1.15(d)(3) and (e); it also isn't true. If your bank fails, merges with or is taken over by another bank, you may find that copies of your four-year-old cancelled client trust bank account checks just aren't available. As previously noted, finding a bank that still offers "cancelled checks" may take some searching and, if you're unable to find such a bank, be sure to access and maintain "cancelled check" information by requesting check imaging or other electronic or online accessible statement documentation from your bank. At its website, the Federal Reserve Board posts answers to Frequently Asked Questions about Check 21, explaining in part that:

> "The Check Clearing for the 21st Century Act (Check 21) was signed into law on October 28, 2003, and became effective on October 28, 2004. Check 21 is designed to foster innovation in the payments system and to enhance its efficiency by reducing some of the legal impediments to check truncation. The law facilitates check truncation by creating a new negotiable instrument called a substitute check, which permits banks to truncate original checks, to process check information electronically, and to deliver substitute checks to banks that want to continue receiving paper checks. A substitute check is the legal equivalent of the original check and includes all the information contained on the original check."
> (https://www.federalreserve.gov/paymentsystems/regcc-faq-check21.htm)

While it isn't required by the rule, you should also keep your client trust bank account deposit slips and checkbook stubs so you will have a complete audit trail. (See **Key Concept 7: Always Maintain an Audit Trail**.) These records will make it much easier to balance your books and to show what you did with your clients' money.

How Should You File Bank-Created Records?

To ensure that you have a complete set of bank-created records, and to save you time when you need to find a particular record, you should have a simple, consistent filing system. One good system is to keep separate binders for each of your client trust bank accounts. Each binder should have one section for bank statements, one section for cancelled checks, one section for deposit slips and one section for checkbook stubs. File each record in date order in the appropriate section of the binder for the account they refer to. Just label each binder with the name of the client trust bank account and the period it covers, and you should be able to find any record in one or two minutes.

What Records Do YOU Have to Create?

As we've discussed, rule 1.15(d)(3) and (e) requires you to create three kinds of records to show that you know at all times what you're doing with your clients' money. We'll discuss each of these records in detail below, but a few general points apply to all of them:

- Like bank-created records, rule 1.15(d)(5) requires you to retain these records for a minimum of five years after you pay out the money the records refer to.

- Never round off figures in these records. Rule 1.15(d)(3) and (e) says that you must record "all funds" received on behalf of a client. That means all receipts and payments must be recorded to the penny.

- These records can be handwritten, typed or printed out from a computer file. However, they should be complete, neat and legible, and stored in such a way that you can find them—and read them—as many as five years later. Handwritten records should be kept *in ink*—not pencil or magic marker—in bound accounting books, and typed records or computer printouts should be filed in binders. As with bank-created records, you can save yourself time and trouble by labeling the covers of the books and binders with complete account or client names and the dates the records cover.

- All deposits and payments should be recorded to the account journal and client ledger within 24 hours. Waiting longer increases the chance that you will forget to record a transaction or will record it wrong. It also means that your records aren't up-to-date, and that you might be spending money your clients don't have. (See **Key Concept 5: You Can't Play the Game Unless You Know the Score**.)

The client ledger. Rule 1.15(d)(3) and (e) says you must keep a "written ledger" for each client whose money you hold. This client ledger must give the name of the client, detail all money you receive and pay out on behalf of the client, and show the client's balance following every receipt or payment.

Maintaining a client ledger is like keeping a separate checkbook for each client, regardless of whether or not the client's money is being held in your common client trust bank account. (See **Key Concept 1: Separate Clients Are Separate Accounts**.) The only difference between properly maintaining a client ledger and properly maintaining your personal checkbook is that you can be disciplined if you fail to properly maintain your client ledger.

Every receipt and payment of money for a client must be recorded in that client's client ledger. For every receipt, you must list the date, amount and source of the money. For every payment, you must list the date, the amount, the payee (who the payment went to) and purpose of the payment. After you record each receipt, you must add the amount to the client's old balance and write in the new total. After you record each payment, you must subtract the amount from the client's old balance and write in the new total. Leave a number of blank lines after the last entry of each month, so that you can make additional entries during the monthly reconciliation process.

When you deposit more than one check at a time for a client (i.e., using one deposit slip for all the checks), you should record each check as a separate deposit in your account journal. If you don't, it will be harder to reconcile your books and to answer any questions that may come up later.

You will find it much easier to keep your records straight if you don't put more than one client's records on a given page. Also, you shouldn't use the front of a page for one client and the back of the page for another. This means wasting some paper, but it will enable you to file all the client ledger pages that refer to a given client in chronological order and find those pages faster if you need them. If you're handling more than one case for the same client, it may be helpful to maintain a separate client ledger for each matter. If you don't, make sure that it's clear to which case the transaction is related when you record your client's receipts and payments.

Let's go through the motions of opening and maintaining a client ledger for a new client, KB. At your first meeting, on Thursday, July 9, KB gives you a check for $1,500 as an advance against costs and expenses. The first question is whether you should open an individual client trust bank account for KB, where it will earn interest for her, or deposit this money into your IOLTA account, where it will earn interest for the Legal Services

Trust Fund Program. When you apply the requirements of Business and Professions Code section 6211, you decide that the $1,500 couldn't earn interest for KB after costs are deducted. (See **What MUST Be Held in Your IOLTA Account?**.) Therefore, you deposit KB's money into your IOLTA account and create a new client ledger for her, starting on the front of an unused page in the book you use for client ledgers. The new client ledger looks like this:

_CLIENT LEDGER
CLIENT:KB
CASE#: 920137

DATE	SOURCE OF DEPOSIT	PAYEE, # & PURPOSE	CHECKS (SUBTRACT)	DEPOSITS (ADD)	RUNNING BALANCE
7/09/06	KB			1,500.00	1,500.00

As rule 1.15(d)(3) and (e) requires, you've recorded the date you received KB's money, who the money came from, the amount of money and the balance you're holding for KB. Notice that the "Payee, # & Purpose" and "Checks (Subtract)" columns are left blank, since they are only used when you are recording a payment out of the account.

The first thing KB needs is a private investigator to locate witnesses for her case. Since you know that your bank won't clear KB's check (which is drawn on an out-of-town bank) until the third working day after the deposit, you wait until then to hire one. (If the matter required immediate attention, you could have paid the private investigator with a check drawn on your general office account, and then reimbursed yourself for the expense after KB's check had cleared.)

On Tuesday, July 14, when the check has cleared, you look up KB's balance to make sure she has enough money in the account (you can't keep every client's balance in your head) and then make out a client trust bank account check, #437, for $500 to FS, a private investigator. You record the payment in KB's client ledger, subtract the amount of the check from her running balance and write in the new balance. KB's client ledger now looks like this:

CLIENT LEDGER
CLIENT:KB
CASE#: 920137

DATE	SOURCE OF DEPOSIT	PAYEE, # & PURPOSE	CHECKS (SUBTRACT)	DEPOSITS (ADD)	RUNNING BALANCE
7/09/06	KB			1,500.00	1,500.00
7/14/06		FS, #437 Investigation	500.00		1,000.00

As rule 1.15(d)(3) and (e) requires, you've recorded the date you paid out KB's money, who you paid the money out to, why you spent the money, the amount of money you spent and the balance you're holding for KB. You also recorded the number of the check you wrote, to make it easier to reconcile your records at the end of the month. Notice that the "Source of Deposit" and "Deposits (Add)" columns were left blank, since they are only used when you are recording a deposit to the account. Also notice that you didn't round off; you recorded the amount of the payment to "FS" and the new balance to the penny.

During the next couple of weeks, you receive two more checks from KB and (after checking KB's balance) make one additional payment to cover court costs. Following the procedure above, you record these transactions in KB's client ledger. When KB calls you at 5:30 p.m. on Friday, July 24, to ask how much you're still holding for her, you are able to tell her immediately, even though your secretary has already gone home. When KB's case is closed at the end of the month, per your written fee agreement, you pay yourself your legal fees. At the time you close the matter, KB's client ledger looks like this:

CLIENT LEDGER
CLIENT:KB
CASE#: 920137

DATE	SOURCE OF DEPOSIT	PAYEE, # & PURPOSE	CHECKS (SUBTRACT)	DEPOSITS (ADD)	RUNNING BALANCE
7/09/06	KB			1,500.00	1,500.00
7/14/06		FS, #437 Investigation	500.00		1,000.00
7/15/06	KB			325.00	1,325.00
7/15/06		SF Muni Court, #446 Filing Fee	50.00		1,275.00
7/19/06	KB			225.00	1,500.00
8/01/06		Self, #448 Legal Fee	1,500.00		0

If KB questions your fees, or if a State Bar investigator asks you to explain what you did with KB's money, this client ledger gives you a complete, clear record to account for the funds you held in trust. In the course of keeping this client ledger, you've completely fulfilled the client ledger requirements of rule 1.15(d)(3) and (e). You've also fulfilled six of the seven key concepts. You've kept KB's money separate from all your other clients', even though it's being held in your common client trust bank account (**Key Concept 1: Separate Clients Are Separate Accounts**); you haven't spent more money than KB had and have thus avoided a "negative balance" (**Key Concept 2: You Can't Spend What You Don't Have** and **Key Concept 3: There's No Such Thing as a "Negative Balance"**); you waited until KB's check cleared before paying out any of the money (**Key Concept 4: Timing Is Everything**); you've been able to tell at all times exactly how much of KB's money you're holding (**Key Concept 5: You Can't Play the Game Unless You Know the Score**); and you've zeroed out KB's balance (**Key Concept 6: The Final Score Is Always Zero**). As for **Key Concept 7: Always Maintain an Audit Trail**, your goal of maintaining an audit trail is not complete until you have identified and corrected any accounting errors that can be ascertained by reviewing and reconciling your records (see **Reconciliation**).

The account journal. Rule 1.15(d)(3) and (e) says you must keep a "written journal" for each client trust bank account. This account journal must give the name of the bank account, detail all money you receive and pay out, say which clients you received or paid out the money for, and give the account balance after every receipt or payment.

Maintaining an account journal is very similar to keeping a client ledger. In fact, for your individual client trust bank accounts (i.e., accounts in which you keep only one client's money), you only need to keep the client ledger in order to comply with rule 1.15(d)(3) and (e). But for your common client trust bank account, keeping the account journal is the only way you can know how much you have in the account at any given time. If you maintain the account journal properly, you will never bounce a client trust bank account check unless there's been a bank error.

In the account journal, you must record every deposit into and payment out of the client trust bank account. For every deposit, you must record the name of the client you received the money for, the

date you deposited the money, and the amount of money you deposited. After you record each deposit, you have to add the amount to the account's old balance and write in the new total. For every payment, you must list the client for whom you paid out the money, the date and the amount of the payment. Although it's not required by the rule, you will find it a lot easier to balance your books if you also record the number of the check and the payee or source of the money. After you record each payment, you have to subtract the amount from the account's old balance and write in the new total. As with the client ledger, leave a number of lines blank after the last entry of each month, so that you can make additional entries during the monthly reconciliation process.

When you deposit more than one check at a time (i.e., using one deposit slip for all the checks), you must record each check as a separate deposit in your account journal. If you don't, you won't be able to indicate how much was deposited for each client, thus you won't be in compliance with rule 1.15(d)(3) and (e).

If you are keeping your own money in the account to cover bank charges, you must also record every deposit of your own funds and every bank charge. In the account journals for interest-bearing client trust bank accounts, you must also record any interest the bank credits to or charges the bank takes from the account.

Let's look at an example of an account journal for a common client trust bank account. To show you how the account journal relates to the client ledger, we'll look at the account journal page for the day you deposited KB's first check, July 9, 2006:

ACCOUNT JOURNAL
CLIENT TRUST BANK ACCOUNT NAME: Common Client Trust Bank Account

DATE	CLIENT	SOURCE OF DEPOSIT	PAYEE, # & PURPOSE	CHECKS (SUBTRACT)	DEPOSITS (ADD)	RUNNING BALANCE
7/09/06	DS		FB, #423 Prof. Fee	1,800.00		13,000.00
7/09/06	KB	KB			1,500.00	14,500.00
7/09/06	GC	Insurance Co.			3,500.00	18,000.00
7/09/06	DC		DC, #424 Settlement Proceeds	6,500.00		11,500.00

As you can see, at the time you deposited KB's first check, there was already a substantial amount of money in the account that belonged to other clients. The account journal *doesn't* show you how much of this money belonged to each client. To find that out, you have to look in the client ledgers for those clients. What the account journal *does* tell you is how much, to the penny, was in your common client trust bank account at any given time.

As rule 1.15(d)(3) and (e) requires, for each transaction you've recorded the date you received or paid out the money, which client you received or paid out the money for, how much you received or paid out and what your client trust bank account balance was after each deposit or payment. As with the client ledger, you've recorded who the money came from (in the “Source of Deposit” column), who the money went to, why you paid out the money and the number of the client trust bank account check you used to make each payment (in the “Payee, # and Purpose” column). You recorded the amount of each deposit in the “Deposits (Add)” column, the amount of each payment in the “Checks (Subtract)” column, and, after adding in each deposit and subtracting each payment, you recorded a new running balance in the “Balance” column.

Bank charges ledger. Rule 1.15(d)(3) and (e) requires you to record every bank charge against your client trust bank account in the account journal and permits you to keep your own money in your common client trust bank account to pay these bank charges. If you keep your own money in the client trust bank account to pay these charges, you should create a separate ledger where this money,

and all the bank charges you pay with it, are recorded. We'll call this the "bank charges ledger." You should keep the bank charges ledger the same way you keep your client ledgers, recording every deposit, every charge the bank makes against the account, and the running balance of money you have left to cover the charges.

The bank charges ledger should look like this:

BANK CHARGES LEDGER
CLIENT: Bank Charges
CASE#: N/A

DATE	SOURCE OF DEPOSIT	PAYEE, # & PURPOSE	CHECKS (SUBTRACT)	DEPOSITS (ADD)	RUNNING BALANCE
6/30/06	CORRECTED MONTH ENDING BALANCE				50.00
7/01/06	Self			100.00	150.00
7/31/06		Check printing	10.00		140.00

What Records Do You Have to Keep of Other Properties?

Rule 1.15(d)(3) and requires you to keep a written journal of all securities and other properties you hold in trust for clients that explains what you were holding, who you were holding it for, when you received it, when you distributed it, and who you distributed it to. You have to maintain this written record, which we'll call the other properties journal, from the day you receive the properties until five years after the day you disburse them. (Naturally, if these properties become the subject of a disciplinary investigation, you have to keep the records until the investigation is completed.) As with the other records we've discussed, it's prudent to retain these records for five years after you closed the matter of the client for whom you held the other properties.

While you can keep a separate other properties journal for each client, the simplest thing to do is maintain a single journal in which you record all other properties. Here's a sample of such a journal:

OTHER PROPERTIES JOURNAL

CLIENT/ CASE#	ITEM	DATE RECEIVED	DATE DISBURSED	DISBURSED TO
KB/920137	Emerald Brooch	7/09/06	8/01/06	KB
DS/920123	AT&T stock	7/16/06		
GC/920125	Red Porsche	8/07/06	8/15/06	GC

Rule 1.15(d)(2) requires you to actually label the properties to identify the owner (i.e., put a tag on them with the owner's name) and put them into a "safe deposit box or other place of safe keeping as soon as practicable." In this case, a safe deposit box is fine for the brooch and the stock certificates, but you'll need to find a secured garage or similar "place of safekeeping" for the Porsche.

As rule 1.15(d)(3) and e) requires, the sample journal lists the client you're holding the properties for, what properties you're holding for the client, when you received the properties, when you disbursed them, and who you disbursed them to. If you're holding many properties for a single client, you may want to keep a separate other properties journal for that client; otherwise, a single journal like the one shown above is sufficient.

SECTION VIII: RECONCILIATION

Rule 1.15(d)(3) and (e) requires you to keep records of your “monthly reconciliation (balancing)” of your client ledgers, account journals and bank statements. “Reconciliation” means checking the three basic records you are required to keep—the bank statements, the client ledgers, and the account journal—against each other so you can find and correct any mistakes.

Rule 1.15(d)(3) and (e) requires you to reconcile your client trust bank account records because mistakes always happen when people keep track of money. Even banks make mistakes when it comes to recording money transactions. That's because when you're working with numbers, mistakes are easy to make and difficult to notice. No amount of training can eliminate these mistakes.

To make sure that you find and correct these mistakes, rule 1.15(d)(3) and (e) requires that you record every client trust bank account transaction twice (in your client ledger and your account journal), check these records against each other and against the bank's records. For example, let's say you deposit a check for $1,000 into your common client trust bank account but mistakenly record it as “$10,000" in your client ledger and add $10,000 to your client's running balance. In your account journal, you record the check correctly and add $1,000 to your client trust bank account's running balance. How will you find the mistake? The account journal balance is right, so you won't find the mistake by bouncing a check. The numbers in the client ledger all add up—there's no way to tell you made a mistake. Unless you compare your client ledger balance to your account journal balance, you won't be able to find the recording error. And unless you compare your client ledger and account journal against the bank statement, you won't know which entry was right—$10,000 or $1,000.

We've just described the reconciliation process. The theory is that it's unlikely that the same mistakes will be made in three different records—the client ledgers, the account journal and the bank statement—so if those records are all checked against each other, any mistakes will show up.

Rule 1.15(d)(3) and (e) requires that your client trust bank account records be reconciled every month and that you create a written record that shows you went through the reconciliation process. It's alright to hire a bookkeeper or the equivalent, but you are still personally responsible for accounting to your clients and to the State Bar for the money in your client trust bank accounts. Therefore, even if you never intend to do the reconciling, you should understand the process. Even if it's your bookkeeper's mistake, if you bounce a client trust bank account check, you're the one your client or the State Bar is going to come to for an explanation.

You can't do a reconciliation for one month until you're sure you have correct balances in all your client ledgers and account journals for the previous month. If you haven't recently reconciled your books, or if you are worried that they're wrong, you may want to bring in a bookkeeper to straighten them out before you take on the monthly reconciliations yourself. Once you have correct balances for the previous month, you are ready to reconcile.

There are four main steps in reconciling your books:

1. Reconciling the account journal with the client ledgers to make sure they agree with one another.

2. Entering bank charges and interest shown on the bank statement into your account journal and client ledgers as appropriate.

3. Reconciling the account journal and client ledgers with the bank statement to make sure that your records agree with the bank's.

4. Entering Corrected Month Ending Balances and Corrected Current Running Balances into your account journal and client ledgers.

As you can see, the third step of the reconciliation process is comparing your monthly bank statement with the account records you've created. A bank statement is a list of all the withdrawals, deposits, charges and interest that the bank has credited to your account during the month. (For IOLTA accounts, the bank statement may also show interest paid to the State Bar, and amounts charged to the State Bar, which should not be entered into your account journal.) It takes some banks several weeks to prepare and mail out statements for the previous month; that means you may be reconciling your books as much as three or four weeks after the month in which the deposits or withdrawals are made. (In the example that follows, you are reconciling your records for July on August 22.) Also, as we've discussed, it can take days or weeks for checks to be presented for payment. These delays mean that you can't just compare the balance in your account journal to the balance shown on the bank statement to see if anything is wrong. You have to "adjust" your account balance by backing out all the transactions that weren't debited or credited by the time the bank statement was prepared. This adjustment process may seem complicated, but if you carefully follow the instructions for filling out the forms below, you shouldn't have any problems.

The goal of the reconciliation process is to figure out the Corrected Month Ending Balance for the month you are reconciling (that is, the amount of money that was actually in the account on the last day of the month) and the Corrected Current Running Balance as of the date you complete the reconciliation (that is, the amount of money that is actually in the account now) by entering interest, bank charges and mistake corrections into your account journal and client ledgers. (You'll put these entries in the space you left after the last entry of the month so that you could add entries during the reconciliation process.) Since you can't be sure you've found every mistake until you've finished reconciling, you can't enter a Corrected Month Ending Balance or a Corrected Current Running Balance into your account journal and client ledgers until you've finished the reconciliation process.

The following is a recommended three-form system that makes reconciliation simple. Remember that each of the three forms—the Client Ledger Balance form, the Adjustments to Month Ending Balance form, and the Reconciliation form—should be filled out *every month* for *every* client trust bank account.

When filling out these forms, it's a good idea to use an adding machine or other calculator that will produce a printed record of the calculation you performed. That way, if your records don't match, you can easily check to see if the reason is a mathematical mistake made while preparing the form.

Reconcile the Account Journal with the Client Ledgers

The first step in reconciliation is to reconcile the account journal with the client ledgers. The purpose of this step is to make sure that the entries in your client ledgers agree with the entries in your account journal. Here's an example:

FORM ONE

CLIENT LEDGER BALANCE
RECONCILIATION DATE: 8/22/06
CLIENT TRUST BANK ACCOUNT NAME: COMMON CLIENT TRUST BANK ACCOUNT
PERIOD COVERED BY BANK STATEMENT: 7/1/106 TO 7/31/06

CLIENT	CLIENT LEDGER BALANCE
KB	1,500.00
DC	200.00
GC	8,500.00
DS	250.00
Bank Charges	125.00

TOTAL CLIENT LEDGER BALANCE:	10,575.00
MONTH ENDING ACCOUNT JOURNAL BALANCE:	10,575.00
TOTAL MISTAKE CORRECTION ENTRIES (+ or -): _____ (From Form Two)	
ADJUSTED MONTH ENDING ACCOUNT JOURNAL BALANCE:	_____

In the space after "Reconciliation Date," write the day, month and year you are doing the reconciliation; in the space after "Client Trust Bank Account Name," write the name of the client trust bank account (e.g., "Common Client Trust Bank Account"); in the space after "Period Covered by Bank Statement," write the dates of the period covered by your most recent bank statement (e.g., 7/1/06 to 7/31/06, if you are doing your July 2006 reconciliation).

On the lines under "Client," write the name of each client whose money you are holding in the client trust bank account. On the lines under "Client Ledger Balance," write the running balance as of the last day covered by the bank statement (in this case, July 31, 2006) from each client ledger next to the name of that client. (For your common client trust bank account, this may require more lines than shown here. For an individual client trust bank account, you will only need the first line.) Add up the client ledger balances in the "Client Ledger Balance" column and write in the total after "Total Client Ledger Balance." Even if only one client's money is in the client trust bank account, you have to write that client's balance on this line. In the space after "Month Ending Account Journal Balance," write in the running balance for the client trust bank account as of the last day covered by the bank statement.

Notice that the "Total Client Ledger Balance" exactly matches the "Month Ending Account Journal Balance." That means that your client ledger balance entries for the month agree with your account journal entries, and you're ready to move on to the next step of the reconciliation process. For the moment, leave the last two lines, "Total Mistake Correction Entries (+ or -)" and "Adjusted Month Ending Balance," blank; you might find mistakes during the rest of the reconciliation process.

When the "Total Client Ledger Balance" *doesn't* exactly match the "Month Ending Account Journal Balance," don't panic; you've found a mistake, and that's what reconciliation is for. You can call in a bookkeeper to help you, or make the correction yourself (see **Finding and correcting mistakes**, below). When you've found and corrected the mistake, move on to step 2.

Finding and correcting mistakes. What do you do if you add up all your client ledger balances and the total doesn't match the month ending account journal balance?

Since rule 1.15(d)(3) and (e) requires you to record every deposit and withdrawal twice, if you systematically compare each entry in the account journal with the corresponding entry in the client ledger, and check the new balance you entered after each entry, you will always find the mistake.

For example, let's say that the sample form shown above had looked like this:

FORM ONE

CLIENT LEDGER BALANCE
RECONCILIATION DATE: 8/22/06
CLIENT TRUST BANK ACCOUNT NAME: COMMON CLIENT TRUST BANK ACCOUNT
PERIOD COVERED BY BANK STATEMENT: 7/1/106 TO 7/31/06

CLIENT	CLIENT LEDGER BALANCE
KB	1,500.00
DC	200.00
GC	8,500.00
DS	250.00
Bank Charges	125.00

TOTAL CLIENT LEDGER BALANCE:	10,575.00
MONTH ENDING ACCOUNT JOURNAL BALANCE:	**10,500.00**
TOTAL MISTAKE CORRECTION ENTRIES (+ or -): _____ (From Form Two)	
ADJUSTED MONTH ENDING ACCOUNT JOURNAL BALANCE:	_____

The Total Client Ledger Balance and Month Ending Account Journal Balance differ by $25.00. This difference could be the result of a single mistake, or of several mistakes; it could be in a client ledger, the account journal, or both. It could be that you forgot to record a deposit or withdrawal, or that you recorded the amounts incorrectly; or it could be the result of incorrectly adding a deposit or subtracting a withdrawal.

You open your account journal to the page that shows the corrected month ending balance for the previous month and the first entries for the month you are reconciling, which looks like this:

ACCOUNT JOURNAL
CLIENT TRUST BANK ACCOUNT NAME: Common Client Trust Bank Account

DATE	CLIENT	SOURCE OF DEPOSIT	PAYEE, # & PURPOSE	CHECKS (SUBTRACT)	DEPOSITS (ADD)	RUNNING BALANCE
6/30/06	CORRECTED MONTH ENDING BALANCE					9,500.00
7/01/06	DS		FB, #408 Prof. Fee	500.00		9,000.00
7/01/06	GC		Self, #409 Atty Fees	1,500.00		7,500.00
7/01/06	DC	DC			2,000.00	9,500.00
7/02/06	DS	DS			1,000.00	10,500.00

Since you reconciled this account last month, you know that the corrected month ending balance shown for June 30, 2006, is right, and agrees with the total client ledger balance for that date; whatever is causing the $25.00 difference between the account journal balance and the total client ledger balance must have happened since then. Therefore, you look at the first entry for July 1, 2006, check #408 which you wrote for DS to FB for $500, which gave you a new running balance of $9,000.00. You make sure that you correctly subtracted $500 from the 6/30/06 corrected month ending balance to get this new running balance, then open DS's client ledger to the page where you recorded check #408:

CLIENT LEDGER
CLIENT:DS
CASE#: 920123

DATE	SOURCE OF DEPOSIT	PAYEE, # & PURPOSE	CHECKS (SUBTRACT)	DEPOSITS (ADD)	RUNNING BALANCE
6/30/06	CORRECTED MONTH ENDING BALANCE				600.00
7/01/06		FB. #408 Prof. Fee	**500.00**		100.00
7/02/06	DS			1,800.00	1,900.00

You compare the entry in the client ledger with the entry in the account journal; they are both for the same check and the same amount. You subtract the amount of the check—$500—from the client ledger's 6/30/06 corrected month ending balance of $600.00, and see that the new running balance of $100.00 you entered was right. You have now determined that the $25.00 difference you are trying to correct wasn't caused by recording the check to FB, and that the balances in the account journal and in this client ledger after you wrote this check are right.

You put a light pencil mark (shown as an asterisk) next to these balances and repeat this process with each entry in the account journal. Everything is right until you get to the deposit of $3,550.00 on July 9, 2006 for GC:

ACCOUNT JOURNAL
CLIENT TRUST BANK ACCOUNT NAME: Common Client Trust Bank Account

DATE	CLIENT	SOURCE OF DEPOSIT	PAYEE, # & PURPOSE	CHECKS (SUBTRACT)	DEPOSITS (ADD)	RUNNING BALANCE
7/09/06	DS		FB, #423 Prof. Fee	1,800.00		13,000.00*
7/09/06	KB	KB			1,500.00	14,500.00*
7/09/06	GC	**Insurance Co.**			**3,500.00**	**18,000.00**
7/09/06	DC		DC, #424 Settlement Proceeds	6,500.00		11,500.00

Notice the asterisks you put next to each balance that you have already verified. You add the $3,500.00 to the last verified balance, and see that the new running balance of $18,000.00 you entered was right. You open GC's client ledger to the page where you recorded this deposit:

CLIENT LEDGER
CLIENT:GC
CASE#: 920125

DATE	SOURCE OF DEPOSIT	PAYEE, # & PURPOSE	CHECKS (SUBTRACT)	DEPOSITS (ADD)	RUNNING BALANCE
6/30/06	CORRECTED MONTH ENDING BALANCE				13,000.00
7/01/06		Self, #409 Atty Fees	1,500.00		11,500.00*
7/09/06	**Insurance Co.**			**3,525.00**	**15,025.00**

You compare the entry in the client ledger with the entry in the account journal; the deposit was recorded, but the amount of the deposit is $3,**525**.00, not $3,**500**.00. You subtract one amount from another and find that the difference is exactly $25.00. You add $3,525.00 to the previous client ledger balance and verify that the new running balance is right. That means the mistake was made by entering the amount of the deposit incorrectly; but which entry is wrong, the account journal entry or the client ledger entry?

To find out, you can compare the account journal and client ledger entries to the deposit slip, which you filed in the appropriate binder, or to your most recent bank statement. The bank statement shows one deposit on 7/9/06 of $5,025.00, which doesn't match either number. But your account journal shows that you made two deposits on July 9:

ACCOUNT JOURNAL
CLIENT TRUST BANK ACCOUNT NAME: Common Client Trust Bank Account

DATE	CLIENT	SOURCE OF DEPOSIT	PAYEE, # & PURPOSE	CHECKS (SUBTRACT)	DEPOSITS (ADD)	RUNNING BALANCE
7/09/06	DS		FB, #423 Prof. Fee	1,800.00		13,000.00*
7/09/06	KB	**KB**			**1,500.00**	**14,500.00***
7/09/06	GC	**Insurance Co.**			**3,500.00**	**18,000.00**
7/09/06	DC		DC, #424 Settlement Proceeds	6,500.00		11,500.00

Since the bank statement shows only one deposit for July 9, 2006, that means you deposited both checks on the same deposit slip. You add these two deposits together, and get $5,**000**.00, not $5,**025**.00, as the bank statement shows. You subtract the smaller amount from the larger amount, and get $25.00, the exact difference you're looking for. That means that the entry in the account journal—$3,**500**.00—is wrong, and the entry in the client ledger, $3,**525**.00 is right. (If you'd kept a copy of the deposit slip you filled out on July 9, which listed the two deposits separately, you could have found the mistake without doing the math.)

Now that you've found the mistake, you need to correct it so that your account journal reflects the right amount of the July 9, 2006 deposit. Since you keep your records in ink, not in pencil, you can't just erase and write in the correct deposit amount and balance. You don't want to scratch out the incorrect amount and write in the new one. This is messy, and it means you'll have to scratch out all the running balances from the July 9 deposit on; they were all based on the mistaken entry, and they are all wrong. The easiest—and clearest—way to correct the mistake is to mark the wrong entry (you can use any prominent notation that doesn't make it hard to read the entry), make a mistake correction entry using the lines you left blank for entering the Corrected Month Ending Balance, and make the same mistake correction entry after your most recent entry to correct your current running balance. (Since the mistake was in the account journal, not the client ledger, you don't have to make any mistake corrections entries there.) This means that you have to record the correction twice; at the end of the month in which you made the mistake, so that it's included in the Corrected Month Ending Balance, and after your last entry, so that it's included in the Corrected Current Running Balance. In this example, the mistake correction entry for the Corrected Month Ending Balance would look like this:

ACCOUNT JOURNAL
CLIENT TRUST BANK ACCOUNT NAME: Common Client Trust Bank Account

DATE	CLIENT	SOURCE OF DEPOSIT	PAYEE, # & PURPOSE	CHECKS (SUBTRACT)	DEPOSITS (ADD)	RUNNING BALANCE
7/31/06	DS		FB, #447 Prof. Fee	250.00		8,000.00
7/31/06	DC	JA			2,500.00	10,500.00
7/09/06	**ERROR**	**- backing out wrong deposit**		**3,500.00**		
		- adding in correct deposit			**3,525.00**	
7/31/06	CORRECTED MONTH ENDING BALANCE					
8/01/06	KB		Self, #448 Atty. Fees	1,500.00		9,000.00

To show that you've backed out the wrong amount and inserted the correct amount, the mistake correction entry shows that you have subtracted the wrong amount from the account balance, and added the right amount to the account balance. (If you make a mistake in recording a withdrawal, you do the same thing.) You could have corrected the mistake with a mistake correction entry that just added the missing $25.00; however, that entry wouldn't tell you what the mistake was, or help you track it down if any questions come up in the future. Notice that you haven't filled in the Corrected Month Ending Balance yet; you won't do that until you complete all the steps in the reconciliation process. Now let's look at the mistake correction entry that corrects the account's current running balance:

ACCOUNT JOURNAL
CLIENT TRUST BANK ACCOUNT NAME: Common Client Trust Bank Account

DATE	CLIENT	SOURCE OF DEPOSIT	PAYEE, # & PURPOSE	CHECKS (SUBTRACT)	DEPOSITS (ADD)	RUNNING BALANCE
8/21/06	Bank Chg.	Self			100.00	11,500.00
8/22/06	DS		FB, #447 Prof. Fee	1,000.00		10,500.00
8/22/06	DC	DC			6,500.00	17,000.00
7/09/06	**ERROR**	**- backing out wrong deposit - adding in correct deposit**		**3,500.00**	**3,525.00**	

This entry ensures that when you enter the Corrected Current Running Balance at the end of the reconciliation process, it will reflect the correct deposit, instead of the mistake.

Now that you've corrected the mistake and the account journal entries agree with the client ledger entries, go back to Form One and fill out the last two lines with the total of the mistake correction entries you made and the Adjusted Month Ending Account Balance:

FORM ONE

CLIENT LEDGER BALANCE
RECONCILIATION DATE: 8/22/06
CLIENT TRUST BANK ACCOUNT NAME: COMMON CLIENT TRUST BANK ACCOUNT
PERIOD COVERED BY BANK STATEMENT: 7/1/106 TO 7/31/06

CLIENT	CLIENT LEDGER BALANCE
KB	1,500.00
DC	200.00
GC	8,500.00
DS	250.00
Bank Charges	125.00

TOTAL CLIENT LEDGER BALANCE:	10,575.00
MONTH ENDING ACCOUNT JOURNAL BALANCE:	10,500.00
TOTAL MISTAKE CORRECTION ENTRIES (+ or -) : 25.00 (From Form Two)	
ADJUSTED MONTH ENDING ACCOUNT JOURNAL BALANCE	**10,575.00**

When we get to step 3, we'll record these mistake correction entries, and any others we have to make, on Form Two, "Adjustments to Month Ending Balance."

What if the mistake had been in the entry in GC's client ledger instead of in the account journal entry? In that case, you would put mistake correction entries in the client ledger the same way you would in the account journal, once in the space above the Corrected Month Ending Balance and once after the most recent entry. However, on Form One, instead of recording the mistake on the "Total Mistake Correction Entries (+ or -)" line, you would simply cross out the incorrect client ledger balance for GC and write the correct balance beside it. Since GC's balance was wrong, the Total Client Ledger Balance you recorded is wrong. Cross it out and write in the correct total; it should exactly match the Month Ending Account Journal Balance. Put a zero on the "Total Mistake Correction Entries (+ or -)" line; this line is only for recording mistakes in the account journal, not for mistakes in client ledgers. Fill in the "Adjusted Month Ending Account Journal Balance" line.

When you're done, Form One should look like this:

FORM ONE		
CLIENT LEDGER BALANCE		
RECONCILIATION DATE:	8/22/06	
CLIENT TRUST BANK ACCOUNT NAME:	COMMON CLIENT TRUST BANK ACCOUNT	
PERIOD COVERED BY BANK STATEMENT:	7/1/106 TO 7/31/06	
CLIENT	CLIENT LEDGER BALANCE	
KB	1,500.00	
DC	200.00	
GC	~~8,525.00~~	8,500.00
DS	250.00	
Bank Charges	125.00	
		10,550.00
TOTAL CLIENT LEDGER BALANCE:		**~~10,575.00~~**
MONTH ENDING ACCOUNT JOURNAL BALANCE:		10,550.00
TOTAL MISTAKE CORRECTION ENTRIES (+ or -) : 0.00 (From Form Two)		
ADJUSTED MONTH ENDING ACCOUNT JOURNAL BALANCE		**10,550.00**

Enter Bank Charges and Interest

The purpose of this step is to make sure that bank charges and interest credits reflected on the bank statement are also reflected in your records. Since you don't know what these bank charges or interest credits are until you receive the bank statement, you need to enter them into your records after you receive the bank statement.

All bank charges must be recorded in the account journal. If a bank charge was incurred on behalf of a specific client (as, for example, a charge for wiring money to a client), the charge must **also** be entered in that client's client ledger. (This ensures that the account journal balance will continue to match the total of the individual client ledger balances.) If the charge was not for a specific client (for example, a charge for printing common client trust bank account checks), the charge must **also** be entered in the bank charges ledger.

Since all interest earned on money held in an individual interest-bearing client trust bank account belongs to the client, interest must always be entered in the account journal *and* the client ledgers. (Since the interest on IOLTA accounts is transmitted by the bank to the State Bar, it shouldn't be entered into your records.)

Like mistake correction entries, bank charge and interest entries must be recorded twice; at the end of the month in which the transaction occurred, so that they are included in the Corrected Month Ending Balance, and after your last entry, so that they are included in the Corrected Current Running Balance.

This example will deal with an IOLTA account which pays interest to the State Bar. (Remember, interest which is paid to the State Bar should not be entered in your account journal.) In the account journal for our sample common client trust bank account, the bank charges (other than the regular service charges to the State Bar) for July are entered twice, once in the space above the Corrected Month Ending Balance:

ACCOUNT JOURNAL
CLIENT TRUST BANK ACCOUNT NAME: Common Client Trust Bank Account

DATE	CLIENT	SOURCE OF DEPOSIT	PAYEE, # & PURPOSE	CHECKS (SUBTRACT)	DEPOSITS (ADD)	RUNNING BALANCE
7/31/06	DS		FB, #447 Prof. Fee	250.00		8,000.00
7/31/06	DC	JA			2,500.00	10,500.00
7/09/06	ERROR	- backing out wrong deposit		3,500.00		
		- adding in correct deposit			3,525.00	
7/31/06	**BANK CHARGE**	**- new checks**		**10.00**		
		- wire for DS		**15.00**		
7/31/06	CORRECTED MONTH ENDING BALANCE					
8/01/06	KB		Self, #448 Atty. Fees	1,500.00		9,000.00

And once after the most recent entry:

ACCOUNT JOURNAL
CLIENT TRUST BANK ACCOUNT NAME: Common Client Trust Bank Account

DATE	CLIENT	SOURCE OF DEPOSIT	PAYEE, # & PURPOSE	CHECKS (SUBTRACT)	DEPOSITS (ADD)	RUNNING BALANCE
8/21/06	Bank Chg.	Self			100.00	11,500.00
8/22/06	DS		FB, #457 Prof. Fee	1,000.00		10,500.00
8/22/06	DC	DC			6,500.00	17,000.00
7/09/06	ERROR	- backing out wrong deposit		3,500.00		13,500.00
		- adding in correct deposit			3,525.00	17,025.00
7/31/06	**BANK CHARGE**	**- new checks**		**10.00**		
		- wire for DS		**15.00**		

As you can see, there were two bank charges during July; one for printing new checks, which is not specific to an individual client and must be recorded in the bank charges ledger; and one for sending money by wire for DS, which is specific to an individual client and must be recorded in DS's client ledger. (Notice that we still haven't filled in the "Corrected Month Ending Balance" for July; as we've discussed, we won't do that until we've finished the reconciliation process.)

The bank charge entry in DS's client ledger should look like this:

CLIENT LEDGER
CLIENT: DS
CASE#: 920123

DATE	SOURCE OF DEPOSIT	PAYEE, # & PURPOSE	CHECKS (SUBTRACT)	DEPOSITS (ADD)	RUNNING BALANCE
7/31/06		FB, #447 Prof. Fee	250.00		1,000.00
7/31/06	**BANK CHARGE – wiring $ to FB**		**15.00**		
7/31/06	CORRECTED MONTH ENDING BALANCE				
8/03/06	DS			250.00	1,250.00
8/07/06		FS, #451 Investigation	500.00		775.00
8/15/06	DS			250.00	1,000.00
8/22/06		FB, #456 Prof. Fee	750.00		250.00
7/31/06	**BANK CHARGE – wiring $ to FB**		**15.00**		

The entry in the bank charges ledger should look like this:

BANK CHARGES LEDGER
CLIENT: Bank Charges
CASE#: N/A

DATE	SOURCE OF DEPOSIT	PAYEE, # & PURPOSE	CHECKS (SUBTRACT)	DEPOSITS (ADD)	RUNNING BALANCE
6/30/06	CORRECTED MONTH ENDING BALANCE				50.00
7/01/06	Self			100.00	150.00
7/31/06		Check Printing	**10.00**		**140.00**
7/31/06	**CORRECTED MONTH ENDING BALANCE**				

Reconcile the Account Journal with the Bank Statement

The purpose of this step is to make sure that the bank's records of the deposits and withdrawals you've made to your client trust bank account during the past month match your records. Since you've already reconciled the client ledgers with the account journal, you know that the entries in the client ledger agree with the ones in the account journal. Therefore, unless you find a mistake, during this stage of the reconciliation process you only have to compare the bank statement with the account journal.

Adjustments to Month Ending Balance. First, record any mistake correction entries that you made in the account journal and all uncredited deposits and undebited withdrawals on the "Adjustments to Month Ending Balance" form, as shown on the following page:

FORM TWO

ADJUSTMENTS TO MONTH ENDING BALANCE
RECONCILIATION DATE: 8/22/06
CLIENT TRUST BANK ACCOUNT NAME: COMMON CLIENT TRUST BANK ACCOUNT
PERIOD COVERED BY BANK STATEMENT: 7/1/106 TO 7/31/06

A. DEPOSITS AND WITHDRAWALS NOT POSTED ON BANK STATEMENTS

UNCREDITED DEPOSITS		UNDEBITED WITHDRAWALS	
Date	Amount	Date	Amount
7/31/06	2,500.00	7/09/06	1,800.00
_____	_____	7/31/06	250.00
_____	_____	6/30/06	30.00
TOTAL:	2,500.00		2,080.00

B. MISTAKE CORRECTION ENTRIES (from Account Journal)

DATE	AMOUNT Additions	AMOUNT Subtraction	NET MISTAKE (+ OR -)
7/09/06	3,525.00	3,500.00	25.00
_____	_____	_____	_____
TOTAL MISTAKE CORRECTION ENTRIES:			25.00

In the space after "Reconciliation Date," write the day, month and year you do the reconciliation; in the space after "Client Trust Bank Account Name," write the name of the client trust bank account (e.g., "Common Client Trust Bank Account"); in the space after "Period Covered by Bank Statement," write the dates of the period covered by your most recent bank statement (e.g., 7/1/06 to 7/31/06, if you are doing your July 2006 reconciliation).

Deposits and withdrawals not posted on bank statement. Generally, the bank sends out statements one to three weeks after the end of the month. As a result, by the time you reconcile the account, you will usually have made deposits or withdrawals that aren't shown on the bank statement. In addition, checks you wrote or deposits you made may not have cleared by the time the bank produced the statement, and therefore the amounts of those checks or deposits won't be reflected in the account balance shown on the bank statement. Thus, in order to compare the balance the bank statement says is in the account at the end of the month with the balance your account journal shows for the end of the month, you have to adjust the account journal balance by *subtracting* all uncredited deposits and *adding* all undebited withdrawals.

These unposted transactions should be listed under "Deposits and Withdrawals Not Posted by the Bank." To find out which transactions haven't been posted, you have to compare the entries on the bank statement with the entries in your account journal.

Go through each entry on the bank statement and compare it to the corresponding entry in your account journal. If the entry in the account journal exactly matches the entry on the bank statement, mark off the entry in the account journal to show that the money has cleared the banking process, and mark off the entry on the bank statement to show that you have verified it against the account journal. The marks in the account journal will help you keep track of items like checks that are never cashed, which otherwise can become those small, inactive balances that make your account harder to reconcile. (See **Key Concept 6: The Final Score is Always Zero**.) The marks should be permanent (i.e., in ink) and clearly visible, but shouldn't make it harder to read the entries. You should use the same mark consistently, to avoid confusion later.

When you are finished, all the entries on the bank statement should be checked off to show that you have verified them against the corresponding entries in the account journal. Now go back through the account journal to find any entries that are unmarked; these transactions haven't yet been debited or credited by the bank, and should therefore be listed in the appropriate column on the Adjustments to Month Ending Balance form. All entries in your account journal must either be marked to indicate that they have appeared on a bank statement, or recorded on this form.

Write the date and amount of the entry in the appropriate column on the Adjustments to Month Ending Balance form. Write uncredited deposits in the "Uncredited Deposits" column and undebited withdrawals in the "Undebited Withdrawals" column. (For busy client trust bank accounts, you may need more lines than the sample form gives to list all the unposted transactions. If you do, you can add lines to the copies of the forms you use, or attach additional pages that list the transactions that didn't fit on the form.)

When you've listed all the unposted transactions, add up the amounts in the "Uncredited Deposits" column and write the total in the space at the bottom of that column. Then add up the amounts in the "Undebited Withdrawals" column and write the total in the space at the bottom of that column.

As you go through the bank statement, there are two kinds of mistakes you may find:

1. **You find a deposit or withdrawal listed on the bank statement that isn't in your account journal**. To correct this mistake, go through your cancelled checks (if it's a withdrawal) or deposit slips (if it's a deposit) until you find the one that reflects the transaction on the bank statement. If you can't find a cancelled check or deposit slip that matches the entry on the bank statement, contact your banker and ask him or her to help you track down the transaction. DON'T record the bank statement entry in your records until you verify that the transaction occurred; banks make mistakes too.

   When you find the cancelled check or deposit slip that shows the transaction, record the transaction in both your account journal and in the client ledger of the client for whom the

money was deposited or paid out. Remember that you have to enter the transaction twice in the account journal and twice in the client ledger; once above the "CORRECTED MONTH ENDING BALANCE" line, and once after the latest entry. The entries should be the same as when recording any other transaction, but include a notation indicating that you'd forgotten to enter the transaction at the time it occurred.

After you correct the mistake in your client ledger and account journal, record it on Form Two under "Mistake Correction Entries," as described below.

2. **An entry in the bank statement is different from the corresponding entry in the account journal.** You correct this mistake the same way you correct a transaction you forgot to record. First, find the cancelled check or deposit slip that shows the transaction to figure out which record is correct, the account journal or the bank statement. If you can't find a cancelled check or deposit slip for this transaction, contact your banker and ask him or her to help you track it down before you make any changes in your records.

   If the cancelled check or deposit slip shows that the bank statement is wrong, write a note on the bank statement that clearly describes the mistake, then contact your banker and tell him or her to correct their records. If it shows that your account journal is wrong, record the correction in the account journal and the appropriate client ledgers using the same kind of mistake correction entries we used in our example. Like all mistake correction entries, these must be entered twice in both the account journal and the client ledger for the client on whose behalf you deposited or paid out the money; once above the "Corrected Month Ending Balance" line, and once after the latest entry.

   After you correct the mistake in your client ledger and account journal, record it on Form Two under "Mistake Correction Entries," as described below.

Mistake correction entries. Under "MISTAKE CORRECTION ENTRIES," list all mistake correction entries you entered in the space above the Corrected Month Ending Balance in your account journal. In the "Date" column, write the date of each mistake. In the "Amount" column, write the amount of each mistake correction entry. As you remember, each mistake correction entry requires two notations; one to back out the incorrect amount, and one to add in the correct amount. If the mistake correction entry amount was entered under the "Deposits (Add)" column in your account journal, write the amount under the "Additions" column. If the mistake correction entry amount was entered under the "Withdrawals (Subtract)" column in your account journal, write the amount under the "Subtractions" column. Then write in the net amount of the mistake under the "Net Mistake (+ or -)" column. (If the amount in the "Subtractions" column is larger than the amount in the "Additions" column, the net mistake will be negative and should be recorded with parentheses around it. If the amount in the "Additions" column is larger than the amount in the "Subtractions" column, the net mistake will be positive and should be recorded without parentheses around it.) When you have recorded all the mistake correction entries, total the amounts in the "Net Mistake (+ or -)" column and enter it in the space after "Total Mistake Correction Entries." If this amount is negative, put parentheses around it. If it's positive, don't.

If you found mistakes while you were going through the bank statement (in other words, after you finished filling out Form One), you have to go back to Form One, enter the new "Total Mistake Correction Entries" and a new "Adjusted Month Ending Account Balance" before you go on to the next step.

Reconciliation form. The next step is to reconcile the balance the bank statement shows for the end of the month you are reconciling with the balance your account journal shows for the date by filling out the "Reconciliation" form:

FORM THREE		
RECONCILIATION RECONCILIATION DATE: 8/22/06 CLIENT TRUST BANK ACCOUNT NAME: COMMON CLIENT TRUST BANK ACCOUNT PERIOD COVERED BY BANK STATEMENT: 7/1/106 TO 7/31/06		
ADJUSTED MONTH ENDING BALANCE: (From Form One)		10,575.00
MINUS TOTAL BANK CHARGES (From Bank Statement)	(25.00)	
PLUS TOTAL INTEREST EARNED (From Bank Statement)	IOLTA	
CORRECTED MONTH ENDING BALANCE: (Total)		10,550.00
MINUS UNCREDITED DEPOSITS: (From Form Two)	(2,500.00)	
PLUS UNDEBITED WITHDRAWALS: (From Form Two)	2,080.00	
RECONCILED TOTAL:		10,130.00
BANK STATEMENT BALANCE:		10,130.00

1. In the space after "Reconciliation Date," write the day, month and year you did the reconciliation; in the space after "Client Trust Bank Account Name," write the name of the client trust bank account (e.g., "Common Client Trust Bank Account"); in the space after "Period Covered by Bank Statement," write the dates of the period covered by your most recent bank statement (e.g., 7/1/06 to 7/31/06, if you are doing your July 2006 reconciliation).

2. In the space after "Adjusted Month Ending Balance," write the balance shown in the "Adjusted Month Ending Account Journal Balance" space on the Client Ledger Balance form.

3. In the space after "Minus Total Bank Charges," write in the total of all bank charges to the account shown on the bank statement. For IOLTA accounts, don't include amounts charged to the State Bar. (Note the parentheses around this number show it is negative and should be subtracted.)

4. If this is an individual interest-bearing individual client trust bank account, in the space after "Plus Total Interest Earned," write in the total interest shown on the bank statement. Write "IOLTA" in this space if this is an IOLTA account, and "non-interest bearing" if it is a non-interest bearing client trust bank account.

5. To the amount in the "Month Ending Balance" space:

   Subtract the amount you wrote in the "Total Bank Charges" space;

   Add the amount in the "Total Interest Earned" space; and

   Write the result in the "Corrected Month Ending Balance" space.

6. In the "Minus Uncredited Deposits" space, write the total of the "Uncredited Deposits" column you listed on Form Two.

7. In the "Plus Uncredited Withdrawals" space, write the total of the "Uncredited Withdrawals" column you listed on Form Two.

8. To the amount in the "Corrected Month Ending Balance" space:

   Add the undebited withdrawals;

   Subtract the uncredited deposits; and

   Write the total in the "Reconciled Total" space.

9. Write the balance shown on the bank statement in the space after "Bank Statement Balance." This amount should exactly match the reconciled total above it. If it does, you have successfully reconciled the account and are ready to proceed to the last step. (If it doesn't, call in a bookkeeper or refer to Appendix 5, **What to Do When the Reconciled Total and the Bank Statement Balance Don't Exactly Match**, and use the process it describes to find and correct the mistake.)

Entering the Corrected Month Ending Balance and Corrected Current Running Balance

When you have completed all three forms and the Corrected Month Ending Balance is exactly the same as the Bank Statement Balance, the account is reconciled. Now you are ready to enter the Corrected Month Ending Balance for July and the Corrected Current Running Balance in the account journal and in each client ledger.

Here's how the Corrected Month Ending Balance entry would look in the account journal:

ACCOUNT JOURNAL
CLIENT TRUST BANK ACCOUNT NAME: Common Client Trust Bank Account

DATE	CLIENT	SOURCE OF DEPOSIT	PAYEE, # & PURPOSE	CHECKS (SUBTRACT)	DEPOSITS (ADD)	RUNNING BALANCE
7/31/06	DS		FB, #447 Prof. Fee	250.00		8,000.00
7/31/06	DC	JA			2,500.00	10,500.00
7/09/06	ERROR	- backing out wrong deposit		3,500.00		7,000.00
		- adding in correct deposit			3,525.00	10,525.00
7/31/06	BANK CHARGE	- new checks		10.00		10,515.00
		- wire for DS		15.00		10,500.00
7/31/06	**CORRECTED MONTH ENDING BALANCE**					**10,500.00**
8/01/06	DC		Self, #448 Legal Fee	1,500.00		9,000.00

As you can see, you got the Corrected Month Ending Balance by subtracting the amount of the wrong deposit from the old July 31 balance of $10,500.00, adding the amount of the correct deposit and subtracting the amounts of the bank charges. Notice that the Corrected Month Ending Balance is identical to the balance after the interest entry.

This is how the Corrected Current Running Balance entry looks in the account journal:

ACCOUNT JOURNAL
CLIENT TRUST BANK ACCOUNT NAME: Common Client Trust Bank Account

DATE	CLIENT	SOURCE OF DEPOSIT	PAYEE, # & PURPOSE	CHECKS (SUBTRACT)	DEPOSITS (ADD)	RUNNING BALANCE
8/21/06	Bank Chg.	Self			100.00	11,500.00
8/22/06	DS		FB, #457 Prof. Fee	1,000.00		10,500.00
8/22/06	DC	DC			6,500.00	17,000.00
7/09/06	ERROR	- backing out wrong deposit		3,500.00		13,500.00
		- adding in correct deposit			3,525.00	17,025.00
7/31/06	BANK CHARGE	- new checks		10.00		17,015.00
		- wire for DS		15.00		17,000.00
8/22/06	**CORRECTED CURRENT RUNNING BALANCE**					**17,000.00**

As you can see, you got the Corrected Current Running Balance by subtracting the amount of the wrong deposit from the old August 22 balance of $17,000.00, adding the amount of the correct deposit and subtracting the amounts of the bank charges.

Now you have to go into each client ledger and enter the Corrected Month Ending Balance for July and Corrected Current Running Balance for each client. Let's look at DS's ledger to see what these entries should look like:

CLIENT LEDGER
CLIENT:DS
CASE#: 920123

DATE	SOURCE OF DEPOSIT	PAYEE, # & PURPOSE	CHECKS (SUBTRACT)	DEPOSITS (ADD)	RUNNING BALANCE
7/31/06		FB, #447 Prof. Fee	250.00		1,000.00
7/31/06	BANK CHARGE – wiring $ to FB		15.00		985.00
7/31/06	CORRECTED MONTH ENDING BALANCE				**985.00**
8/03/06	DS			250.00	1,235.00
8/07/06		FS, #451 Investigation	500.00		735.00
8/15/06	DS			250.00	985.00
8/22/06		FB, #456 Prof. Fee	750.00		235.00
7/31/06	BANK CHARGE – wiring $ to FB		15.00		220.00
8/22/06	**CORRECTED CURRENT RUNNING BALANCE**				**220.00**

As you can see, you got the Corrected Month Ending Balance by subtracting the amount of the bank charge from the old July 31 balance of $1,000.00. You got the Corrected Current Running Balance by subtracting the amount of the bank charge from the old August 22 balance of $235.00.

When you write in the Corrected Month Ending Balance for July and the Corrected Current Running Balance for KB, DC and GC, you will have reconciled this trust account and fully complied with rule 1.15(d)(3) and (e) . These steps are particularly important since you may have written a client trust account check based on an erroneous balance shown on one or more of your written records. If, at some point in the future the State Bar asks you about the issuance of that check, you can respond by showing that it was an isolated mistake in posting an entry; and that you found and corrected the entry when you reconciled the account.

Now clip all the pages that relate to the reconciliation process together (all three forms, any attached pages, and any adding machine tapes) and file them away.

Afterword

If you've read all the way through this handbook, you should now know everything you need in order to properly receive, pay out and account for money you hold for your clients. However, your professional responsibility isn't to know client trust accounting, it's to do client trust accounting. There are three final points without which your best efforts to properly account for your clients' money will be in vain:

1. Set up a complete client trust accounting system;
2. Consistently and rigorously follow your client trust accounting system; and
3. Don't rely on others to do your client trust accounting. It's your responsibility.

APPENDIX 1: OTHER REGULATIONS RELATING TO CLIENTS AND MONEY

There are a few basic rules relating to clients and money that, while not directly related to client trust accounting, are so fundamental to the attorney-client relationship that we have to mention them here. (The text of these rules can be found in Appendix 2.)

Amount of Fees. The amount you can charge for your services is regulated by Rule of Professional Conduct 1.5, which in part provides that: "A lawyer shall not make an agreement for, charge, or collect an unconscionable or illegal fee." The rule lays out thirteen of the many factors that might go into determining whether or not a fee is unconscionable, including the amount of the fee in proportion to the value of the services, the relative sophistication of attorney and client, the novelty and difficulty of the case and skill necessary to handle it, whether the fee is fixed or contingent, and the time and work involved. This rule also prohibits the charging of a "non-refundable" fee unless it is a "true retainer" fee arrangement. Rule 1.5(d) provides that:

> (d) A lawyer may make an agreement for, charge, or collect a fee that is denominated as "earned on receipt" or "non-refundable," or in similar terms, only if the fee is a true retainer and the client agrees in writing* after disclosure that the client will not be entitled to a refund of all or part of the fee charged. A true retainer is a fee that a client pays to a lawyer to ensure the lawyer's availability to the client during a specified period or on a specified matter, but not to any extent as compensation for legal services performed or to be performed.

Fee Agreements. There are three provisions of the Business and Professions Code relating to fee agreements. Section 6148 requires that whenever you can reasonably foresee that the total expense to the client, including attorney's fees, will exceed $1,000, you must enter into a written fee agreement with your client. The written fee agreement must contain the hourly rate and any standard rates, fees and charges applicable to the case, the general nature of the services to be provided to the client, and the responsibilities you and the client have with respect to performance of the contract. Consider utilizing the fee agreement to advise your client of your duties to third parties in the presence of an executed medical lien.

All bills for services rendered must include the basis for the bill, including the amount, rate, and the basis for calculation or other method of determining your fee. You are obligated to give a bill to your client no later than 10 days after your client requests one. Your client is entitled to request a bill every 30 days.

If you fail to enter into a written agreement with your client, the fee agreement is voidable at the client's option, after which you are entitled to collect a reasonable fee. The provisions of section 6148 don't apply if you render legal services in an emergency, if the services are of the same general kind you've already provided to and been paid for by the client, if the client knowingly states in writing after full disclosure that a written fee agreement isn't required, or if the client is a corporation.

Business and Professions Code section 6149 makes the required written fee agreement a confidential communication within the meaning of Business and Professions Code section 6068, subdivision (e) and Evidence Code section 952.

When you and your client enter into a fee agreement on a contingency fee basis, you must comply with the provisions of Business and Professions Code section 6147. You and your client must sign the fee agreement and you must give the client a duplicate copy. The contract must be in writing and must include the contingency rate, how disbursement and costs will be handled, whether your client will be required to pay any compensation arising out of matters not covered by the agreement, notice that the fee is not set by law but is negotiable, and a statement that the rates set forth pursuant to section 6146, which applies in medical malpractice actions, sets the maximum contingency fee limits. If you fail to comply with the provisions of this section, the agreement is voidable at your client's option, after which you are entitled to collect a reasonable fee.

Business and Professions Code section 6146 sets the limits on the fee you can charge a client on a contingency basis where your client is seeking damages in connection with an action for an injury or damage against a health care provider based on the health care provider's alleged professional negligence. For example, section 6146 provides that you can only charge up to 40% of the first $50,000 recovered, 33.3% of the next $50,000, and so forth. The limits in section 6146 apply regardless of whether the recovery is by settlement, arbitration or judgment, and whether the person for whom the recovery is made is a responsible adult, an infant, or a person of unsound mind.

Fee Disputes. Fee disputes with your client are regulated by Business and Professions Code section 6200 *et seq.*, which sets forth the fee arbitration program. This section requires you to participate in fee arbitration if your client requests it. When you file a fee collection action against your client, you must forward a written notice to the client before or at the time of service of the summons. Failure to give this written notice is a grounds for dismissal of your fee collection action. If the client fails to request fee arbitration within 30 days of receipt of this notice, the client is deemed to have waived the right to arbitration. Most fee arbitrations are conducted by the county bar association in the county where the fee dispute took place. However, if the county bar association isn't equipped to carry out the fee arbitration, the State Bar will conduct it. If an attorney fails to pay a binding award to the client of fees or costs, the attorney can be placed on inactive status and would not be eligible to practice law until the award is paid.

Loans To and From Clients and Securing Payments from Clients. You are permitted to borrow money from or lend money to your client, or obtain a security interest to ensure payment of fees, provided that you fully comply with Rule of Professional Conduct 1.8.1. This rule requires that:

1. The transaction and terms of the acquisition are fair and reasonable to the client and are transmitted to the client in a manner and under terms which should have been reasonably understood by the client;

2. The client is given a reasonable opportunity to seek the advice of independent counsel on the transaction; and

3. The client consents in writing to the transaction.

Cash Reporting Requirement. The Internal Revenue Code (26 U.S.C. § 6050I) requires that when you receive more than $10,000 in cash, you report that fact to the IRS on form 8300 within 15 days of the date of the transaction. This section appears to apply to both cash you receive for fees, and cash you hold in trust.

APPENDIX 2: TEXT OF RULES AND LINKS TO STATUTES CITED

Relevant California Rules of Professional Conduct

Current California Rule *(operative on November 1, 2018)*	**Former California Rule** *(operative until November 1, 2018)*
Rule 1.5 Fees for Legal Services	**Rule 4-200** Fees for Legal Services
Rule 1.8.1 Business Transactions with a Client and Pecuniary Interests Adverse to a Client	**Rule 3-300** Avoiding Interests Adverse to a Client
Rule 1.15 Safekeeping Funds and Property of Clients and Other Persons*	**Rule 4-100** Preserving Identity of Funds and Property of a Client

Rule 1.5 Fees for Legal Services

(Added by order of Supreme Court, operative November 1, 2018)

(a) A lawyer shall not make an agreement for, charge, or collect an unconscionable or illegal fee.

(b) Unconscionability of a fee shall be determined on the basis of all the facts and circumstances existing at the time the agreement is entered into except where the parties contemplate that the fee will be affected by later events. The factors to be considered in determining the unconscionability of a fee include without limitation the following:

(1) whether the lawyer engaged in fraud* or overreaching in negotiating or setting the fee;

(2) whether the lawyer has failed to disclose material facts;

(3) the amount of the fee in proportion to the value of the services performed;

(4) the relative sophistication of the lawyer and the client;

(5) the novelty and difficulty of the questions involved, and the skill requisite to perform the legal service properly;

(6) the likelihood, if apparent to the client, that the acceptance of the particular employment will preclude other employment by the lawyer;

(7) the amount involved and the results obtained;

(8) the time limitations imposed by the client or by the circumstances;

(9) the nature and length of the professional relationship with the client;

(10) the experience, reputation, and ability of the lawyer or lawyers performing the services;

(11) whether the fee is fixed or contingent;

(12) the time and labor required; and

(13) whether the client gave informed consent* to the fee.

(c) A lawyer shall not make an agreement for, charge, or collect:

(1) any fee in a family law matter, the payment or amount of which is contingent upon the securing of a dissolution or declaration of nullity of a marriage or upon the amount of spousal or child support, or property settlement in lieu thereof; or

(2) a contingent fee for representing a defendant in a criminal case.

(d) A lawyer may make an agreement for, charge, or collect a fee that is denominated as "earned on receipt" or "non-refundable," or in similar terms, only if the fee is a true retainer and the client agrees in writing* after disclosure that the client will not be entitled to a refund of all or part of the fee charged. A true retainer is a fee that a client pays to a lawyer to ensure the lawyer's availability to the client during a specified period or on a specified matter, but not to any extent as compensation for legal services performed or to be performed.

(e) A lawyer may make an agreement for, charge, or collect a flat fee for specified legal services. A flat fee is a fixed amount that constitutes complete payment for the performance of described services regardless of the amount of work ultimately involved, and which may be paid in whole or in part in advance of the lawyer providing those services.

Comment

Prohibited Contingent Fees

[1] Paragraph (c)(1) does not preclude a contract for a contingent fee for legal representation in connection with the recovery of post-judgment balances due under child or spousal support or other financial orders.

Payment of Fees in Advance of Services

[2] Rule 1.15(a) and (b) govern whether a lawyer must deposit in a trust account a fee paid in advance.

[3] When a lawyer-client relationship terminates, the lawyer must refund the unearned portion of a fee. (See rule 1.16(e)(2).)

Division of Fee

[4] A division of fees among lawyers is governed by rule 1.5.1.

Written Fee Agreements*

[5] Some fee agreements must be in writing* to be enforceable. (See, e.g., Bus. & Prof. Code, §§ 6147 and 6148.)

Rule 4-200 Fees for Legal Services

(former California rule operative until October 31, 2018)

(A) A member shall not enter into an agreement for, charge, or collect an illegal or unconscionable fee.

(B) Unconscionability of a fee shall be determined on the basis of all the facts and circumstances existing at the time the agreement is entered into except where the parties contemplate that the fee will be affected by later events. Among the factors to be considered, where appropriate, in determining the conscionability of a fee are the following:

(1) The amount of the fee in proportion to the value of the services performed.

(2) The relative sophistication of the member and the client.

(3) The novelty and difficulty of the questions involved and the skill requisite to perform the legal service properly.

(4) The likelihood, if apparent to the client, that the acceptance of the particular employment will preclude other employment by the member.

(5) The amount involved and the results obtained.

(6) The time limitations imposed by the client or by the circumstances.

(7) The nature and length of the professional relationship with the client.

(8) The experience, reputation, and ability of the member or members performing the services.

(9) Whether the fee is fixed or contingent.

(10) The time and labor required.

(11) The informed consent of the client to the fee.

(Amended by order of Supreme Court, operative September14, 1992.)

Rule 1.8.1 Business Transactions with a Client and Pecuniary Interests Adverse to a Client

(Added by order of Supreme Court, operative November 1, 2018)

A lawyer shall not enter into a business transaction with a client, or knowingly* acquire an ownership, possessory, security or other pecuniary interest adverse to a client, unless each of the following requirements has been satisfied:

(a) the transaction or acquisition and its terms are fair and reasonable* to the client and the terms and the lawyer's role in the transaction or acquisition are fully disclosed and transmitted in writing* to the client in a manner that should reasonably* have been understood by the client;

(b) the client either is represented in the transaction or acquisition by an independent lawyer of the client's choice or the client is advised in writing* to seek the advice of an independent lawyer of the client's choice and is given a reasonable* opportunity to seek that advice; and

(c) the client thereafter provides informed written consent* to the terms of the transaction or acquisition, and to the lawyer's role in it.

Comment

[1] A lawyer has an "other pecuniary interest adverse to a client" within the meaning of this rule when the lawyer possesses a legal right to significantly impair or prejudice the client's rights or interests without court action. (See *Fletcher v. Davis* (2004) 33 Cal.4th 61, 68 [14 Cal.Rptr.3d 58]; see also Bus. & Prof. Code, § 6175.3 [Sale of financial products to elder or dependent adult clients; Disclosure]; Fam. Code, §§ 2033-2034 [Attorney lien on community real property].) However, this rule does not apply to a charging lien given to secure payment of a contingency fee. (See *Plummer v. Day/Eisenberg, LLP* (2010) 184 Cal.App.4th 38 [108 Cal.Rptr.3d 455].)

[2] For purposes of this rule, factors that can be considered in determining whether a lawyer is independent include whether the lawyer: (i) has a financial interest in the transaction or acquisition; and (ii) has a close legal, business, financial, professional or personal relationship with the lawyer seeking the client's consent.

[3] Fairness and reasonableness under paragraph (a) are measured at the time of the transaction or acquisition based on the facts that then exist.

[4] In some circumstances, this rule may apply to a transaction entered into with a former client. (Compare *Hunniecutt v. State Bar* (1988) 44 Cal.3d 362, 370-71 ["[W]hen an attorney enters into a transaction with a former client regarding a fund which resulted from the attorney's representation, it is reasonable to examine the relationship between the parties for indications of special trust resulting therefrom. We conclude that if there is evidence that the client placed his trust in the attorney because of the representation, an attorney-client relationship exists for the purposes of [the predecessor rule) even if the representation has otherwise ended [and] It appears that [the client] became a target of [the lawyer's] solicitation because he knew, through his representation of her, that she had recently received the settlement fund [and the court also found the client to be unsophisticated]."] with *Wallis v. State Bar* (1942) 21 Cal.2d 322 [finding lawyer not subject to discipline for entering into business transaction with a former client where the former client was a sophisticated businesswoman who had actively negotiated for terms she thought desirable, and the transaction was not connected with the matter on which the lawyer previously represented her].)

[5] This rule does not apply to the agreement by which the lawyer is retained by the client, unless the agreement confers on the lawyer an ownership, possessory, security, or other pecuniary interest adverse to the client. Such an agreement is governed, in part, by rule 1.5. This rule also does not apply to an agreement to advance to or deposit with a lawyer a sum to be applied to fees, or costs or other expenses, to be incurred in the future. Such agreements are governed, in part, by rules 1.5 and 1.15.

[6] This rule does not apply: (i) where a lawyer and client each make an investment on terms offered by a third person* to the general public or a significant portion thereof; or (ii) to standard commercial transactions for products or services that a lawyer acquires from a client on the same terms that the client generally markets them to others, where the lawyer has no advantage in dealing with the client.

Rule 3-300 Avoiding Interests Adverse to a Client

(former California rule operative until October 31, 2018)

A member shall not enter into a business transaction with a client; or knowingly acquire an ownership, possessory, security, or other pecuniary interest adverse to a client, unless each of the following requirements has been satisfied:

(A) The transaction or acquisition and its terms are fair and reasonable to the client and are fully disclosed and transmitted in writing to the client in a manner which should reasonably have been understood by the client; and

(B) The client is advised in writing that the client may seek the advice of an independent lawyer of the client's choice and is given a reasonable opportunity to seek that advice; and

(C) The client thereafter consents in writing to the terms of the transaction or the terms of the acquisition.

Discussion:

Rule 3-300 is not intended to apply to the agreement by which the member is retained by the client, unless the agreement confers on the member an ownership, possessory, security, or other pecuniary interest adverse to the client. Such an agreement is governed, in part, by rule 4-200.

Rule 3-300 is not intended to apply where the member and client each make an investment on terms offered to the general public or a significant portion thereof. For example, rule 3-300 is not intended to apply where A, a member, invests in a limited partnership syndicated by a third party. B, A's client, makes the same investment. Although A and B are each investing in the same business, A did not enter into the transaction "with" B for the purposes of the rule.

Rule 3-300 is intended to apply where the member wishes to obtain an interest in client's property in order to secure the amount of the member's past due or future fees. (Amended by order of Supreme Court, operative September 14, 1992.)

Rule 1.15 Safekeeping Funds and Property of Clients and Other Persons*

(Added by order of Supreme Court, operative November 1, 2018)

(a) All funds received or held by a lawyer or law firm* for the benefit of a client, or other person* to whom the lawyer owes a contractual, statutory, or other legal duty, including advances for fees, costs and expenses, shall be deposited in one or more identifiable bank accounts labeled "Trust Account" or words of similar import, maintained in the State of California, or, with written* consent of the client, in any other jurisdiction where there is a substantial* relationship between the client or the client's business and the other jurisdiction.

(b) Notwithstanding paragraph (a), a flat fee paid in advance for legal services may be deposited in a lawyer's or law firm's operating account, provided:

(1) the lawyer or law firm* discloses to the client in writing* (i) that the client has a right under paragraph (a) to require that the flat fee be deposited in an identified trust account until the fee is earned, and (ii) that the client is entitled to a refund of any amount of the fee that has not been earned in the event the representation is terminated or the services for which the fee has been paid are not completed; and

(2) if the flat fee exceeds $1,000.00, the client's agreement to deposit the flat fee in the lawyer's operating account and the disclosures required by paragraph (b)(1) are set forth in a writing* signed by the client.

(c) Funds belonging to the lawyer or the law firm* shall not be deposited or otherwise commingled with funds held in a trust account except:

(1) funds reasonably* sufficient to pay bank charges; and

(2) funds belonging in part to a client or other person* and in part presently or potentially to the lawyer or the law firm,* in which case the portion belonging to the lawyer or law firm* must be withdrawn at the earliest reasonable* time after the lawyer or law firm's interest in that portion becomes fixed. However, if a client or other person* disputes the lawyer or law firm's right to receive a portion of trust funds, the disputed portion shall not be withdrawn until the dispute is finally resolved.

(d) A lawyer shall:

(1) promptly notify a client or other person* of the receipt of funds, securities, or other property in which the lawyer knows* or reasonably should know* the client or other person* has an interest;

(2) identify and label securities and properties of a client or other 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 property of a client or other person* coming into the possession of the lawyer or law firm;*

(4) promptly account in writing* to the client or other person* for whom the lawyer holds funds or property;

(5) preserve records of all funds and property held by a lawyer or law firm* under this rule for a

period of no less than five years after final appropriate distribution of such funds or property;

(6) comply with any order for an audit of such records issued pursuant to the Rules of Procedure of the State Bar; and

(7) promptly distribute, as requested by the client or other person,* any undisputed funds or property in the possession of the lawyer or law firm* that the client or other person* is entitled to receive.

(e) The Board of Trustees of the State Bar shall have the authority to formulate and adopt standards as to what "records" shall be maintained by lawyers and law firms* in accordance with paragraph (d)(3). The standards formulated and adopted by the Board, as from time to time amended, shall be effective and binding on all lawyers.

Standards:

Pursuant to this rule, the Board of Trustees of the State Bar adopted the following standards, effective November 1, 2018, as to what "records" shall be maintained by lawyers and law firms* in accordance with paragraph (d)(3).

(1) A lawyer shall, from the date of receipt of funds of the client or other person* through the period ending five years from the date of appropriate disbursement of such funds, maintain:

(a) a written* ledger for each client or other person* on whose behalf funds are held that sets forth:

(i) the name of such client or other person;*

(ii) the date, amount and source of all funds received on behalf of such client or other person;*

(iii) the date, amount, payee and purpose of each disbursement made on behalf of such client or other person;* and

(iv) the current balance for such client or other person;*

(b) a written* journal for each bank account that sets forth:

(i) the name of such account;

(ii) the date, amount and client or other person* affected by each debit and credit; and

(iii) the current balance in such account;

(c) all bank statements and cancelled checks for each bank account; and

(d) each monthly reconciliation (balancing) of (a), (b), and (c).

(2) A lawyer shall, from the date of receipt of all securities and other properties held for the benefit of client or other person* through the period ending five years from the date of appropriate disbursement of such securities and other properties, maintain a written* journal that specifies:

(a) each item of security and property held;

(b) the person* on whose behalf the security or property is held;

(c) the date of receipt of the security or property;

(d) the date of distribution of the security or property; and

(e) person* to whom the security or property was distributed.

Comment

[1] Whether a lawyer owes a contractual, statutory or other legal duty under paragraph (a) to hold funds on behalf of a person* other than a client in situations where client funds are subject to a third-party lien will depend on the relationship between the lawyer and the third-party, whether the lawyer has assumed a contractual obligation to the third person* and whether the lawyer has an independent obligation to honor the lien under a statute or other law. In certain circumstances, a lawyer may be civilly liable when the lawyer has notice of a lien and disburses funds in contravention of the lien. (See *Kaiser Foundation Health Plan, Inc. v. Aguiluz* (1996) 47 Cal.App.4th 302 [54 Cal.Rptr.2d 665].) However, civil liability by itself does not establish a violation of this rule. (Compare *Johnstone v. State Bar of California* (1966) 64 Cal.2d 153, 155-156 [49 Cal.Rptr. 97] ["'When an attorney assumes a fiduciary relationship and violates his duty in a manner that would justify disciplinary action if the relationship had been that of attorney and client, he may properly be disciplined for his misconduct.'"] with *Crooks v. State Bar* (1970) 3 Cal.3d 346, 358 [90 Cal.Rptr. 600] [lawyer who agrees to act as escrow or stakeholder for a client and a third-party owes a duty to the nonclient with regard to held funds].)

[2] As used in this rule, "advances for fees" means a payment intended by the client as an advance payment for some or all of the services that the lawyer is expected to perform on the client's behalf. With respect to the difference between a true retainer and a flat fee, which is one type of advance fee, see rule 1.5(d) and (e). Subject to rule 1.5, a lawyer or law firm* may enter into an agreement that defines when or how an advance fee is earned and may be withdrawn from the client trust account.

[3] Absent written* disclosure and the client's agreement in a writing* signed by the client as provided in paragraph (b), a lawyer must deposit a flat fee paid in advance of legal services in the lawyer's trust account. Paragraph (b) does not apply to advance payment for costs and expenses. Paragraph (b) does not alter the lawyer's obligations under paragraph (d) or the lawyer's burden to establish that the fee has been earned.

Rule 4-100 Preserving Identity of Funds and Property of a Client

(former California rule operative until October 31, 2018)

(A) All funds received or held for the benefit of clients by a member or law firm, including advances for costs and expenses, shall be deposited in one or more identifiable bank accounts labeled "Trust Account," "Client's Funds Account" or words of similar import, maintained in the State of California, or, with written consent of the client, in any other jurisdiction where there is a substantial relationship between the client or the client's business and the other jurisdiction. No funds belonging to the member or the law firm shall be deposited therein or otherwise commingled therewith except as follows:

(1) Funds reasonably sufficient to pay bank charges.

(2) In the case of funds belonging in part to a client and in part presently or potentially to the member or the law firm, the portion belonging to the member or law firm must be withdrawn at the earliest reasonable time after the member's interest in that portion becomes fixed. However, when the right of the member or law firm to receive a portion of trust funds is disputed by the client, the disputed portion shall not be withdrawn until the dispute is finally resolved.

(B) A member shall:

(1) Promptly notify a client of the receipt of the client's funds, securities, or other properties.

(2) Identify and label securities and properties of a client 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 coming into the possession of the member or law firm and render appropriate accounts to the client regarding them; preserve such records for a period of no less than five years after final appropriate distribution of such funds or properties; and comply with any order for an audit of such records issued pursuant to the Rules of Procedure of the State Bar.

(4) Promptly pay or deliver, as requested by the client, any funds, securities, or other properties in the possession of the member which the client is entitled to receive.

(C) The Board of Governors of the State Bar shall have the authority to formulate and adopt standards as to what "records" shall be maintained by members and law firms in accordance with subparagraph (B)(3). The standards formulated and adopted by the Board, as from time to time amended, shall be effective and binding on all members.

Standards:

Pursuant to rule 4-100(C) the Board of Governors of the State Bar adopted the following standards, effective January 1, 1993, as to what "records" shall be maintained by members and law firms in accordance with subparagraph (B)(3).

(1) A member shall, from the date of receipt of client funds through the period ending five years from the date of appropriate disbursement of such funds, maintain:

(a) a written ledger for each client on whose behalf funds are held that sets forth:

(i) the name of such client,

(ii) the date, amount and source of all funds received on behalf of such client,

(iii) the date, amount, payee and purpose of each disbursement made on behalf of such client, and

(iv) the current balance for such client;

(b) a written journal for each bank account that sets forth:

(i) the name of such account,

(ii) the date, amount and client affected by each debit and credit, and

(iii) the current balance in such account;

(c) all bank statements and cancelled checks for each bank account; and

(d) each monthly reconciliation (balancing) of (a), (b), and (c).

(2) A member shall, from the date of receipt of all securities and other properties held for the benefit of client through the period ending five years from the date of appropriate disbursement of such securities and other properties, maintain a written journal that specifies:

(a) each item of security and property held;

(b) the person on whose behalf the security or property is held;

(c) the date of receipt of the security or property;

(d) the date of distribution of the security or property; and

(e) person to whom the security or property was distributed.

(Trust Account Record Keeping Standards as Adopted by the Board of Governors on July 11, 1992, effective on January 1, 1993.)

Relevant Business and Professions Code Sections

§ 6069 Authorization for Disclosure of Financial Records; Subpoena; Notice; Review

§ 6091.1 Client Trust Fund Accounts—Investigation of Overdrafts and Misappropriations

§ 6091.2 Definitions Applicable to Section 6091.1

§ 6106.3 Mortgage Loan Modifications: Violation of Civil Code Sections 2944.6 or 2944.7–Grounds for Discipline

§ 6146 Limitations; Periodic Payments; Definitions

§ 6147 Contingency Fee Contract: Contents; Effect of Noncompliance; Application to Contracts for Recovery of Workers' Compensation Benefits

§ 6147.5 Contingency Fee Contracts; Recovery of Claims between Merchants

§ 6148 Written Fee Contract: Contents; Effect of Noncompliance

§ 6149 Written Fee Contract Confidential Communication

§ 6149.5 Insurer Notification to Claimant of Settlement Payment Delivered to Claimant's Attorney

§ 6200 Establishment of System and Procedure; Jurisdiction; Local Bar Association Rules

§ 6201 Notice to Client; Request for Arbitration; Client's Waiver of Right to Arbitration

§ 6202 Disclosure of Attorney-Client Communication and Work Product; Limitation

§ 6203 Award; Contents; Finality; Petition to Court; Award of Fees and Costs

§ 6204 Agreement to be Bound by Award of Arbitrator; Trial After Arbitration in Absence of Agreement; Prevailing Party; Effect of Award and Determination

§ 6204.5 Disqualification of Arbitrators; Post-arbitration Notice

§ 6206 Arbitration Barred if Time for Commencing Civil Action Barred; Exception

§ 6211 Maintenance of Interest Bearing IOLTA Account; Payment of Interest and Dividends into Fund

§ 6212 Requirements in Establishing Client Trust Accounts; Amount of Interest; Remittance to State Bar; Statements and Reports

§ 6213 Definitions

§ 6242 Definitions

§ 22442.5 Immigration Consultants–Client Trust Account for Immigration Reform Act Services

§ 22442.6 Immigration Consultants–Immigration Reform Act Services; Refunding of Advance Payment; Statement of Accounting

Relevant Civil Code Section

§ 2944.6 Mortgage Loan Modifications–Person Offering to Perform Modification for a Fee; Notice to Borrower; Violations

§ 2944.7 Mortgage Loan Modifications–Person Offering to Perform Modification for a Fee; Prohibitions; Violations

Relevant Code of Civil Procedure Section

§ 1518 When Fiduciary Property Escheats to State

Relevant Evidence Code Sections

§ 1270 "A business"

§ 1271 Business record

§ 1272 Absence of entry in business records

§ 1552 Printed Representation of Computer Generated Information or Computer Program

§ 1553 Evidence—Printed Representation of Images Stored on Video or Digital Medium; Burden of Proof

Relevant Internal Revenue Code Section

§ 6050I Returns relating to cash received in trade or business

RULES OF THE STATE BAR OF CALIFORNIA

TITLE 2. RIGHTS AND RESPONSIBILITIES OF MEMBERS

Division 5. Trust Accounts

Chapter 1. Global Provisions

Rule 2.100 Definitions

(A) A “Chargeable fee” is a per-check charge, per-deposit charge, fee in lieu of minimum balance, federal deposit insurance fee, or sweep fee.

(B) A "Client" is a person or a group of persons that has engaged the attorney or firm for a common purpose.

(C) Comparably conservative” in Business and Professions Code 6213(j) includes, but is not limited to, securities issued by Government Sponsored Enterprises.

(D) An “Exempt Account” is exempt from IOLTA requirements because it does not meet the productivity criteria established by the Legal Services Trust Fund Commission.

(E) “Funds” are monies held in a fiduciary capacity by a member for the benefit of a client or a third party.

(F) An “IOLTA account” is an Interest on Lawyers’ Trust Account as defined in Business and Professions Code section 6213(j).

(G) An “IOLTA-eligible institution” is an eligible institution as defined in 6213(k) that meets the requirements of these rules, State Bar guidelines, and the State Bar Act.

(H) “IOLTA funds” are the interest or dividends generated by IOLTA accounts.

(I) A “member” is a member and a member’s law firm.

(J) A “member business expense” is an expense that a member incurs in the ordinary course of business, such as charges for check printing, deposit stamps, insufficient fund charges, collection charges, wire transfer fees, fees for cash management, and any other fee that is not a chargeable fee.

Chapter 2. Members’ Duties

Rule 2.110 Funds to be held in an IOLTA account

(A) Members must establish IOLTA accounts for funds that cannot earn income for the client or third party in excess of the costs incurred to secure such income because the funds are nominal in amount or held for a short period of time. In determining whether funds can earn income in excess of costs, a member must consider the following factors:

(1) the amount of the funds to be deposited;

(2) the expected duration of the deposit, including the likelihood of delay in resolving the matter for which the funds are held;

(3) the rates of interest or dividends at eligible institutions where the funds are to be deposited;

(4) the costs of establishing and administering non-IOLTA accounts for the client or third party's benefit, including service charges, the costs of the member's services, and the costs of preparing any tax reports required for income earned on the funds;

(5) the capability of eligible institutions or the member to calculate and pay income to individual clients or third parties;

(6) any other circumstances that affect the ability of the funds to earn a net return for the client or third party.

(B) The State Bar will not bring disciplinary charges against a member for determining in good faith whether or not to place funds in an IOLTA account.

Rule 2.111 Funds not to be held in an IOLTA account

(A) If a member determines that the funds can earn income for the benefit of the client or third party in excess of the costs incurred to secure such income, the funds must be deposited in a trust account in accordance with the provisions of Section 6211(b) of the Business and Professions Code and Rule 4-100 of the Rules of Professional Conduct or as the client or third party directs in writing

(B) A member should not designate an exempt account as an IOLTA account.

Rule 2.112 Review of funds in an IOLTA account

A member must review an IOLTA account at reasonable intervals to determine whether changed circumstances require funds be moved out of the IOLTA account.

Rule 2.113 Charges against IOLTA funds

A member may allow an IOLTA-eligible institution to deduct chargeable fees permitted by Business and Professions Code 6212(c) from IOLTA funds. A member must pay any member business expense and may not allow the bank to deduct such expenses from IOLTA funds. If the State Bar becomes aware that a member business expense is erroneously deducted from IOLTA funds, the State Bar will inform the IOLTA-eligible institution and request that the error be corrected.

Rule 2.114 Reporting to the State Bar

A member must report compliance with these rules.

Rule 2.115 Consent to reporting

By establishing funds in an account, a member consents to the eligible institution's furnishing account information to the State Bar as required by these rules, State Bar guidelines, and the State Bar Act.

Rule 2.116 Liquidity Requirements

IOLTA accounts must allow prompt withdrawal of funds, except that such accounts may be subject to notification requirements applicable to all other accounts of the same class at the eligible institution so long as the notification requirement does not exceed thirty days.

Rule 2.117 Institution eligibility requirements

A member may place an IOLTA account only in an IOLTA-eligible institution. The State Bar will maintain a list of IOLTA-eligible institutions.

Rule 2.118 No change to other duties and obligations of a member

Nothing in these rules shall be construed as affecting or impairing the duties and obligations of a member pursuant to the statutes and rules governing the conduct of members of the State Bar including, but not limited to, provisions of Rule 4-100 of the Rules of Professional Conduct requiring a member to promptly notify a client of the receipt of the client's funds and to promptly pay or deliver to the client, as requested by the client, the funds in the possession of the member which the client is entitled to receive.

Chapter 3. Duties of an IOLTA Eligible Institution

Rule 2.130 Comparable Interest Rate or Dividend Requirement

(A) An IOLTA-eligible institution must pay comparable interest rates or dividends as required under Business and Professional Code 6212(b) and 6212(e) and may choose to do so in one of three ways:

(1) allow establishment of IOLTA accounts as comparable-rate products;

(2) pay the comparable-product rate on IOLTA deposit accounts, less chargeable fees, if any; or

(3) pay the Established Compliance Rate determined by the Legal Services Trust Fund Commission.

(B) "Accounts of the same type" in section 6212(b) refers to comparable-rate products described in sections 6212(e) and 6212(j) for which the IOLTA-eligible institution pays no less than the highest interest rate or dividend generally available from the institution to non-IOLTA account customers when the IOLTA account meets the same minimum balance or other eligibility qualifications.

Rule 2.131 Payments to the State Bar

An IOLTA-eligible institution must remit payments to the State Bar in accordance with Business and Professions Code 6212(d)(1-3) and State Bar rules and guidelines.

APPENDIX 3: INDEX OF SELECTED CASES AND OPINIONS BY TOPIC

Selected Recent Cases

In The Matter of Song (Review Dept. 2013) 5 Cal. State Bar Ct. Rptr. 273

In The Matter of Lawrence (Review Dept. 2013) 5 Cal. State Bar Ct. Rptr. 239

In The Matter of Connor (Review Dept. 2008) 5 Cal. State Bar Ct. Rptr 93

In The Matter of Seltzer (Review Dept. 2013) 5 Cal. State Bar Ct. Rptr. 263

Duties, In General

In the Matter of Wells (Rev. Dept. 2006) 4 Cal. State Bar Ct. Rptr. 896. While practicing outside of California, attorney violated rule 4-100 by not depositing in a client trust account settlement benefits that were received for the benefit of the client. A finding that attorney was culpable of unauthorized practice of law compels a conclusion that the attorney charged and collected illegal fees under rule 4-200(A).

In the Matter of Robins (Rev. Dept. 1991) 1 Cal. State Bar Ct. Rptr. 708. The duty to keep client's funds safe is a personal obligation of the attorney which is nondelegable. (See also *Palomo v. State Bar* (1984) 36 Cal.3d 785 [685 P.2d 1185, 205 Cal.Rptr. 834].)

Giovanazzi v. State Bar (1980) 28 Cal.3d 465 [619 P.2d 1005, 169 Cal.Rptr. 581]. The mere fact that the balance in an attorney's trust account has fallen below the total of amounts deposited and purportedly held in trust supports a conclusion of misappropriation.

Advanced Fees

S.E.C. v. Interlink Data Network of Los Angeles (9th Cir. 1996) 77 F.3d 1201, 1206. An attorney must keep advances for fees in a client trust account if the attorney's fee agreement specifically provides that the attorney must do so.

T & R Foods, Inc. v. Rose (1996) 47 Cal.App.4th Supp.1. The appellate department of the Superior Court in Los Angeles held that an attorney has a duty to deposit advanced fees, which are not yet earned, into a client trust account.

Baranowski v. State Bar (1979) 24 Cal.3d 139. The Supreme Court held that rule 8-101 (current rule 4-100) requires that advanced costs be placed in a designated trust account. However, the court declined to resolve the issue of whether an advanced fee payment is required to be placed in an identifiable trust account until such time a s it is earned.

Settlement Drafts

In the Matter of Robert Steven Kaplan (Rev. Dept. 1993) 2 Cal.State Bar Ct. Rptr. 509. An attorney is obligated to act promptly to release funds to a former client by endorsing the settlement draft. A delay has the effect of withholding funds the client is entitled to receive pursuant to Rule 4-100(B)(4).

Maintain Actual Records of Trust Account Activity

In the Matter of Rae Blum (Rev. Dept. 2002) 4 Cal. State Bar Ct. Rptr. 403. Attorney's reliance on her husband/law partner to manage the client trust account does not relieve attorney of her personal, non-delegable duty to monitor client funds and her trust account. An attorney is not relieved from professional responsibility when he or she relies on a partner to maintain client trust accounts.

In the Matter of Doran (Rev. Dept. 1998) 3 Cal. State Bar Ct. Rptr. 871, 876. Where an attorney made no effort to understand the responsibilities involved in maintaining a trust account, never determined the balance in the trust account, and did not maintain a ledger or confirm deposits made to the trust account, the attorney's conduct is no less than gross negligence and supports a finding of moral turpitude.

Dixon v. State Bar (1985) 39 Cal.3d 335 [702 P.2d 590, 216 Cal.Rptr. 432]. The purpose of keeping proper books of account, vouchers, receipts, and checks is to be prepared to make proof of the honesty and fair dealing of attorneys when their actions are called into question. (See also *Clark v. State Bar* (1952) 39 Cal.2d 161 [246 P.2d 1].)

Fitzsimmons v. State Bar (1983) 34 Cal.3d 327 [667 P.2d 700, 193 Cal.Rptr. 896]. An attorney's failure to keep adequate records warrants discipline.

Weir v. State Bar (1979) 23 Cal.3d 564 [591 P.2d 19, 152 Cal.Rptr. 921]. The failure to keep proper books of accounts, vouchers, receipts and checks is a breach of an attorney's duty to his clients.

Maintain Copies of Other Materials Relating to the Attorney's Financial Relationship with the Client

Accounting for Fees

In the Matter of Brockway (Rev. Dept. 2006) 4 Cal. State Bar Ct. Rptr 944. An attorney must satisfy the accounting requirements of rule 4-100 even in the absence of a demand for such an accounting from the client.

In the Matter of Cacioppo (Rev. Dept. 1992) 2 Cal. St. Bar Ct. Rptr. 128, 146. An attorney committed misconduct by providing a confusing, belated accounting to a client. The attorney also did not follow an acceptable procedure to ensure informed consent of the client to the application of her recovery to pay attorney's fees. In this case, the court found that the attorney must give the client an opportunity to review a bill before applying the client's recovery to pay attorney fees.

In the Matter of Fonte (Rev. Dept. 1994) 2 Cal.State Bar Ct. Rptr. 752. An attorney was obligated to maintain adequate records of monies drawn against a $5,000 advanced fee despite his claim that the fee was a retainer and "earned upon receipt." By failing to provide the client with an accounting regarding these funds, the attorney violated rule 4-100(B)(3), the client trust accounting rule, even though the rule does not refer specifically to attorney's fees.

Matthew v. State Bar (1989) 49 Cal.3d 784 [781 P.2d 952, 263 Cal.Rptr. 660]. An attorney should maintain time records or billing statements and account for unearned fees.

All Retainer and Compensation Contracts

In the Matter of Brockway (Rev. Dept. 2006) 4 Cal. State Bar Ct. Rptr 944. The Court found the fee to be an advance against future services even though it had been designated "True Retainer Fee." The designation was not determinative of the obligations of the parties because the fee did not state that it was due and payable regardless of whether professional services were actually rendered.

In the Matter of Respondent F (Rev. Dept. 1992) 2 Cal. State Bar Rptr. 17. Attorneys must retain funds in trust when the attorney's right to the funds is disputed by the client. The funds are required to be kept in trust until the resolution of the dispute.

In the Matter of Koehler (Rev. Dept. 1991) 1 Cal. State Bar Rptr. 615, headnote 5. An attorney applied advanced costs to his legal fees, thereby violating the requirement that advanced costs be held in trust. The failure to return the unused portion of such funds promptly when requested violated the rule requiring prompt payment of client funds on demand.

Friedman v. State Bar (1990) 50 Cal.3d 235 [786 P.2d 359, 266 Cal.Rptr. 632]. The failure to have a written contingency fee contract and to provide a copy to the client constitutes a failure to maintain records of or render appropriate accounts to the client. (See also *Fitzsimmons v. State Bar* (1983) 34 Cal.3d 327 [667 P.2d 700, 193 Cal.Rptr. 896].)

Palomo v. State Bar (1984) 36 Cal.3d 785 [685 P.2d 1185, 205 Cal.Rptr. 834]. General language in fee agreement will not convey general power of attorney to sign checks on client's behalf.

Grossman v. State Bar (1983) 34 C.3d 73 [664 P.2d 542, 192 Cal.Rptr. 397]. Attorney misappropriated client funds where he initially agreed to represent his client in a personal injury matter on a 33 1/3 contingent fee basis, and after settling the case, unilaterally increased the fee to 40 percent.

Academy of CA Optometrists v. Superior Court (1975) 51 Cal.App.3d 999 [124 Cal.Rptr. 668]. Contracts which violate the canons of professional ethics of an attorney may for that reason be void.

Brody v. State Bar (1974) 11 Cal.3d 347 [521 P.2d 107, 113 Cal.Rptr. 371]. An attorney may not unilaterally determine his own fee and withhold trust funds to satisfy it, even though he may be entitled to reimbursement for his fees. (See also *Crooks v. State Bar* (1970) 3 Cal.3d 346 [75 P.2d 872, 90 Cal.Rptr. 60].)

All Statements to Clients Showing Disbursements

Murray v. State Bar (1985) 40 Cal.3d 575 [709 P.2d 480, 220 Cal.Rptr. 677]. A finding of wilful misappropriation where the attorney failed to respond to his client's queries regarding funds held in trust.

Attorney's Liens

In re Popov (N.D.Cal. 2007, No. C-06-2696 MMC) 2007 WL 1970102. District court affirmed a bankruptcy court order finding that attorney did not violate rule 3-300 by not disclosing how an attorney's lien provision in the fee contract might impact the client in the future.

Fletcher v. Davis, (2004) 33 Cal.4th 61 [14 Cal.Rptr.3d 58]

The Supreme Court held that a charging lien, securing payment of attorney's fees and costs against the client's future recovery, is an adverse interests and triggers the requirements of rule 3-300, including the requirements of written client consent and notice to seek the advice of an independent lawyer. The court found that compliance with rule 3-300 was lacking and ruled that the agreement for a charging lien was not enforceable. In a footnote, the court clarified that its decision was limited only to a charging lien securing an hourly fee and expressly declined to address situations involving contingency fees.

In the Matter of Feldsott (Rev. Dept. 1997) 3 Cal. St. Bar Ct. Rptr. 754, 756-758. Where a prior attorney took reasonable and appropriate steps to protect his lien on a former client's recovery, the prior attorney did not violate rule 4-100(B)(4) by refusing to sign a settlement check which was in the possession of the former client's successor attorney and which was payable to the former client, the prior attorney, and the successor attorney. The prior attorney agreed to release all funds not in dispute to his former client. He suggested binding fee arbitration and, while the dispute was pending, requested that the disputed part of the recovery be placed in an account requiring both his and his former client's signatures or be deposited in court until the resolution of the dispute.

In the Matter of Respondent H (Rev. Dept. 1992) 2 Cal. State Bar Ct. Rptr. 234. An attorney is a general creditor of the client and cannot reach monies held by the client's attorney absent an enforceable lien or judgment.

Baca v. State Bar (1990) 52 Cal.3d 294. The WCAB awarded recovery to the applicant and attorney's fees to both prior and subsequent counsel. The WCAB's adjudication caused the settlement funds to have client trust fund status. The attorney's conversion of the funds and failure to pay the prior attorney's liens constituted misappropriation, an act of moral turpitude.

Weiss v. Marcus (1975) 51 Cal.App.3d 390. A valid lien may be created by contract and will survive the prior attorney's discharge. The attorney was permitted to maintain an action against subsequent counsel for constructive trust, interference with contractual relationship, and conversion.

Copies of all bills

Dreyfus v. State Bar (1960) 54 Cal.2d 799 [356 P.2d 213, 8 Cal.Rptr. 469]. No receipt given to client for monies deposited with attorney.

Clark v. State Bar (1952) 39 Cal.2d 161 [246 P.2d 1]. The purpose of keeping vouchers and receipts is to be prepared to make proof of the honesty and fair dealings of attorneys when their actions are called into question.

Maintain "Books" Showing the Trust Account Activity Relating to Each Client or Matter

In the Matter of Respondent F (Rev. Dept. 1992) 2 Cal. State Bar Ct. Rptr. 17. An attorney cannot be held responsible for every detail of office operations. Nevertheless, an attorney is held responsible if the attorney fails to manage funds, regardless of the attorney's intent or the absence of injury to anyone. (See also *Palomo v. State Bar* (1984) 36 Cal.3d 785 [685 P.2d 1185, 205 Cal.Rptr. 834]; *Guzzetta v. State Bar* (1987) 43 Cal.3d 962 [741 P.2d 172, 239 Cal.Rptr. 675].)

Maintain Books And Account To Third Parties

In the Matter of Kaplan (Rev. Dept. 1996) 3 Cal. State Bar Ct. Rptr. 547. Where a client asks the attorney to distribute trust account funds claimed by both the client and a third party to whom the attorney owes a fiduciary duty, the attorney must promptly take affirmative steps to resolve the competing claims in order to disburse the funds.

Guzzetta v. State Bar (1987) 43 Cal.3d 962 [741 P.2d 172, 239 Cal.Rptr. 675]. An attorney's fiduciary obligation to account and pay funds extends to both parties claiming interest therein. Duty extends to opposing party spouse.

Maintain Separate Ledger Page or Card for Each Client

In the Matter of Yagman (Rev. Dept. 1997) 3 Cal. State Bar Ct. Rptr. 788. An attorney must maintain for a period of five years a written ledger for each client for whom funds are held detailing the date, the amount, and source of all funds received on behalf of the client, in compliance with the Trust Account Record Keeping Standards adopted by the Board of Governors of the State Bar. An attorney must promptly withdraw any undisputed portion of the funds pursuant to rule 4-100(A)(2), at the earliest reasonable time after the attorney's right to those funds becomes fixed.

Weir v. State Bar (1979) 23 Cal.3d 564 [591 P.2d 19, 152 Cal.Rprt. 921]. Fee ledger sheet used as evidence that all fees and costs had been paid by clients.

Vaughn v. State Bar (1972) 6 Cal.3d 847 [494 P.2d 1257, 100 Cal.Rptr. 713]. Attorney's records failed to show receipt of client funds. Holding client's funds in cash or cashier's checks disapproved without client's written consent to do so.

Medical Liens

Kaiser Foundation Health Plan v. Aguiluz (1996) 47 Cal.App.4th 302. The Court of Appeal held an attorney civilly liable for conversion for failing to honor a medical lien. The attorney, after attempting unsuccessfully to negotiate a reduction of the lien amount, paid the funds to the client. The court held that the insurer was entitled to its judgment against the attorney for the full amount owed by the client for health care costs. An attorney on notice of a third party's contractual right to funds received on behalf of a client disburses those funds to the client at his or her own risk.

In the Matter of Riley (Rev. Dept. 1994) 3 Cal. State Bar Ct. Rptr. 91. An attorney must make efforts to determine how the client's medical bills have been paid. Ignorance of the client's statutory liens is gross negligence rather than good faith error. The attorney should have known of the existence of liens had a reasonable inquiry of the client been conducted.

In the Matter of Respondent P (Rev. Dept. 1993) 2 Cal. State Bar Ct. Rptr. 622. An attorney has a fiduciary obligation to the State Department of Health Services to ensure DHS has an opportunity to collect the money due under a medical lien created by operation of law (Welfare and Institutions Code section 14124.79). The attorney violated former rule 8-101(B)(4) (current rule 4-100(B)(4)) by distributing the settlement funds to the client. An attorney has a duty to notify DHS when a matter has settled prior to the distribution of the settlement proceeds.

In the Matter of Dyson (Rev. Dept. 1990) 1 Cal. State Bar Ct. Rptr. 280. An attorney is obligated to segregate funds in a trust account, maintain, and render complete records and pay or deliver the funds promptly on request in the presence of a medical lien. An attorney has no excuse for placing funds subject to medical liens in a general account because at no time do the funds belong to the attorney.

In the Matter of Mapps (Rev. Dept. 1990) 1 Cal. State Bar Rptr. 1. An attorney must keep sufficient funds in a trust account to pay the undisputed portion of treating doctor's medical lien. Gross negligence in record keeping and handling funds, affecting non-clients, constituted moral turpitude. (See also *Vaughn v. State Bar* (1972) 6 Cal.3d 847 [494 P.2d 1257, 100 Cal.Rptr. 713].)

Simmons v. State Bar (1969) 70 Cal.2d 361 [450 P.2d 291, 74 Cal.Rptr. 915]. When an attorney receives client money on behalf of a third party, he has a fiduciary duty to the third party.

Other Documentary Support for All Disbursements and Transfers

In the Matter of Koehler (Rev. Dept. 1991) 1 Cal. State Bar Rptr. 615. Respondent committed moral turpitude in violation of Business and Professions Code section 6106 by intentionally secreting his own funds in a client trust account in order to conceal them from the Franchise Tax Board.

In the Matter of Heiner (Rev. Dept. 1990) 1 Cal. State Bar Rptr. 301. An attorney who repeatedly withdraws small amounts of cash for personal use from a trust account indicates that the attorney is improperly treating the trust account as a personal or general office account, and either allowing the attorney's own funds to remain in the trust account longer than they should, or misappropriating funds that properly belong to the clients. This is true regardless of the means by which the withdrawals are accomplished—check, ATM card, withdrawal slip, or other means.

Receipts for fees

Fitzsimmons v. State Bar (1983) 34 Cal.3d 327 [667 P.2d 700, 193 Cal.Rptr. 896]. Attorney's failure to give client receipts for attorney's fees disapproved.

Reconciliation (monthly/quarterly)

Friedman v. State Bar (1990) 50 Cal.3d 235 [786 P.2d 359, 266 Cal.Rptr. 632]. Attorney had no method by which he could reconcile or verify balances.

Records Showing Payments to Attorneys, Investigators, Third Parties

Fitzsimmons v. State Bar (1983) 34 Cal.3d 327 [667 P.2d 700, 193 Cal.Rptr. 896]. Failure to obtain a receipt for the disbursement of cash on a client's behalf constitutes a violation of an attorney's oath and involves moral turpitude.

Redeposit of Funds Withdrawn from a Client Trust Account

In the Matter of Respondent E (Rev. Dept. 1991) 1 Cal. State Bar Ct. Rptr. 716.). A lawyer was disciplined for failing to hold funds in a client trust account where the lawyer's initial withdrawal of funds was based upon a belief that the disbursement was proper but that belief was subsequently discovered to be erroneous.

Guzzetta v. State Bar (1987) 43 Cal.3d 962 [741 P.2d 172, 239 Cal.Rptr. 675]. To restore funds wrongfully withdrawn from a trust account, an attorney may deposit personal funds into the trust account so long as evidence supports a finding that once deposited the attorney believes that the funds belong to the client and do not belong to the attorney.

State Bar Formal Opinion No. 2006-171. Attorney who has properly withdrawn fees from a client trust account in compliance with rule 4-100(A)(2) is not obligated to return to the trust account amounts that are later disputed by clients.

Regularly Perform Accounting Procedures

In the Matter of Respondent E (Rev. Dept. 1991) 1 Cal. State Bar Ct. Rptr. 716. Where fiduciary violations occur as the result of serious and inexcusable lapses in office procedure, they may be deemed "wilful" for disciplinary purposes, even if there was no deliberate wrongdoing. (See also *Palomo v. State Bar* (1984) 36 Cal.3d 785 [686 P.2d 1185, 205 Cal.Rptr. 834].)

Miscellaneous

Mardirossian & Associates, Inc. v. Ersoff (2007) 153 Cal.App.4th 257. Contingency fee law firm discharged prior to settlement may recover in quantum meruit for the reasonable value of services rendered as determined by testimony of the attorneys as to the amount of time spent on and complexity of legal issues involved in the matter despite absence of billing records.

In re Silverton (2005) 36 Cal.4th 81 [29 Cal.Rptr.3d 766]. Attorney violated rule 4-100 by giving clients settlement checks drawn from a client trust account before the opposing party had actually paid the settlement. The court also found violations of rules 3-300 and 4-200 based on the attorney's practice of seeking authorization from his clients in personal injury actions to compromise the clients' medical bills as part of an agreement in which attorney would increase his clients' recoveries in return for the right to keep any of the negotiated savings of the clients' medical bills. Such agreements were not fair and reasonable and the fees collected were unconscionable.

In the Matter of Davis (Rev. Dept. 2003) 4 Cal. State Bar Ct. Rptr. 576. An attorney representing a corporation must follow the instructions of appropriate corporate officers in the handling of trust funds. Where there is an intractable dispute among board members concerning distribution of trust funds, an attorney may interplead the funds to resolve conflicting instructions.

Farmers Insurance Exchange v. Smith (1999) 71 Cal. App.4th 660, 662 [83 Cal. Rptr.2d 911]. In an action to establish an equitable lien interest, the court found an insurer has no right to "press-gang a policyholder's personal injury attorney into service as a collection agent when the policyholder

receives medical payments from the insurer and then later recovers from a third party tortfeasor. . . . The attorney is not the client's keeper."

In the Matter of Kroff (Rev. Dept. 1998) 3 Cal. State Bar Ct. Rptr. 838, 854. Where a client asks an attorney to distribute trust funds and the attorney claims an interest in the funds, the attorney must promptly take appropriate substantive steps to resolve the dispute, such as fee arbitration.

In the Matter of Respondent F (Rev. Dept. 1992) 2 Cal. State Bar Ct. Rptr. 17. An attorney is permitted to keep in a client trust account his or her own funds reasonably sufficient to cover bank charges.

In the Matter of Bleeker (Rev. Dept. 1990) 1 Cal State Bar Rptr. 113. Gross carelessness and negligence in maintaining a client trust account constitutes a violation of the oath of an attorney to faithfully discharge his duties to the best of his knowledge and ability, and involves moral turpitude as they breach the fiduciary relationship owed to clients. (See also *Giovanazzi v. State Bar* (1980) 28 Cal. 3d 465 [619 P.2d 1005, 169 Cal.Rptr. 581].)

In the Matter of Trillo (Rev. Dept. 1990) 1 Cal. State Bar Rptr. 59. All funds held for a client's benefit, including the costs received must be placed in a proper trust account.

Jackson v. State Bar (1979) 25 Cal.3d 398 [600 P.2d 1326, 158 Cal.Rptr. 869]. Attorney engaged in practice of depositing personal funds and unearned fees into client trust account to provide "margin" against overdraft is a violation.

Signatories on Client Trust Account

In the Matter of Malek-Yonan (Rev. Dept. 2003) 4 Cal. State Bar Ct. Rptr. 627. Where an attorney did not sign checks drawn on her client trust account, but instead authorized her staff to do so using a rubber stamp of her signature, attorney failed to supervise the management of the client trust account, resulting in the theft by her employees of $1.7 million which belonged to attorney, her clients, and their medical providers. Attorney did not review any client trust account statement herself, never reconciled the client trust account, and never compared the settlement checks received with the deposits in the account and thus, failed to ensure that client funds were protected.

In the Matter of Steele (Rev. Dept. 1997) 3 Cal. State Bar Ct. Rptr. 708. An attorney was not absolved of his own duty to monitor the client trust account where attorney delegated responsibility of supervising the client trust account to his legal assistant and legal assistant became a signatory on attorney's general and client trust account. Legal assistant failed to balance both the client trust account and business account and embezzled funds from the client trust account.

In re Basinger (1988) 45 Cal.3d 1348 [756 P.2d 833, 249 Cal.Rptr. 110]. Attorney gave secretary/office manager a general power of attorney to handle firm's accounts and issue checks. Secretary and attorney convicted of grand theft of client and partnership monies.

Waysman v. State Bar (1986) 41 Cal.3d 452 [714 P.2d 1239, 224 Cal.Rptr. 101]. Supreme Court disapproved use of presigned checks left with secretary.

APPENDIX 4: MODEL FORMS

CLIENT LEDGER

CLIENT:
CASE #:

DATE	SOURCE OF DEPOSIT	PAYEE, # & PURPOSE	CHECKS (SUBTRACT)	DEPOSITS (ADD)	REMAINING BALANCE

ACCOUNT JOURNAL

CLIENT TRUST BANK ACCOUNT NAME:

DATE	CLIENT	SOURCE OF DEPOSIT	PAYEE, # & PURPOSE	CHECKS (SUBTRACT)	DEPOSITS (ADD)	REMAINING BALANCE

OTHER PROPERTIES JOURNAL

CLIENT/CASE #:	ITEM	DATE RECEIVED	DATE DISBURSED	DISBURSED TO

FORM ONE: CLIENT LEDGER BALANCE

RECONCILIATION DATE:
CLIENT TRUST BANK ACCOUNT NAME:
PERIOD COVERED BY BANK STATEMENT:

CLIENT	CLIENT LEDGER BALANCE

TOTAL CLIENT LEDGER BALANCE: _____

MONTH ENDING ACCOUNT JOURNAL BALANCE: _____

TOTAL MISTAKE CORRECTION ENTRIES (+ or -)
(From Form Two) _____

ADJUSTED MONTH ENDING ACCOUNT JOURNAL
BALANCE: _____

FORM TWO: ADJUSTMENTS TO MONTH ENDING BALANCE

RECONCILIATION DATE:
CLIENT TRUST BANK ACCOUNT NAME:
PERIOD COVERED BY BANK STATEMENT:

A. DEPOSITS AND WITHDRAWALS NOT POSTED ON BANK STATEMENTS

UNCREDITED DEPOSITS		UNDEBITED WITHDRAWALS	
Date	**Amount**	**Date**	**Amount**
TOTAL:		*TOTAL:*	

B. MISTAKE CORRECTION ENTRIES (from Account Journal)

	AMOUNT		
DATE	**Additions**	**Subtractions**	**NET MISTAKE (+ or -)**
TOTAL MISTAKE CORRECTION ENTRIES:			

FORM THREE: RECONCILIATION

RECONCILIATION DATE:
CLIENT TRUST BANK ACCOUNT NAME:
PERIOD COVERED BY BANK STATEMENT:

ADJUSTED MONTH ENDING BALANCE:
(From Form One) _____

MINUS TOTAL BANK CHARGES:
(From Bank Statement) _____

PLUS TOTAL INTEREST EARNED: _____
(From Bank Statement)

CORRECTED MONTH ENDING BALANCE:
(Total) _____

MINUS UNCREDITED DEPOSITS:
(From Form Two): _____

PLUS UNDEBITED WITHDRAWALS:
(From Form Two) _____

RECONCILED TOTAL: _____

BANK STATEMENT BALANCE: _____

APPENDIX 5: WHAT TO DO WHEN THE RECONCILED TOTAL AND THE BANK STATEMENT BALANCE DON'T EXACTLY MATCH

If, after you've filled out Forms One, Two and Three, the Corrected Month Ending Balance for the client trust bank account doesn't exactly match the balance the bank statement shows for the account, it means that either your records are wrong, or the bank's records are wrong. Follow the steps detailed until you find the mistake; when you find it, go to "Correcting the mistake," below:

1. **Subtract the Bank Statement Balance from the Corrected Month Ending Balance so you know exactly what the difference is.** If there's only one mistake, knowing this number will help you recognize it. If there's more than one mistake, knowing this number will ensure that you don't stop looking too soon. Remember that until the whole difference is explained, you have to keep looking for mistakes.

2. **Check your copying**. In preparing the Reconciliation form, you may have copied numbers from the Adjustments to Month Ending Balance form incorrectly. That's the easiest mistake to detect, so first, check to see that you copied those numbers correctly.

3. **Check your math.** You probably did a lot of adding and subtracting to get those numbers, so check your math. (This will be a lot quicker if you kept an adding machine tape or other clear written record of your calculations.)

4. **Check each uncredited deposit and withdrawal you listed**. Go back through the account journal and, using the date on the Adjustments to Month Ending Balance form, find each unposted deposit and withdrawal you listed and check to make sure you copied it correctly onto the form. Make a light pencil mark on the form next to each item after you've made sure it's right so you don't miss any.

   Next, go through the account journal and make sure that every uncredited deposit and undebited withdrawal has been listed on the Adjustments to Month Ending Balance form. Since you marked every entry in the account journal that you found on the bank statement, this should be easy. Go back at least two months; you may have missed an old check that was never deposited.

5. **Compare the bank statement to the account journal and make sure that you have correctly marked all the items that had been credited.** You may have incorrectly marked off as credited an entry in the account journal that wasn't on the bank statement. Go through the bank statement item by item, and in the account journal put a clear additional mark next to every entry that matches the bank statement. When you're done, make sure that every item for the month you're reconciling has two marks: the one you put when you first prepared the Account Journal Balance form, and the one you just put next to every item you verified.

6. **Get last month's Adjustments to Month Ending Balance form and check the unposted deposits and withdrawals against the current month's bank statement.** Since you successfully reconciled your client trust bank account last month, any mistake must have happened in this month's records. Take out last month's Adjustments to Month Ending Balance form and compare the list of uncredited deposits and undebited withdrawals to this month's bank statement. With a light pencil mark, check off all the items in last month's list of unposted transactions that show up on this month's bank statement. Any that aren't checked off are still unposted; therefore, they should be listed on this month's Adjustments to Month Ending Balance form. Make sure they are.

7. **Call in a bookkeeper.** You have now gone through all of the steps necessary to check your own records. The mistake is in there, but the chances are that you aren't going to find it. It's also possible that the difference between the reconciled balance and the bank statement balance is caused by something you can't find this way. Don't waste any more of your valuable time hunting; call in a professional.

Correcting the mistake. If the mistake is on the bank statement, write a note on the bank statement that clearly explains what the mistake is, then contact your banker and tell them to correct their records. Then go back to Form Three, put a line through the Bank Statement Balance (making sure that the original number is still legible) and write in the corrected Bank Statement Balance, which should be exactly the same as the Corrected Month Ending Balance, above it.

If the mistake is in your records, correct it in the account journal and appropriate client ledgers using the same kind of mistake correction entries we described. Like all mistake correction entries, these must be entered twice in both the account journal and the client ledger for the client on whose behalf you deposited or paid out the money; once above the "Corrected Month Ending Balance" line, and once after the latest entry.

After you correct the mistake in your client ledger and account journal, record it on Form Two under "Mistake Correction Entries" and change the "Total Mistake Correction Entries" on Form Two. Then go back to Form One, write in the new "Total Mistake Correction Entries" and new "Adjusted Month Ending Account Journal Balance." Then go to Form Three, write in the new "Adjusted Month Ending Balance," the new "Corrected Month Ending Balance" and the new "Reconciled Total." If you make so many corrections that the numbers are getting hard to read, rewrite the form.

APPENDIX 6: STATE BAR FORMAL OPINION NO. 2005-169

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).[1/] Attorney arranges for overdraft protection for the CTA by linking it to the office business account.

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

[1/] 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).

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.[2/] 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.[3/] 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,[4/] or by an inadvertent bank computer or accounting error.[5/]

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[6/] or as a result of a contract with the depositor for extensions of credit or for the linking of accounts.[7/]

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 Professional Conduct[8/] strictly limits the funds belonging to an attorney that may be deposited into a CTA to (1) funds reasonably sufficient to cover bank charge[9/] and (2) undifferentiated funds belonging in part to a client and in part to the attorney.[10/] The California Supreme

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[2/] California Commercial Code section 4401, subdivision (a).

[3/] *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."

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

[5/] 12 C.F.R. § 225.52(c)(1).

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

[7/] *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").

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

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

[10/] 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."

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.[11/]

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."[12/] 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,[13/] and does not permit the attorney to use the client's funds.[14/] 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.[15/]

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.[16/] 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.[17/]

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.[18/] 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

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[11/] *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.

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

[13/] 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].)

[14/] 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.

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

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

[17/] *Guzzetta v. State Bar*, supra, 43 Cal.3d at p. 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.]"

[18/] *Guzzetta v. State Bar*, supra, 43 Cal.3d at p. 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.]"

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.[19/]

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."[20/] That obligation is nondelegable.[21/] "[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."[22/] 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.[23/] There were indeed mistakes and errors, but they were attributable to Bank and not to Attorney.[24/]

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[25/] - depositing personal funds into a CTA to remedy an overdraft does not constitute impermissible commingling[26/] - 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

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[19/] "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.

[20/] *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").

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

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

[23/] 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.

[24/] 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.

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

[26/] *Guzzetta v. State Bar*, supra, 43 Cal.3d at pages 978-979.

necessary to prevent its recurrence.[27/] 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.[28/]

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."[29/]

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 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.[30/] 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.[31/]

This opinion is issued by the Standing Committee on Professional Responsibility and Conduct of the State Bar of California. It is

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[27/] 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].

[28/] See *Waysman v. State Bar*, supra 41 Cal.3d at p. 458.

[29/] 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]).

[30/] 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).

[31/] 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.

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.

APPENDIX 6: STATE BAR FORMAL OPINION NO. 2006-171

THE STATE BAR OF CALIFORNIA STANDING COMMITTEE ON PROFESSIONAL RESPONSIBILITY AND CONDUCT

FORMAL OPINION NO. 2006-171

ISSUES

Is an attorney who has withdrawn a fee from a client trust account in compliance with rule 4-100(A)(2), ethically obligated to return any of the withdrawn funds to the client trust account when the client later disputes the fee?

DIGEST

Once an attorney has withdrawn a fee from a client trust account in compliance with rule 4-100(A)(2), those funds cease to have trust account status. As such, there is no obligation to return to the trust account amounts that are later disputed by the client.

AUTHORITIES INTERPRETED

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

STATEMENT OF FACTS

Attorney represents Client in a litigation matter that Client has brought against Adversary. A written fee agreement between Attorney and Client states that Attorney will be paid a contingent fee equal to a percentage of Client's "net recovery" in the matter, if any. Consistent with the State Bar's Sample Written Fee Agreement Form for a contingency fee agreement, Client's "net recovery" is defined as the total of all amounts received by settlement or judgment less certain scheduled costs and disbursements. Under the terms of the fee agreement, Attorney is entitled to 25% of Client's net recovery if the matter is resolved prior to the filing of a lawsuit, and one-third (33 1/3%) of Client's net recovery if the matter is resolved at any time thereafter. The agreement complies with California Business and Professions Code section 6147 in all respects, and includes a valid charging lien, and statesing that Attorney is entitled to take his fee from the Client's recovery, whether by judgment, award or settlement.

The case settles after the filing of the lawsuit but before the commencement of trial. Client executes and delivers a settlement agreement with Adversary pursuant to which Adversary agrees to pay Client $100,000. Upon execution and delivery of the settlement agreement, Adversary sends Attorney a check for $100,000 payable jointly to Attorney and Client. As required by rule 4-100(B)(1), Rules of Professional Conduct of the State Bar of California,[1/] Attorney notifies the Client of receipt of the funds, and pursuant to rule 4-100(B)(3) Attorney provides Client a written accounting setting forth the following proposed distribution:

1. Total settlement amount of $100,000;

2. Itemized list of costs and disbursements in the aggregate amount of $7,000;

3. Amount to be paid to Attorney as his fee - one-third of the net recovery of $93,000 or $31,000; and

4. Net amount to be paid to Client - the remaining balance of $62,000.

Client comes to Attorney's office, goes over the accounting with Attorney, endorses the settlement check and signs off on the accounting approving the proposed distribution. As required by rule 4-100(A), Attorney deposits the $100,000 settlement check in Attorney's Client Trust Account ("CTA"). Promptly upon confirming that the $100,000 check has cleared, and reasonably

[1/] All rule references are to the Rules of Professional Conduct of the State Bar of California.

believing the representation concluded and the fee "fixed" within the meaning of rule 4-100(A)(2), Attorney writes two checks out of the CTA as follows: a check to Client in the amount of $62,000 and a check payable to Attorney's general account in the amount of $38,000 as reimbursement of $7,000 in costs and payment of $31,000 in fees. Pursuant to Client's instructions, Attorney immediately mails the $62,000 check to Client. Attorney also immediately deposits the $38,000 check into Attorney's general account. A week later, Attorney receives a telephone call from Client who tells Attorney that the $31,000 fee is too high for the amount of work actually performed and that Attorney should send Client a check for an additional $10,000.

DISCUSSION

1. Trust Account Status

Rule 4-100(A) states that "[a]ll funds received or held for the benefit of clients by a member or law firm, including advances for costs and expenses, shall be deposited in one or more identifiable bank accounts labeled "Trust Account," "Client's Funds Account" or words of similar import...." Money that an attorney holds "for the benefit of clients" includes:

1. Money that belongs to a client;

2. Money in which the attorney and client have a joint interest;

3. Money in which a client and a third party have a joint interest; and

4. Money that doesn't belong to a client, but which counsel is nevertheless holding as part of the subject representation.[2/]

Such funds ("trust account funds," or funds having "trust account status") are subject to various requirements regarding disbursement, payment of interest, record keeping and the like as set forth in rule 4-100 and authorities interpreting it. Principal among these restrictions is a flat prohibition on the commingling of trust account funds and an attorney's personal or office funds. In fact, regarding withdrawal of trust account funds for payment of fees, rule 4-100(A)(2) states that any portion of trust account funds that belong to counsel "must be withdrawn at the earliest reasonable time after [his or her] interest in that portion becomes fixed," unless the attorney's portion is disputed by the client for any reason. In such event, rule 4-100(A)(2) further instructs that "the disputed portion shall not be withdrawn until the dispute is finally resolved."

However, rule 4-100 is silent regarding the situation where a fee properly withdrawn from a CTA is later disputed. In that regard, we believe that the inquiry is whether funds properly withdrawn from a CTA under rule 4-100(A)(2) and later disputed by the client retain or regain its trust account status once the dispute is communicated to the attorney. Based on a plain reading of the rule we answer this question in the negative. Attorney, in the situation presented, neither "received" nor "holds" the withdrawn funds for the benefit of the client. Quite the contrary, at the moment of withdrawal, the withdrawn funds are Attorney's personal property by operation of rule 4-100(A)(2). As such, Attorney is both obligated to withdraw the funds from the CTA and free to do with those funds as she or he pleases. At the moment of withdrawal, none of the indicia of trust account status are present: the withdrawn funds do not belong to the client, are not subject to a joint interest of attorney and client, are not subject to a joint interest of the client and any third party, and are not being held by the Attorney as part of the subject representation.

Likewise, the fact that Attorney has withdrawn the fee from a CTA (as opposed to having received it by way of the client's personal check or by accepting cash from the client) is analytically irrelevant. There is no authority in the text of rule 4-100 or elsewhere to suggest that funds with trust account status,

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[2/] The State Bar of California, *Handbook on Client Trust Accounting for California Attorneys* (2003) at pg. 13. [*Publisher's Note:* Information that appears on page 13 of the *Handbook on Client Trust Accounting for California Attorneys* (2003), now appears on page 15 of the *Handbook on Client Trust Accounting for California Attorneys* (2014).]

properly "fixed" and withdrawn under rule 4-100(A)(2), regain trust account status simply because the client later disputes the fee. Such a conclusion would also create a host of problems for the practical administration of a law office, if, for example, the withdrawn funds were used to pay staff salaries or bona fide office expenses, or, if the withdrawal happens in one tax year while the client's challenge occurs in the next.

As such, absent trust account status, the withdrawn funds are analytically equivalent to money paid by client to Attorney for charged fees by any other means. The fact that the client later expresses remorse, regret or other dissatisfaction with the amount of Attorney's fee is a matter of contract to be resolved by an analysis of the engagement agreement and the respective performance of the parties.

2. Misappropriation Distinguished

It is worth repeating that the Statement of Facts presupposes a proper withdrawal of the fee. We are mindful of the substantial authority relating to the misappropriation of trust account funds.[3/] In that regard, we note simply that funds misappropriated from a CTA, or withdrawn before an attorney's fee becomes "fixed" within the scope of rule 4-100(B)(2), are funds in which the client has a whole or part ownership interest.[4/] As such, misappropriated funds are ones that have never lost their trust account status and remain subject to rule 4-100 in all respects.

CONCLUSION

Funds properly withdrawn from a CTA under rule 4-100(A)(2) and later disputed by the client neither retain nor regain their trust account status, and therefore do not need to be re-deposited into the attorney's CTA. Based on a plain reading of rule 4-100, we believe that such funds bear none of the indicia of trust account status at the moment of withdrawal, i.e., the withdrawn funds do not belong to the client, are not subject to a joint interest of attorney and client, are not subject to a joint interest of the client and any third party, and are not being held by the Attorney as part of the subject representation. As such, absent trust account status, the withdrawn funds are analytically equivalent to money paid by Client to Attorney for charged fees by any other means. The fact that Client later expresses remorse, regret or other dissatisfaction with the amount of Attorney's fee is a matter of contract to be resolved by an analysis of the engagement agreement and the respective performance of the parties.

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.

[3/] See, e.g., *Sternlieb v. State Bar* (1990) 52 Cal.3d 317, 328 [276 Cal.Rptr. 346]; *Bates v. State Bar* (1990) 51 Cal.3d 1056 [275 Cal.Rptr. 381]; *Walker v. State Bar* (1989) 49 Cal.3d 1107 [264 Cal.Rptr. 825]; and *Garlow v. State Bar* (1988) 44 Cal.3d 689 [244 Cal.Rptr. 452]; (failure to restore misappropriated funds warrants discipline).

[4/] Misappropriation of client trust funds may occur without an intent to commit a conversion of client funds. (See: *McKnight v. State Bar* (1991) 53 Cal.3d 1025 [281 Cal. Rptr. 766]; *Giovanazzi v. State Bar* (1980) 28 Cal.3d 465 [169 Cal. Rptr. 581]; *In the Matter of Doran* (Rev. Dept. 1998) 3 Cal. State Bar Ct. Rptr. 871; and *In the Matter of Bleecker* (Rev. Dept. 1990) 1 Cal. State Bar Ct. Rptr. 113.) Readers are cautioned that a lawyer has been disciplined for failing to hold funds in a CTA where a withdrawal of funds was based upon a belief that the disbursement was proper, at the time of the disbursement, but that belief was subsequently discovered to be erroneous. (See I*n the Matter of Respondent E* (Rev. Dept. 1991) 1 Cal. State Bar Ct. Rptr. 716.)

APPENDIX 6: STATE BAR FORMAL OPINION NO. 2007-172

THE STATE BAR OF CALIFORNIA STANDING COMMITTEE ON PROFESSIONAL RESPONSIBILITY AND CONDUCT

FORMAL OPINION NO. 2007-172

ISSUES

1. May an attorney ethically accept payment of earned fees from a client by credit card?

2. May an attorney ethically accept payment of fees not yet earned from a client by credit card?

3. May an attorney ethically accept payment of advances for costs and expenses from a client by credit card?

DIGEST

1. An attorney may ethically accept payment of earned fees from a client by credit card. In doing so, however, the attorney must discharge his or her duty of confidentiality.

2. Likewise, an attorney may ethically accept a deposit for fees not yet earned from a client by credit card, but must discharge his or her duty of confidentiality.

3. By contrast, an attorney may not ethically accept a deposit for advances for costs and expenses from a client by credit card because the attorney must deposit such advances into a client trust account and cannot do so initially because they are paid through an account that is subject to invasion.

AUTHORITIES INTERPRETED

Rules 1-320, 3-100, 3-700, 4-100, and 4-200 of the Rules of Professional Conduct of the State Bar of California.

Business and Professions Code section 6068.

STATEMENT OF FACTS

Attorney desires to accept payments and deposits from her clients by credit card for (1) earned fees, (2) fees not yet earned, and (3) advances for costs and expenses. Attorney intends to absorb the service charge debited by the credit card issuer, which would accordingly result in reducing the amount netted.

DISCUSSION

1. An Attorney May Ethically Accept Payment of Earned Fees by Credit Card.

The first question is whether an attorney may ethically accept payment of earned fees from a client by credit card.[1/]

By way of background, a typical transaction involving a credit card issued by a bank operates as follows: "Issuing banks are members of [various] . . . not-for-profit associations of member banks that operate a worldwide communication system for financial transfers using credit cards. Issuing banks issue credit cards to consumers, enabling those consumers to make credit-card purchases at participating businesses. To

[1/] It should be noted that "earned fees" include fees paid pursuant to a "classic 'retainer fee' arrangement. A retainer is a sum of money paid by a client to secure an attorney's availability over a given period of time. Thus, such a fee is earned by the attorney when paid since the attorney is entitled to the money regardless of whether he [or she] actually performs any services for the client." (*Baranowski v. State Bar* (1979) 24 Cal.3d 153, 164, fn. 4.)

accept credit cards, businesses must open an account with a merchant bank. Merchant banks, like issuing banks, are members of [the same not-for-profit associations], but merchant banks have accounts with businesses, not consumers. Once a business is electronically connected with a merchant bank, it can accept a consumer's credit card by processing the credit card through a point-of-sale terminal provided to it by the merchant bank. If the merchant bank approves the sale, it immediately credits the business for the amount of the consumer's purchase. The merchant bank then transmits the information regarding the sale to [the not-for-profit association in question], who in turn forward[s] the information to the bank that issued the card to the consumer who made the purchase. If the issuing bank approves the sale, it notifies [the not-for-profit association] and then pays the merchant bank at the end of the business day. The issuing bank carries the debt until the cardholder pays the bill."[2/] From all that appears, credit card issuers deposit funds on use of a credit card into the merchant account established for that purpose at the merchant bank; the merchant bank may invade the funds via chargebacks, that is, the imposition of debits, in the event that the credit card holder disputes the charge. Whether and, if so, under what conditions a merchant account might be rendered *not* subject to invasion is unknown to the Committee. But to the extent that a merchant account *is* subject to invasion, it is not, and cannot be deemed, a client trust account.[3/]

More than 25 years ago, in California State Bar Formal Opn. No. 1980-53, the Committee opined that an attorney may ethically charge interest on past due receivables from a client, provided that the client gives his or her informed consent in advance. In the course of its analysis, the Committee stated: "The Commitee [sic] on Ethics and Professional Responsibility of the American Bar Association initially concluded that use of credit cards for payment of legal fees was unprofessional because it was 'wrong' to put professional services in the same category as 'sales of merchandise and sales of nonprofessional services,' especially when all credit card publicity was directed to such sales. (ABA Committee on Ethics and Prof. Responsibility, informal opn. No. 1120 (1969).) The Committee reiterated that this conclusion applied even when the law firm agreed not to display promotional material and where collection of accounts by the banks was without recourse. (See ABA Committee on Ethics and Prof. Responsibility, informal opn. No. 1176 (1971).) [¶] However, upon adoption of the Code of Professional Responsibility by virtually all fifty states, the American Bar Association Committee on Ethics and Professional Responsibility overruled the latter two decisions and approved use of credit cards subject to [various] conditions for services actually rendered." (Cal. State Bar Formal Opn. No. 1980-53.)

In California State Bar Formal Opn. No. 1980-53, the Committee did not resolve the question whether an attorney may ethically accept payment of earned fees from a client by credit card.

The Committee is now of the opinion that the question should be answered in the affirmative. An attorney may ethically accept payment of earned fees by check or cash. By parity, an attorney may do the same by credit card. To be sure, a generation ago, the "use of credit cards for payment of legal fees" was deemed "unprofessional." (ABA Committee on Ethics and Prof. Responsibility, Informal

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[2/] *United States v. Ismoila* (5th Cir. 1996) 100 F.3d 380, 385-386. The law governing credit card transactions is largely based on individual contracts between credit card issuers, credit card holders, and others, and not on general statutory provisions. (See Maggs, *Regulating Electronic Commerce* (2002) 50 Am. J. Comp. L. 665, 678 ["Private contracts rather than legislative enactments establish most of the rights and duties of cardholders, card issuers, and merchants."].) As a result, the specifics of credit card transactions vary greatly the one from the other.

[3/] See *F.T.C. v. Overseas Unlimited Agency, Inc.* (9th Cir. 1989) 873 F.2d 1233, 1233-1234. By parity, to the extent that a merchant account is *not* subject to invasion, it may be a client trust account.

Opn. No. 1120 (1969).) But for many years, that has not been the case.[4/]

Although the Committee is of the opinion that an attorney may ethically accept payment of earned fees from a client by credit card, in doing so, the attorney must nevertheless be careful to comply with various ethical obligations.

For example, an attorney must discharge his or her duty of confidentiality to clients under Business and Professions Code section 6068, subdivision (e), and under rule 3-100 of the Rules of Professional Conduct of the State Bar of California.[5/] Credit card issuers require a description on the credit card charge slip of the goods or services provided. In furnishing such a description, the attorney may not disclose confidential information without the client's informed consent.[6/] To that end, the description should be general in nature, such as "for professional services rendered."

By contrast, an attorney does not implicate his or her duty not to charge the client an unconscionable fee in violation of rule 4-200 simply by accepting payment of earned fees from a client by credit card. To be sure, by accepting such payment, the attorney allows the client to subject him- or herself to interest and late charges imposed by the credit card issuer. There are many credit card issuers; each may set its own interest rates and late charges separately from the rest, and in addition, each may set interest rates and late charges separately for various classes of holders.[7/] If the attorney were attempting to subject the client to interest and late charges, the attorney would be ethically obligated to obtain the client's informed consent and comply with applicable law broadly defined,[8/] including the prohibition of rule 4-200 against unconscionability. But the attorney is subject to no such obligation if the client chooses to subject him- or herself to interest and late charges imposed by the credit card issuer. The attorney may choose to advise the client that the client's credit card issuer sets interest rates and late charges and that the client would do well to determine such rates and charges before using the credit card, but is not ethically obligated to do so.

Likewise, an attorney does not implicate his or her duty not to share fees with a non-attorney in violation of rule 1-320 simply by accepting payment of earned fees from a client by credit card and thereby making a payment to the credit card issuer through a debit of a service charge. The purpose of rule 1-320 is "to protect the integrity of the attorney-client relationship, to prevent control over the services rendered by attorneys from being shifted to lay persons, and to ensure that the best interests of the client remain paramount."[9/] A service-charge debit, which amounts to the attorney's payment for a convenient method of receiving funds owed the attorney, does not frustrate the purpose of rule 1-320, and for that reason does not come within the rule's proscription.

[4/] See, e.g., State Bar Policy Statement on Use of Credit Cards for Payment of Legal Services and Expenses (Feb. 11, 1975); San Diego County Bar Association Formal Opn. Nos. 1972-10, 1972-13, & 1974-6; Bar Association of San Francisco Formal Opn. No. 1970-1; cf. ABA Formal Opn. No. 00-419 (2000) (withdrawing Informal Opn. Nos. 1120 and 1176); Colorado Bar Association Formal Ethics Opn. No. 99 (1997); Mass. Bar. Association Ethics Opn. 78-11 (1978); New Mexico State Bar Association Advisory Opn. 2000-1 (2000); North Carolina State Bar Formal Ethics Opn. 97-9 (1998).

[5/] Unless otherwise indicated, all rule references are to the Rules of Professional Conduct of the State of California.

[6/] Cf. *Hooser v. Superior Court* (2000) 84 Cal.App.4th 997, 1005 (stating that even the fact that an attorney is representing a client may fall within the protection of the attorney-client privilege).

[7/] See footnote 1, *ante*.

[8/] California State Bar Formal Opn. No. 1980-53; see Bar Association of San Francisco Formal Opn. No. 1970-1; Los Angeles County Bar Association Formal Opn. Nos. 370 (1978), 374 (1978) & 499 (1999); San Diego County Bar Association Formal Opn. No. 1983-1; cf. ABA Formal Opn. No. 388 (1974).

[9/] Los Angeles County Bar Association Formal Opn. No. 510 (2003); accord, *Gafcon, Inc. v. Ponsor & Associates* (2002) 98 Cal.App.4th 1388, 1418; see, e.g., *Gassman v. State Bar* (1976) 18 Cal.3d 125, 132.

It follows that Attorney in the Statement of Facts may ethically accept payment of earned fees from her clients by credit card. Attorney may also ethically absorb the service charge debited by the credit card issuer. But as noted above, Attorney would have to be careful to discharge her duty of confidentiality to her clients.

2. An Attorney May Ethically Accept a Deposit for Fees Not Yet Earned by Credit Card.

The second question is whether an attorney may ethically accept a deposit for fees not yet earned from a client by credit card.

At the outset, the Committee is of the opinion that just as the former hostility to the "unprofessional" use of credit cards for payment of legal fees does not justify a conclusion that an attorney may not ethically accept payment of earned fees from a client by credit card, neither does it justify such a conclusion with respect to accepting a deposit for fees not yet earned—so long as the deposit, as will be explained, does not include advances for costs and expenses.

Under rule 4-100, an attorney is subject to an ethical obligation to "deposit[]" "[a]ll funds received or held for the benefit of clients" into a client trust account. (Rule 4-100(A).) This ethical obligation is not qualified, conditional, or avoidable, and therefore does not allow the attorney, with or without the client's consent, to take such actions as depositing client funds initially into an account other than a client trust account and subsequently transferring them into a client trust account if or when reasonable or practicable. The attorney is subject to a concomitant ethical obligation, which is "both personal and nondelegable," to "take reasonable care to protect client funds" deposited into a client trust account.[10/]

Under rule 4-100, as it has been construed by the courts, an attorney is ethically permitted, but not required, to deposit fees not yet earned into a client trust account.[11/]

[10/] California State Bar Formal Opn. No. 2005-169.

[11/] *Securities and Exchange Commission v. Interlink Data Network of Los Angeles, Inc.* (9th Cir. 1996) 77 F.3d 1201, 1205-1207 (semble); see generally Vapnek et al., *Cal. Practice Guide: Professional Responsibility* (The Rutter Group 2006) §§ 9:107-9.108.

In *Baranowski v. State Bar*, *supra*, 24 Cal.3d at page 164, the Supreme Court left open the question whether the substantially identical predecessor of rule 4-100 required an attorney to deposit payment of fees not yet earned—so-called advance fees—into a client trust account. The Supreme Court has not given an answer in any subsequent decision. But it has nevertheless effectively articulated its views. "Although expressly not deciding the advance fee issue in *Baranowski*, . . . the Cal. Supreme Court did approve current [Rule] 4-100 as proposed by the State Bar. In recommending the current Rule, the State Bar specifically noted that it did not intend the Rule to require advance fees to be deposited in a client's trust account: [¶] 'The concept of including in paragraph (4-100)(A) a requirement that "advances for fees" be placed in the client trust account was considered but rejected because it is believed that such a provision is unworkable in light of the realities of the practice of law.' [*In the Matter of the Proposed Amendments to the Rules of Professional Conduct*, California Supreme Court Case No. Bar Misc. 5626, at 'Request that the Supreme Court of California Approve Amendments to the Rules of Professional Conduct of the State Bar of California, and Memorandum and Supporting Documents in Explanation,' at Memorandum, Dec. 1987, p. 42 (parentheses added)]" (Vapnek et al., *Cal. Practice Guide: Professional Responsibility* (The Rutter Group 2006) § 9:107.2.) In approving rule 4-100 as recommended, the Supreme Court allowed an attorney not to deposit advance fees into a client trust account. Since that time, it has "declined to approve a proposed rule amendment requiring advance fees to be paid into client trust accounts." (*Ibid*.; see "Request for Approval of Amendments to Rules 3-700 and 4-100 of the Rules of Professional Conduct," No. S029270 (May 11, 1995).)

It may be noted that, in *T & R Foods, Inc. v. Rose* (1996) 47 Cal.App.4th Supp. 1, 7, the Appellate Department of the Superior Court construed rule 4-100 to require an attorney to deposit payment of fees not yet earned into a client trust account, but did so without consideration of the Supreme Court's action, and inaction, with respect to rule 4-100 following *Baranowski*.

If an attorney were required to deposit fees not yet earned into a client trust account, the attorney would not be permitted to accept such a deposit from a client by credit card *to the extent that the credit card issuer deposits funds into a merchant account that is subject to invasion*. That is because to that extent: (1) the credit card issuer deposits the funds into a merchant account; (2) the attorney, however, must deposit the funds into a client trust account; (3) the attorney must take reasonable care to protect the funds deposited into a client trust account; and (4) before the attorney can assert control over the funds, the merchant bank may invade the funds in the merchant account, thereby putting the funds at risk beyond the attorney's protection. As a consequence, the attorney could not immediately deposit such fees into a client trust account or take care to protect them, but would have to cede control to the merchant bank, at least initially.[12/]

But because an attorney need not deposit fees not yet earned into a client trust account, the attorney may accept such a deposit by credit card, resulting in a deposit into a merchant account.

The fact that an attorney need not deposit fees not yet earned into a client trust account does not mean that, solely as a matter of prudence, the attorney should decline to do so. Upon termination of employment, an attorney is subject to an ethical obligation under rule 3-700(D)(2) to "[p]romptly refund any part of a fee paid in advance that has not been earned." Failure to deposit such fees into a client trust account risks their unavailability at the time, if any, at which they must be refunded. After they are deposited in a merchant account by a credit card issuer, such fees may ethically be transferred into a client trust account. By means of such a transfer, an attorney would ensure their availability should he or she be required to refund any or all of them to the client. Although not ethically required to make a transfer of this sort, the attorney may consider doing so solely as a matter of prudence.

It follows that Attorney in the Statement of Facts may ethically accept a deposit for fees not yet earned from her clients by credit card. As stated above, she may also ethically absorb the service charge debited by the credit card issuer. But again, as stated above, she would have to be careful to discharge her duty of confidentiality to her clients.

3. An Attorney May Not Ethically Accept A Deposit for Advances for Costs and Expenses by Credit Card.

The third question is whether an attorney may ethically accept a deposit for advances for costs and expenses from a client by credit card.

Under rule 4-100, among the "funds received or held for the benefit of clients" that an attorney is ethically obligated to deposit into a client trust account are "advances for costs and expenses." (Rule 4-100(A).)

Because an attorney must deposit advances for costs and expenses from a client into a client trust account, he or she may not ethically accept such a deposit by credit card, as explained above, *to the extent that the credit card issuer deposits funds into a merchant account that is subject to invasion*. It follows that the attorney may not ethically accept any payment or deposit from a client by credit card, whether for earned fees or fees not yet earned, if the payment or deposit includes advances for costs and expenses.[13/] The attorney, however, *may* accept reimbursement

[12/] Of course, even though funds deposited into a client trust account are not subject to invasion as are funds deposited into a merchant account, they may suffer a similar adverse effect in their amount or availability as a result of acts or omissions by the attorney—who might, for example, erroneously issue a check against insufficient funds in the client trust account—or by others—including the bank, which might, for instance, mispost a check intended for deposit into the client trust account. The possibility of such adverse effects, however, does not release the attorney from the ethical obligation to deposit funds into a client trust account. Neither does that possibility allow the attorney to deposit funds into an account other than a client trust account if he or she is ethically obligated to deposit them into a client trust account.

[13/] See footnote 12, *ante*.

by credit card for costs and expenses already paid. By definition, reimbursement of costs and expenses already paid does not constitute an "advance" of such costs and expenses, and consequently it need not—and indeed may not—be deposited into a client trust account.

It follows that Attorney in the Statement of Facts may not ethically accept a deposit for advances for costs and expenses from her clients by credit card. She may, however, accept reimbursement by credit card of costs and expenses already paid.

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.

CONCLUSION

Funds properly withdrawn from a CTA under rule 4-100(A)(2) and later disputed by the client neither retain nor regain their trust account status, and therefore do not need to be re-deposited into the attorney's CTA. Based on a plain reading of rule 4-100, we believe that such funds bear none of the indicia of trust account status at the moment of withdrawal, i.e., the withdrawn funds do not belong to the client, are not subject to a joint interest of attorney and client, are not subject to a joint interest of the client and any third party, and are not being held by the Attorney as part of the subject representation. As such, absent trust account status, the withdrawn funds are analytically equivalent to money paid by Client to Attorney for charged fees by any other means. The fact that Client later expresses remorse, regret or other dissatisfaction with the amount of Attorney's fee is a matter of contract to be resolved by an analysis of the engagement agreement and the respective performance of the parties.

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THE STATE BAR OF CALIFORNIA STANDING COMMITTEE ON PROFESSIONAL RESPONSIBILITY AND CONDUCT

FORMAL OPINION NO. 2008-175

ISSUES

What are a successor attorney's ethical obligations when her client in a contingency fee matter instructs her not to notify prior counsel, who has a valid lien against the recovery, of the fact or the amount of a settlement?

DIGEST

1. When a client instructs successor counsel not to disclose a settlement to a prior counsel with a valid lien, successor counsel must advise the client of the adverse ramifications of concealing the settlement, including a potential claim by prior counsel against the client. Should the client persist, successor counsel must nevertheless disclose the settlement to prior counsel.

2. A lawyer may not reveal confidential client information except with the consent of the client or as authorized or required by the State Bar Act, the Rules of Professional Conduct, or other law. Disclosure is required by law to fulfill the attorney's fiduciary duties to prior counsel. Disclosure is also authorized by law to enable both attorneys to protect their right to recover fees.

3. While the successor attorney is both obligated and permitted to disclose the fact and the amount of the settlement to the prior attorney, successor counsel may not disclose anything more to the prior attorney, without the client's consent, including the client's demand that the fact and the amount of the settlement be concealed from the prior attorney.

4. Once prior counsel is notified, both attorneys must remain mindful of their duty of confidentiality to the client in attempting to reach an accord, amicably or through legal process, on the proper allocation of fees. Moreover, should the attorneys resort to legal process to resolve any dispute over allocation of the fee, successor counsel should provide the client with notice and an opportunity to participate. In any legal proceeding, the presiding officer will be in a position to limit the disclosure of confidential information appropriately.

AUTHORITIES INTERPRETED

Rules 3-100, 3-110, 3-500, 4-100, and 5-200 of the Rules of Professional Conduct of the State Bar of California.

Business and Professions Code sections 6068, subdivisions (d), (e), and (m), 6106, and 6147.

STATEMENT OF FACTS

Client retains Attorney A to represent him in a legal malpractice claim against Former Attorney. A written fee agreement between Client and Attorney A states that Attorney A will be paid a contingency fee of 25% of Client's recovery against Former Attorney if settled before the filing of a complaint, and 1/3 of any recovery obtained after suit is filed. Attorney A's fee agreement complies in all respects with Business and Professions Code section 6147 and includes a valid and enforceable charging lien.[1/]

Attorney A undertakes an extensive review of the underlying matter in which Former Attorney represented Client. Upon

[1/] A charging lien is an attorney's lien for compensation against the fund or judgment the attorney recovers for the client. *Fletcher v. Davis* (2004) 33 Cal.4th 61, 66 [14 Cal.Rptr.3d 58].

completion of that review, Attorney A advises Client of problems with the case against Former Attorney, and asks Client to authorize him to settle for $150,000 before filing suit. Client, who believes his case against Former Attorney is worth at least $1 million, rejects Attorney A's advice, promptly terminates Attorney A, and demands the return of his file. Attorney A complies.

Thereafter, and unbeknownst to Attorney A, Client retains Attorney B to pursue the malpractice case against Former Attorney. Attorney B's fee agreement with Client also calls for Attorney B to receive 1/3 of any recovery after suit is filed and includes a valid charging lien. In the course of one of their early consultations, Client tells Attorney B about Attorney A's prior involvement in the matter.

After months of intensive litigation, Client settles his malpractice case against Former Attorney for $150,000. Attorney A is not aware that the legal malpractice case has been filed so he has not filed a notice of lien. On the defense side, no one is aware of Attorney A's lien as he was discharged prior to suit being filed. As a result, the settlement check is made payable solely to Client and Attorney B.

Having learned of the terms of the original fee agreement between Client and Attorney A, Attorney B presents Client with an accounting showing $100,000 payable to Client and $50,000 in attorney's fees to be divided between Attorney B and Attorney A.

Client endorses the $150,000 check for deposit into Attorney B's Client Trust Account ("CTA"), demands the immediate payment of the $100,000 due him, and signs the accounting after adding the following handwritten statement: "I authorize the payment of $50,000 in attorneys' fees to Attorney B. I prohibit payment of any fee to Attorney A, and I prohibit Attorney B to disclose the fact or the amount of the settlement to Attorney A."

The Committee has been asked to provide guidance to Attorney B on her ethical responsibilities in this situation.

DISCUSSION

1. Attorney B's Ethical Responsibilities to Client Regarding Disbursement of the Undisputed Funds Held in Attorney B's CTA

Pursuant to Rule of Professional Conduct 4-100(B)(4),[2/] an attorney must promptly pay, as requested by the client, any funds in the attorney's possession which the client is entitled to receive. Settlement funds in an attorney's CTA are funds in an attorney's possession.

Both Attorney A and Attorney B contracted to receive 1/3 of the recovery after suit was filed. As a result, the total due to both attorneys is limited to 1/3 of the recovery with the amount owing to Attorney A to be determined based upon a *quantum meruit* analysis. (*Fracasse v. Brent* (1972) 6 Cal.3d 785, 791 [100 Cal.Rptr. 385]; *Spires v. American Bus Lines* (1984) 158 Cal.App.3d 211, 215-216 [204 Cal.Rptr. 531]; *Cazares v. Saenz* (1989) 208 Cal.App.3d 279, 288-289 [256 Cal.Rptr. 209].) As there is no dispute as to Client's right to receive $100,000, representing 2/3 of the recovery, Attorney B is ethically obligated to release $100,000 to Client promptly.

The ethical dilemma concerns how Attorney B should handle the remaining $50,000 in her CTA. We begin by analyzing Attorney B's ethical obligations to Attorney A. We then examine Attorney B's ethical obligations to Client regarding those funds.

2. Attorney B's Ethical Responsibilities to Attorney A Regarding Disbursement of the Disputed Funds Held in Attorney B's CTA

In *Johnstone v. State Bar* (1966) 64 Cal.2d 153, 155-156 [49 Cal.Rptr. 97], the Supreme Court held:

> "When an attorney receives money on behalf of a third party who is not his client, he nevertheless is a fiduciary as to such third party. Thus the funds in his possession are impressed with a

[2/] Unless otherwise indicated, all further references to rules are to the Rules of Professional Conduct of the State Bar of California.

trust, and his conversion of such funds is a breach of the trust."

Applying this principle, the Supreme Court disciplined a lawyer for failing to honor the lien of a workers' compensation carrier after settling a personal injury action, concluding that the attorney was guilty of commingling funds as well as dishonesty and moral turpitude in violation of Business and Professions Code section 6106. (*Id.* at p. 156.) It is also settled that an attorney who settles a personal injury action and holds funds in her or his CTA is under a fiduciary duty to the medical lienholders. (See, e.g., *In the Matter of Nunez* (Review Dept. 1992) 2 Cal. State Bar Ct. Rptr. 196, 200.)

Although rule 4-100(B)(4) speaks only in terms of the duty to promptly pay or deliver funds held in trust to the client, the Supreme Court and State Bar Court have both repeatedly confirmed that the rule applies to third parties, such as lienholders, as well as to clients. (See, *Guzzetta v. State Bar* (1987) 43 Cal.3d 962, 979 [239 Cal.Rptr. 675] [Rule 8-101, the predecessor to rule 4-100, requiring an attorney to maintain complete records, to render appropriate accounts, and to promptly pay or deliver funds held in trust to a client, applies to third parties as well as clients]; *In the Matter of Mapps* (Review Dept. 1990) 1 Cal. State Bar Ct. Rptr. 1, 10 [even though rule 8-101 refers only to meeting obligations to pay clients and not to meeting obligations to pay third parties, the attorney nonetheless violated the rule by failing to honor a medical lien]; *Baca v. State Bar* (1990) 52 Cal.3d 294, 299 (fn. 3) [276 Cal.Rptr. 169] [because attorney liens are payable out of the client's recovery, an attorney who does not honor valid liens payable to another attorney is not only guilty of conversion and acts of moral turpitude, but also violates rule 4-100]; *In the Matter of Respondent F* (Review Dept. 1992) 2 Cal. State Bar Ct. Rptr. 17, 19 ["Where an attorney assumes the responsibility to disburse funds as agreed by the parties in an action, the attorney owes an obligation to the party who is not the attorney's client to ensure compliance with the terms of the agreement."]; and *In the Matter of Respondent P* (Review Dept. 1993) 2 Cal. State Bar Ct. Rptr. 622, 633 [Former rule 8-101(B)(4) applied not only to the attorney's obligations to clients, but also to the attorney's obligations to pay third parties out of funds held in trust, including the obligation to pay medical lienholders].)

In California State Bar Formal Opinion No. 1988-101, this Committee addressed the ethical issue posed when a client instructs an attorney not to disburse funds to satisfy a health care provider's lien, but instead to disburse the funds to the client. In that opinion, the Committee cited the comment to ABA Model Rule 1.15 to the effect that a lawyer may have a duty under applicable law to protect third-party claims against funds in the attorney's possession from "wrongful interference by the client" and that lawyer's duties with respect to trust funds held in the lawyer's possession "go beyond those limited solely to the client." The Committee then concluded that this commentary was "consistent with California law" that an attorney who holds funds on behalf of a non-client third party "is a fiduciary as to that party and is governed by the California Rules of Professional Conduct, even when not acting as an attorney per se in the transaction." (Citations omitted.) In that regard, the Committee specifically noted that without the consent of both parties who had an interest in the funds (the client and the medical lienholder), the attorney was not authorized to hold the funds in his or her client trust account. The Committee therefore opined that the safest course was for the attorney to interplead the funds so that ownership could be determined by a court.

Consistently, the State Bar Court Review Department ("Review Department") has stated that in order to meet the fiduciary duty owed to a third party for whom the lawyer holds funds in trust, the attorney has a duty to communicate with the lienholder as to the subject of the fiduciary obligation. (*In the Matter of Nunez* (Review Dept. 1992) 2 Cal. State Bar Ct. Rptr. 196, 200-201.) (See also Bus. &. Prof. Code § 6068, subd.(m) and rule 3-500.)

Additionally, in *In Matter of Riley* (Review Dept. 1994) 3 Cal. State Bar Ct. Rptr. 91, 111-115, the Review Department found that: (a) an attorney's duty to the lienholder is not limited to withholding funds for the benefit of the

lienholder, but also includes *a duty to notify the lienholder if a judgment, award or settlement is pending;* (b) failure to pay a third-party lien promptly, without justification, constitutes a violation of rule 4-100(B)(4); (c) where a dispute over a lien cannot be resolved through negotiations, the attorney must either pay the lien in full or take appropriate steps to resolve the dispute promptly, leaving the disputed funds in trust during the pendency of the dispute; and (d) a client's wrongful act, in that case deception, does not justify a failure to promptly resolve a lienholder's claim.

In *Virtanen v. O'Connell* (2006) 140 Cal.App.4th 688 [44 Cal.Rptr.3d 702], the court of appeal addressed a conflict arising from an attorney's duty to a client, on the one hand, and to a client's adversary, on the other hand, when the attorney took on the fiduciary obligations of an escrow holder to both parties.

> "The fact that [the attorney] owed duties to his clients does not excuse him for violating his duty to [the third party] . . . [I]f [the attorney] believed that no joint resolution of the conflicting demands was forthcoming, he could have filed an interpleader action. He had a statutorily sanctioned method for dealing with conflicting demands, even when one of those demands came from his own clients. He just chose not to take advantage of that method." (*Id.* at pp. 701-702.)

The attorney in *Virtanen* also claimed that he should not be held liable for breach of his duty to the third party for whom he held funds in trust because he could not defend against the third party's claim without breaching his duty not to reveal confidential communications with his client. The *Virtanen* court rejected that argument, noting that no disclosure of confidential information was necessary for the attorney to address whether he (a) owed a fiduciary duty to the third party with regard to property held in trust, and (b) breached that duty. (*Id*. at p. 702.)

A valid attorney's charging lien in a contingency fee case survives discharge of the lawyer by the client, to the extent of the reasonable value of services rendered prior to discharge. (*Weiss v. Marcus* (1975) 51 Cal.App.3d 590, 598 [124 Cal.Rptr. 297].) Thus, a discharged attorney who obtains a lien in a contingency fee case may maintain claims for money had and received, conversion, constructive trust, and intentional interference with a contractual relationship against the client's successor attorney who fails to honor the charging lien. (*Id.*)

We also note that it is the duty of an attorney to employ, for those matters confided to him or her, those "means only as are consistent with truth." (Bus. & Prof. Code, § 6068, subd. (d); rule 5-200(A).) Thus, an attorney in a fiduciary or confidential relationship with a third party not only must refrain from affirmative misrepresentations, but also has a duty not to conceal material facts. (Civ. Code § 1710, subd. (3); *Goodman v. Kennedy* (1976) 18 Cal.3d 335, 346-347 [134 Cal.Rptr. 375]; *Hobart v. Hobart Estate Co.* (1945) 26 Cal.2d 412 [159 P.2d 958].)

3. Attorney B's Ethical Responsibilities to Client Regarding the Disputed Funds

A. Duty to Advise Client of Reasonably Foreseeable Adverse Consequences of Concealing the Settlement from Attorney A

In the *Matter of Riley*, *supra*, the Review Department held that an attorney who fails to ensure the payment of medical liens breaches ethical duties owed to the lienholders. In that decision, the Review Department also held that the attorney breaches an ethical duty to the client to perform services competently (rule 3-110) by exposing the client to the lienholder's collection efforts. Similarly, in Opinion 1989-1 of the Legal Ethics Committee of the Bar Association of San Francisco, that Committee concluded (citing *Weiss v. Marcus, supra*) that a successor attorney should alert the client to the risk of being sued by a discharged attorney should the discharged attorney's lien not be satisfied. (*Id.* at p.2.)

In *Nichols v. Keller* (1993) 15 Cal.App.4th 1672, 1683-1684 [19 Cal.Rptr.2d 601], the court stated:

> "One of an attorney's basic functions is to advise . . . Not only should an attorney furnish advice when requested, but he or she should also volunteer opinions when necessary to further the client's objectives. The attorney need not advise and caution of every possible alternative, but only of those that may result in adverse consequences if not considered."

The holding in *Nichols* is consistent with the attorney's ethical duty to keep a client reasonably informed about significant developments relating to the representation. (Bus. & Prof. Code, § 6068, subd. (m); rule 3-500.) Based on these authorities, as well as the authorities discussed with respect to Issue No. 2 above, we conclude that Attorney B has a duty to inform Client of the risks to Client inherent in the Client's demand to conceal the settlement from Attorney A.

Attorney B should therefore attempt to persuade Client to permit disclosure, explaining the applicable legal and ethical principles, the policies underlying those principles, and the potential adverse ramifications to Client and Attorney B of pursuing the proposed course of conduct. In most cases, a client will heed the attorney's advice and grant permission for the settlement to be disclosed to the discharged attorney, thus resolving the matter. We next examine the ethical considerations at play in the situation where Client, having received Attorney B's advice, nevertheless persists in his demand that Attorney B conceal the settlement from Attorney A.

3. Is Disclosure of the Receipt of Settlement Proceeds to Attorney A, Who Has A Valid Lien Against Those Proceeds, Authorized or Required by the State Bar Act, the Rules of Professional Conduct or Other Law?

Based upon the authorities cited in our discussion of Issue No. 2 above, we conclude that disclosure to Attorney A of the fact and amount of the settlement between Client and Former Attorney is both authorized and required under applicable ethical rules and case law.

First, Attorney B is required by law to take affirmative steps to permit Attorney A to assert any claims he has pursuant to his valid lien against the $50,000 attorney's fee recovery. In this regard, Attorney B is required by law to disclose the fact and the amount of the settlement to Attorney A because, as a fiduciary to Attorney A, Attorney B has an affirmative duty to notify the lienholder of the settlement (*In the Matter of Riley, supra*, 3 Cal. State Bar Ct. Rptr. at pp. 111-115; *In the Matter of Nunez, supra*, 2 Cal. State Bar Ct. Rptr. at pp. 200-201) as well as an affirmative duty not to conceal material facts from Attorney A (Bus. & Prof. Code, § 6068, subd. (d); Civ. Code, § 1710, subd. 3; rule 5-200(A); *Johnstone v. State Bar, supra*, 64 Cal. 2d at pp. 155-156; *Goodman v. Kennedy, supra*, 18 Cal. 3d at pp. 346-347).

Second, disclosure of the fact and amount of settlement to Attorney A is authorized by law. Attorney B cannot unilaterally decide what portion of the $50,000 total fee can be disbursed from trust to pay her own fee. Thus, without disclosure to Attorney A, Attorney B has no basis upon which to calculate and to remove from trust the portion of the fee she earned, leaving both attorneys uncompensated. In that regard, we note that under California law attorneys are expressly released from the duty to maintain client secrets in order to obtain compensation for services rendered. (See, e.g., *Carlson, Collins, Gordon & Bold v. Banducci, supra*, 257 Cal.App.2d at pp. 227-228.)

While Attorney B is both authorized and required to disclose the fact and the amount of the settlement, there is no justification for her to disclose to Attorney A, without Client's consent, privileged confidential information such as the Client's demand that the fact and the amount of the settlement be concealed from Attorney A. Thus, Attorney B must keep that statement confidential even though it could potentially work to Attorney B's advantage in negotiating with Attorney A over his *quantum meruit* claim.

Once Attorney A has been notified of the settlement, both attorneys must remain mindful of their duty of confidentiality to Client in attempting to reach an accord, amicably or through legal process, on the proper allocation of fees. Moreover, should the attorneys resort to legal process to resolve

any dispute over allocation of the fee, Attorney B should provide Client with notice and an opportunity to participate should Client so desire. In any legal proceeding, the presiding officer will be in a position to limit the disclosure of confidential information to the greatest extent possible.

In reaching our conclusion we have undertaken a thorough review of the Committee's prior ethics opinions. Those opinions support our conclusion here as they adopt approaches designed to ensure the attorney is not pressured by a client to engage in conduct that violates the State Bar Act, the rules, or other law in order to preserve client confidential information. (See, e.g., Cal. State Bar Formal Opn. No. 1981-58 [attorneys who found their client's decision not to disclose defects in a building to the tenants morally repugnant (a) owed no fiduciary duty to the tenant/adversaries, and (b) could avoid any perceived risk of complicity in the client's wrongdoing by withdrawing from the representation]; Cal. State Bar Formal Opn. No. 1983-74 (attorney who learns of client's testimonial perjury is ethically obligated to pursue remedial action promptly, and absent a correction by the client must (a) move to withdraw, and (b) if withdrawal is not permitted is precluded from relying upon the perjured testimony];[3/] Cal. State Bar Formal Opn. No. 1986-87 [attorney concerned that a failure to respond to a court's inquiry regarding a client's prior criminal record could mislead the court could (a) advise the court that his/her silence was not intended as an affirmation of no prior record, and (b) deflect further questions to the prosecutor]; Cal. State Bar Formal Opn. No. 1988-96 [attorney who originally represented both mother and child, learns while representing child only that mother previously misappropriated trust funds (a) may not disclose the information to the court, (b) would ordinarily be required to disclose the information to the child, but (c) had to withdraw from representing the child because the child was not capable of comprehending the disclosure]; Cal. State Bar Formal Opn. No. 1995-139 (in the unique setting of the tripartite relationship in which the attorney has limited duties to the insurer and primary duties to the insured, the attorney may not disclose client confidential information to the insurer, but must withdraw to avoid perpetuating a fraud against the insurer].)

Finally, and of particular significance here, we note that in California State Bar Formal Opinion No. 1996-146, the Committee stated that: (1) a lawyer may not disclose a client's fraudulent conduct; but (2) the lawyer also may not participate in or further such conduct, citing Business and Professions Code section 6068, subdivision (d). (See also rule 5-200(D).) The Committee further found that when a client is engaging in an ongoing fraud, the attorney "must be careful to avoid furthering the fraud in any way." Finally, the Committee concluded that where the fraud persists, the attorney must either limit the scope of the representation to matters that do not involve participation in or furthering of the fraud, or withdraw.

Of course, in our hypothetical, unlike the hypotheticals in most of the Committee's earlier opinions, withdrawal does not prevent Attorney B from participating in or furthering the client's fraud as: (1) there is no representation from which to withdraw as Attorney B has completed her handling of Client's case; and (2) even though Attorney B is no longer attorney of record for Client, she continues to further the fraud by holding attorneys' fees subject to Attorney A's lien in her client trust account without so advising Attorney A or providing him with an accounting.

Applying these authorities to the facts of our hypothetical, it follows that Attorney B had both a legal and an ethical duty to notify Attorney A of the pendency of the lawsuit against Former Attorney once it was filed and now has both a legal and an ethical duty to notify Attorney A of the receipt of funds subject to Attorney A's valid lien so that he

[3/] In *People v. Johnson* (1998) 62 Cal.App.4th 608 [72 Cal.Rptr.2d 805], the court concluded that if withdrawal is not permitted in this circumstance (a) the attorney should advise the court, in camera, that it would be unethical to put the client on the stand, (b) the court should then allow the client to provide narrative testimony, and (c) the attorney could make no reference to the perjured testimony in closing argument.

may assert his rights to the funds Attorney B is holding in trust for his benefit.

While Attorney B must account to Attorney A for the funds held in trust, she may not disclose to Attorney A, Client's confidential communications regarding Client's desire to conceal all information about the settlement. (Cal. State Bar Formal Opn. No. 1996-146.)

CONCLUSION

Funds properly withdrawn from a CTA under A lawyer may not reveal client confidential information except with the consent of the client or as authorized or required by the State Bar Act, the rules, or other law.

An attorney cannot follow a client's direction not to pay a lienholder from settlement proceeds because to do so would be a breach of the attorney's fiduciary duty to the lienholder. The fact that the client directs the attorney not to tell the lienholder about the settlement does not change the result. The attorney is ethically prohibited from concealing from the lienholder funds she holds in trust. The attorney has a duty to render an accounting to the lienholder.

We conclude that disclosure of the fact and amount of the settlement to Attorney A is required by law. More specifically, Attorney B cannot conceal the settlement from Attorney A because in doing so she would be in breach of her own independent ethical duties: (1) not to conceal material information she has a duty to disclose as a fiduciary to Attorney A; (2) to render an accounting disclosing the fact and the amount of the settlement to Attorney A, in his capacity as a lienholder; (3) to pay Attorney A's lien or to take appropriate steps to resolve any dispute over Attorney A's lien promptly so long as the disputed fees remain in her client trust account. (See Bus. & Prof. Code, §§ 6068, subd. (d), 6106, rules 4-100 and 5-200, and other law, including the case law and Review Department authorities cited above.)

We also conclude that disclosure is *authorized* by law because Attorney B cannot unilaterally determine what portion of the $50,000 held in trust belongs to Attorney A and what portion belongs to her, and thus disclosure of the settlement represents the only way that Attorney A and Attorney B can protect their respective rights to recover unpaid fees.

Finally, Attorney B cannot disclose the privileged confidential information disclosed to her by Client to the effect that Client sought to defraud Attorney A by concealing the settlement from him

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.

APPENDIX 6: STATE BAR FORMAL OPINION NO. 2009-177

THE STATE BAR OF CALIFORNIA STANDING COMMITTEE ON PROFESSIONAL RESPONSIBILITY AND CONDUCT

FORMAL OPINION NO. 2009-177

ISSUES

In what manner may an attorney maintain her rights in a charging lien when her former client demands that the attorney endorse a settlement check jointly payable to the client and his current and former attorneys without violating the requirement of rule 4-100 of the California Rules of Professional Conduct that the attorney promptly pay or deliver funds to which the client is entitled?

DIGEST

When responding to a request to endorse a settlement check made jointly payable to a client and his or her current and former attorneys where the former attorney has asserted a valid lien on the settlement proceeds, the former attorney must take prompt steps to find a reasonable method or methods of delivering the undisputed portion of the proceeds to which the client is entitled. The former attorney does not violate rule 4-100 by refusing to use a method that would extinguish the attorney's charging lien, but has a duty to consult governing legal authorities and make a reasonable determination of the amount to which he or she is entitled under the circumstances. If the client does not agree to proposed reasonable methods for delivering the undisputed portion or does not agree with the former attorney's determination of the amount of the proceeds that undisputedly belong to the client, the attorney must promptly seek resolution of the fee dispute through arbitration or judicial determination, as appropriate.

AUTHORITIES INTERPRETED

Rules 3-700 and 4-100 of the Rules of Professional Conduct of the State Bar of California.

Commercial Code section 3110(d).

Civil Code section 2913.

STATEMENT OF FACTS

Client retained Attorney A to represent Client in a personal injury action against a construction company. The retainer agreement between Attorney A and Client provided for a contingency fee of 35 percent of any recovery obtained by Client through judgment, settlement or other recovery and specifically included a legally valid charging lien in favor of Attorney A upon the proceeds of Client's prospective recovery. Upon receiving the signed retainer agreement, Attorney A commenced work on the matter. After two years of active litigation, Client discharged Attorney A and retained Attorney B. Attorney A filed a notice of lien in the litigation. The litigation was resolved several months later by settlement when the opposing party sent Attorney B a check made out to "Client, Attorney A, and Attorney B." Client demanded that Attorney A endorse the check. Fearing that endorsing the check in that manner would forfeit certain legal rights she had pursuant to the lien, Attorney A declined to endorse the check under those conditions, but did offer to take prompt and reasonable steps so that the portion of the settlement check that undisputedly belonged to Client, as determined in accordance with applicable governing authorities concerning the reasonable value of the services Attorney A had rendered at the time of discharge, could be immediately released to Client. Client refused to agree to the steps Attorney A proposed. Consequently, Attorney A initiated an independent action to determine the amount of fees to which she is entitled and provided timely and proper notice to Client of his right to arbitration.

DISCUSSION

1. Rule 4-100 of the California Rules of Professional Conduct / Obligates an Attorney To Promptly Pay or Deliver Any Funds or Property the Client Is Entitled To Receive.

The dilemma faced by Attorney A is created when the settlement check is jointly made payable to Client, Attorney A and Attorney B. Attorney A does not want to endorse the check if it will forfeit her lien, but, alternatively, does not want to take any action that improperly delays Client's receipt of the settlement proceeds to which Client is entitled.

Rule 4-100(B)(4) provides that an attorney shall "[p]romptly pay or deliver, as requested by the client, any funds, securities, or other properties in the possession of the member which the client is entitled to receive." Thus, where an attorney has asserted no lien rights over the settlement proceeds and no valid rights to any portion of such proceeds exist in favor of any third parties, the attorney must promptly pay or deliver all the settlement proceeds to the client. (*In the Matter of Kaplan* (Rev. Dept. 1993) 2 Cal. State Bar Ct. Rptr. 509 [attorney who was not protecting lien rights violated rule 4-100 by delaying and impeding his own endorsement of the client's settlement draft].) Where the attorney is asserting lien rights against less than all of the settlement proceeds, the attorney nonetheless has a duty to promptly take reasonable steps to pay or deliver to the client the portion of the proceeds that are not in dispute. (Rule 4-100(B)(4); *In the Matter of Feldsott* (Rev. Dept. 1997) 3 Cal. State Bar Ct. Rptr. 754 [an attorney with a charging lien did not violate rule 4-100 where attorney offered reasonable options to release the undisputed portion of the proceeds to the client, but client refused]; *Fletcher v. Davis* (2004) 33 Cal.4th 61, 69 [14 Cal.Rptr.3d 58] [stating that, when the proceeds have been deposited into a client trust account, "the attorney may withhold an amount equivalent to the disputed portion"].)

Under current California law, if Attorney A were to endorse the settlement check as Client has requested, Attorney A would forfeit her legal rights under the charging lien. (*Feldsott, supra*, 3 Cal. State Bar Ct. Rptr. at pp. 757-758, citing Civ. Code, § 2913.)[1/] Section 2913 of the California Civil Code provides that "[t]he voluntary restoration of property to its owner by the holder of a lien thereon dependent upon possession extinguishes the lien as to such property, unless otherwise agreed by the parties, and extinguishes it, notwithstanding any such agreement, as to creditors of the owner and persons, subsequently acquiring a title to the property, or a lien thereon, in good faith, and for value." In circumstances like those presented by the fact pattern considered herein, namely, when the settlement check is made payable jointly to the Client, Attorney A (the former attorney) and Attorney B (the successor attorney), the former attorney may refuse to endorse the check in order to preserve the charging lien until a resolution is reached. (*Fletcher v. Davis, supra*, 33 Cal.4th at p. 69; *Feldsott, supra*, 3 Cal. State Bar Ct. Rptr. at p. 758.) Because rule 4-100 requires prompt payment or delivery of only those funds "which the client is *entitled to receive*" (emphasis added), the Committee is of the opinion that the attorney need not endorse the check because the check includes certain funds that in some part are owed to the attorney and to which the client is not entitled. "The unfortunate effect . . . is that '[t]he settlement proceeds will thus be tied up until everyone involved can agree on how the money should be divided . . . or until one or the other brings an independent action for declaratory relief.'" (*Carroll v. Interstate Brands Corp.* (2002) 99 Cal.App.4th 1168, 1176 [121 Cal.Rptr.2d 532], internal citation omitted.)[2/]

As a result, the attorney must fulfill his or her duty to promptly find other reasonable methods of delivering the undisputed portion to the client. Indeed, where the client requests

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[1/] In accordance with section 3110(d) of the California Commercial Code, "[i]f an instrument is payable to two or more persons not alternatively, it is payable to all of them and may be negotiated, discharged, or enforced only by all of them."

[2/] An independent action is often required because the court in the underlying action may lack jurisdiction to determine the validity of the charging lien where the attorney is neither a party nor an intervenor in the action. (*Carroll, supra*, 99 Cal.App.4th at pp. 1176-1177.)

that the attorney disburse the funds to the client and the attorney claims an interest in such funds, "the attorney violates rule 4-100(B)(4) if he or she does not promptly take appropriate, substantive steps to resolve the dispute in order to disburse the funds." (*In the Matter of Kroff* (Rev. Dept. 1998) 3 Cal. State Bar Ct. Rptr. 838.) Attorney A may not simply sit back and wait for such a resolution. Where the attorney and client cannot reach agreement on disbursement of the funds, and the client has requested payment or delivery of those funds, the attorney has *an affirmative obligation* to seek arbitration or a judicial determination without delay in order to comply with rule 4-100(B)(4). (L.A. County Bar Assn. Formal Opn. No. 438.)

Rule 4-100 does not suggest how an attorney may comply with the rule when there is a lien dispute as to a portion of the proceeds from the underlying matter. In *Feldsott*, *supra*, the attorney who was asserting his lien acted reasonably in offering to place the disputed funds in his trust account or in a separate blocked account requiring signatures from the attorney and the client, among other reasonable alternatives, and both of those alternatives were held not to be in violation of the rule. (3 Cal. State Bar Ct. Rptr. at p. 757.) Alternatively, in *Kroff*, *supra*, the attorney participated in a fee arbitration requested by the clients and promptly abided by the arbitration award. The Review Department of the State Bar Court also determined that such conduct did not violate rule 4-100(B)(4). (3 Cal. State Bar Ct. Rptr. at p. 854.)

The Committee is of the opinion that agreeing to place the settlement proceeds in the successor counsel's account, pursuant to an express agreement to hold the disputed portion of the funds in trust for former counsel pending resolution of the lien dispute, also would be reasonable where the successor counsel has notice of a valid lien in favor of the former attorney and the dispute over the amount to which the former attorney is entitled. The successor counsel assumes a fiduciary obligation to the former attorney when agreeing to hold such funds, and cannot favor his or her client by converting the property to the client's use pending resolution of the competing claims to the funds. (See: *Virtanen v. O'Connell* (2006) 140 Cal.App.4th 688, 693, 702-703 [44 Cal.Rptr.3d 702]; Cal. State Bar Formal Opn. No. 2008-175; but see *In the Matter of Respondent H* (Rev. Dept. 1992) 2 Cal. State Bar Ct. Rptr. 234 [rejecting argument that attorney owes fiduciary duties to hold in trust funds that third parties claim to have an interest in, when no evidence exists that the funds are subject to a proper lien by the prior attorney].)

2. An Attorney May Decline To Promptly Pay or Deliver Only That Portion of the Settlement Proceeds to Which the Attorney Is Reasonably Entitled under a Valid Charging Lien.

The Review Department of the State Bar Court determined in *Feldsott*, *supra*, that, in a situation such as the one between Attorney A and Client, the former attorney "continue[s] to owe [the client] a fiduciary duty of utmost good faith and fair dealing with respect to, at least, the subject matter of [the attorney's] prior representation of [the client], including [the attorney's] express lien for his attorney's fees." (3 Cal. State Bar Ct. Rptr. at p. 757; see also Rest.3d, Law Governing Lawyers § 33.) In that case, the State Bar Court reviewed a determination that the respondent attorney did not violate rule 4-100(B)(4) by refusing to endorse a draft settlement check jointly payable to the client, the respondent attorney and the client's current attorney when the funds were subject to a charging lien in favor of the respondent attorney and the client continued to dispute the attorney's right to the fees. The client had signed a retainer agreement with the respondent attorney to represent him in litigation for a flat fee of $2,000 and 25 percent of any gross recovery. The agreement also granted the attorney a lien on any recovery in favor of the client. Due to attorney-client relationship problems and unspecified ethical issues, the attorney moved for a continuance of the trial date and permission to withdraw as counsel shortly before trial. Although the motions were denied initially, the client obtained substitution counsel at a later date after an unrelated four-month continuance was ordered. The respondent attorney filed a notice of lien in the action for $5,000, which was substantially less than the attorney would have been able to charge if the engagement

had been based on an hourly arrangement only. The underlying lawsuit was settled and the opposing party issued a check payable to the client and both his former and current attorneys, which the client and his new attorney asked the respondent attorney to endorse. The respondent attorney offered to accept $2,000, and when the client refused, the attorney offered multiple suggestions for dealing with the funds or participating in binding arbitration. Although the client agreed to the suggestion of placing $5,000 of the settlement funds in a blocked account, he did not follow through on the agreement and, instead, filed a malpractice action against the attorney. The attorney filed a cross-complaint to recover the reasonable value of his services. In response to the State Bar's contention that the attorney was required by rule 4-100(B)(4) to endorse the check and could only pursue fees through his cross-complaint, the Review Department disagreed:

> Respondent affirmatively demonstrated good faith by asserting and perfecting his lien only on $5,000 out of the full $26,500 settlement proceeds. His duty of good faith and fair dealing did not require that he abandon his lawfully perfected lien by endorsing the $26,500 settlement draft when it was under [the client's] control. Under Civil Code section 2913, had respondent endorsed the settlement draft when it was under [the client's] control as the State Bar contends he was required to do, respondent's lien would have been immediately extinguished as to [the client's] creditors and thereafter subject to extinguishment if [the client] spent the money.

(3 Cal. State Bar Ct. Rptr. at pp. 757-758.)

Consequently, Attorney A must make a reasonable determination of the amount of fees to which she is entitled under the lien and promptly offer reasonable suggestions for the disbursement or release of any and all remaining funds belonging to Client. An attorney's duty under rule 4-100(B)(4) to pay or deliver any funds which the former client is entitled to receive is not extinguished by the termination of the attorney-client relationship.[3/]

A single rule does not exist to determine in all cases the fees to which an attorney is entitled, if any, after withdrawing or being discharged from a matter. (See Vapnek, et al., "California Practice Guide: Professional Responsibility" (TRG 2006), section 5:1030, et seq.) The amount of the funds in dispute in such situations may turn on several factors, including: whether the attorney fully or partially performed the agreement with the client (see, e.g., *Fracasse v. Brent* (1972) 6 Cal.3d 784, 790-791 [100 Cal.Rptr. 385]); whether the attorney was discharged or withdrew, whether withdrawal was justifiable or not (see, e.g., *Hensel v. Cohen* (1984) 155 Cal.App.3d 563, 568-569 [202 Cal.Rptr. 85]); and other factors, such as the reasonable value of the services, taking into account the hourly or contingent nature of the fee agreement (see, e.g., *Cazares v. Saenz* (1989) 208 Cal.App.3d 279, 287 [256 Cal.Rptr. 209]), and the availability of contractual pre-judgment interest (Civ. Code, § 3287; see, e.g., *Fitzsimmons v. Jackson* (Bankr. 9th Cir. 1985) 51 B.R. 600, 612-613).

In addition, the legal procedures for establishing the amount the attorney is entitled to receive and for enforcing the lien vary depending on the circumstances. In many instances where a contractual lien for attorneys' fees is contested, an independent action by the attorney against the client must be used to establish the amount of the lien and to enforce it. (See, e.g., *Valenta v. Regents of the Univ. of Cal.* (1991) 231 Cal.App.3d 1465, 1470 [282 Cal.Rptr. 812]; *Hansen v. Jacobsen* (1986) 186 Cal.App.3d 350, 356 [230 Cal.Rptr. 580]; *Bandy v. Mount Diablo Unified School Dist.* (1976) 56 Cal.App.3d 230, 234-235 [126 Cal.Rptr. 890].) In certain types of actions, the court hearing the underlying matter has jurisdiction to determine the validity of the claim and a reasonable amount to be paid to the attorneys. (See, e.g., *Padilla v. McClellan* (2001) 93 Cal.App.4th 1100, 1104-1106 [113 Cal.Rptr.2d

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[3/] Termination of the attorney-client relationship itself triggers the duty to promptly return unearned fees that are paid in advance under rule 3-700(D).

680]; *Curtis v. Fagan* (2000) 82 Cal.App.4th 270, 278-280 [98 Cal.Rptr.2d 84].) In some circumstances, mandatory fee arbitration may be pursued (Bus. & Prof. Code, § 6200 et seq.; State Bar Rules of Proc. for Fee Arbitrations, Rules 1.0 et seq.; see *Hansen*, *supra*, 186 Cal.App.3d at p. 356, fn. 5 ["The discharged attorney is not required to comply with the procedures set out in Business and Professions Code sections 6200-6206 for fee arbitration until his or her independent action to establish the amount of the fees is commenced."]), or the retainer agreement with the client may provide for an alternative form of arbitration (see: *Schatz v. Allen Matkins Leck Gamble & Mallory LLP* (2009) 45 Cal.4th 557, 571-575 [87 Cal.Rptr. 3d 700, 710-714]; *Aguilar v. Lerner* (2004) 32 Cal.4th 974, 987-990 [12 Cal.Rptr.3d 287]).

In light of the different considerations applicable in any individual case, the attorney has a duty to consult governing legal authorities and make a reasonable determination of the amount to which he or she is entitled under the circumstances.[4/] If the client does not agree with that determination, the attorney should seek prompt resolution through arbitration or judicial determination, as appropriate.

Here, it is the Committee's opinion that Attorney A did not violate rule 4-100(B)(4) by refusing to endorse the check because her charging lien was valid and she reasonably believed she was entitled to a portion of the proceeds, she suggested reasonable alternatives to enable Client to promptly receive those funds to which he was undisputedly entitled, and she initiated proceedings to promptly resolve the issue while providing timely and proper notice to Client of his right to arbitration. While attempting to informally resolve the matter with Client, Attorney A also made a reasonable determination concerning the amount of funds she would be entitled to receive under the circumstances so that the undisputed amount could be delivered to Client.

CONCLUSION

When a former attorney has valid lien rights in settlement proceeds, that attorney will not violate rule 4-100 by taking prompt and reasonable action to resolve a dispute with his or her former client over the amount which the attorney is entitled to receive, and any undisputed amount to which the client is entitled is promptly disbursed through a method upon which the attorney and client agree. In light of the different considerations applicable in any individual case, the attorney has a duty to consult governing legal authorities and make a reasonable determination of the amount to which he or she is entitled under the circumstances. If no agreement can be reached with the former client on these issues, the attorney has an affirmative obligation to promptly seek resolution of the dispute through arbitration or judicial determination, as appropriate. However, the attorney is not required to endorse a settlement check that is jointly payable to him or her, the client and successor counsel pending resolution of the dispute, because doing so would extinguish the attorney's charging lien under current California law.

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.

[4/] In *Feldsott*, *supra*, the State Bar Court used the term "fiduciary duty" to describe the duty of utmost good faith and fair dealing in the context of dealing with an express lien for attorneys' fees. Although the duty of good faith and fair dealing is typically understood as contractual in nature, attorneys should be aware that the State Bar Court may view such a duty as arising from the fiduciary relationship.

THE STATE BAR OF CALIFORNIA STANDING COMMITTEE ON PROFESSIONAL RESPONSIBILITY AND CONDUCT

FORMAL OPINION NO. 2013-187

ISSUES

Who is entitled to the refund of remaining advanced fees at the end of a case where fees were paid by a non-client?

DIGEST

Where a third-party pays the attorney's fees for a client and there are funds remaining after the representation is concluded, the attorney must return the balance to the payor, rather than to the client, unless the agreements with the client and the payor specify otherwise.

AUTHORITIES INTERPRETED

Rules 3-310(F), 3-700(D)(2), and 4-100 of the Rules of Professional Conduct of the State Bar of California.[1/]

Code of Civil Procedure section 285.1.

Labor Code section 2802.

STATEMENT OF FACTS

Attorney is retained by Spouse to handle Spouse's dissolution of marriage. Spouse's Parent agrees to pay the attorney's fees on an hourly basis and the attorney's costs, and advances a sum to the lawyer for that purpose. There is no dispute that Attorney made all proper disclosures under rule 3-310(F), including "disclosure" under rule 3-310(A)(1), and Spouse consented in writing after such disclosures. Spouse's Parent also signed an agreement, covering payment arrangements and her acknowledgement of the restrictions specified in rule 3-310(F). Neither agreement addresses the disposition of any surplus funds at the end of the case. Upon termination of the representation, Attorney files a Notice of Withdrawal pursuant to Code of Civil Procedure section 285.1.[2/] Spouse insists unused sums in the trust account be disbursed to her, while Spouse's Parent asks for the money to be returned to her.[3/]

DISCUSSION

There are several common circumstances in which a third-party may pay the attorney's fees and/or costs for a party to litigation or a transaction. For example, parents may pay the attorney for fees incurred on behalf of their adult child in a domestic relations or criminal matter. Employers often pay the fees for an employee being sued, such as pursuant to Labor Code section 2802.[4/] Sometimes the

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[1/] Unless otherwise indicated, all rule references are to the Rules of Professional Conduct of the State Bar of California.

[2/] Code of Civil Procedure Section 285.1 reads: "An attorney of record for any party in any civil action or proceeding for dissolution of marriage, . . . may withdraw at any time subsequent to the time when any judgment in such action or proceeding, other than an interlocutory judgment, becomes final, and prior to service upon him of pleadings or motion papers in any proceeding then pending in said cause, by filing a notice of withdrawal."

[3/] These facts assume that fees have been appropriately earned and paid and the only issue is with regard to surplus funds.

[4/] Labor Code section 2802 requires an employer to "indemnify his or her employee for all necessary expenditures or losses incurred by the employee in direct consequence of the discharge of his or her duties, or of his or her obedience to the directions of the employer…." This requires an employer to defend or indemnify an employee who is sued by third persons for conduct in the course and scope of his employment. *Douglas v. Los Angeles*

attorney is representing both the employee and the employer. In commercial lending transactions, the borrower sometimes pays the fees of the lender's attorney.[5/] In any such case, rule 3-310(F)[6/] sets forth that the third-party must not be allowed to interfere with the client-lawyer relationship, or have access to confidential client information. Rule 3-310(F) does not answer the question of what happens to surplus funds when the case ends.

Three state bar ethics committees have opined on this question. The Maryland State Bar Committee on Ethics said in Opinion 2001-6: "absent agreement to the contrary, once the retainer check was made payable to you and deposited in your escrow account as a retainer for your handling the representation, that you were accountable to your client for those funds and not to the client's mother." They went on to say: "the only person who could demand the return of any funds would be the client." The North Carolina State Bar, in 2005 Formal Ethics Opinion 12, analyzed it this way: "The lawyer understands that the legal fees were paid by a third-party for the purpose of Client's representation. See ABA Model Rule 1.8(f). The unearned funds held in trust belong to the third-party, not the client. In the event the payor wants the funds returned, Lawyer is obliged to do so."[7/] South Carolina Formal Opinion 02-07 provides the fullest analysis of the issue. It states: "The present case may be reduced to the question of which individual is 'entitled to receive' the funds at issue – client or his brother, the third-party payor. The comments to ABA Model Rule 1.15 acknowledge that a third-party may have just claims against property in a lawyer's custody.… In addition, a lawyer must balance this duty to third parties with the duty of loyalty owed to his client." After analyzing ABA Model Rule 1.15 and its comments, the South Carolina Ethics Advisory Committee concluded: "The lawyer should retain the disputed fees in trust until the parties reach an agreement resolving the dispute or an appropriate court determines the rights of the parties."

In California, rule 4-100(B)(4) requires an attorney to "[p]romptly pay or deliver, as requested by the client, any funds . . . in the possession of the member <u>which the client is entitled to receive</u>." [Emphasis added.] This raises the question of whether the client is entitled to receive the money.

This Committee, in Cal. State Bar Formal Opn. No. 2008-175, concluded that rule 4-100(B)(4), although it refers to the duty to deliver funds to the client, also includes the duty to deliver funds to a third-party who is entitled to receive them. Rule 3-700(D)(2) requires an attorney, at the end of the matter, to "[p]romptly <u>refund</u> any part of a fee paid in advance that has not been earned." [Emphasis added.] The rules do not define "refund."

Herald-Examiner (1975) 50 Cal.App.3d 449 [123 Cal.Rptr. 683].

[5/] This opinion only addresses the situation where the paying party is not a party to the action. Also it does not address payment by an insurer, payment by a parent for a minor child, or third-party financing of matters, where the third-party is loaning money to the attorney or client, rather than paying the funds.

[6/] Rule 3-310(F) states: A member shall not accept compensation for representing a client from one other than the client unless:

> (1) There is no interference with the member's independence of professional judgment or with the client-lawyer relationship; and
>
> (2) Information relating to representation of the client is protected as required by Business and Professions Code section 6068, subdivision (e); and
>
> (3) The member obtains the client's informed written consent, provided that no disclosure or consent is required if:
>
> > (a) such nondisclosure is otherwise authorized by law; or
> >
> > (b) the member is rendering legal services on behalf of any public agency which provides legal services to other public agencies or the public.

[7/] The ABA Model Rules are not binding in California but may be used for guidance by lawyers where there is no direct California authority and the ABA Model Rules do not conflict with California policy. See *State Compensation Insurance Fund v. WPS, Inc.* (1999) 70 Cal.App.4th 644, 655-656 [82 Cal.Rptr.2d 799].

The dictionary defines it as "to return (money) in restitution, repayment, or balancing of accounts."[8/] [Emphasis added.] The concept of a refund implies that the money is returned to its source, in this case the third-party payor. We conclude that, absent a fee agreement with the payor spelling out the disposition of the surplus funds, the money should be returned to the payor.

Under our hypothetical, the client asked that the balance in the trust account be paid to her. The California Supreme Court discussed a similar issue in *Johnstone v. State* Bar (1966) 64 Cal.2d 153, 155-156 [49 Cal.Rptr. 97]. The court looked at what an attorney does when receiving funds in a settlement that are subject to a third-party lien. The court held that the attorney receiving funds holds the funds as a fiduciary for that third-party. ("When an attorney receives money on behalf of a third-party who is not his client, he nevertheless is a fiduciary as to such third-party. Thus the funds in his possession are impressed with a trust, and his conversion of such funds is a breach of the trust." (*Johnstone*, at pp. 155-156.) See also *In the Matter of Riley* (Review Dept. 1994) 3 Cal. State Bar Ct. Rptr. 91.) While both *Johnstone* and *Riley* dealt with medical liens, the issue here is similar—funds held by the lawyer belonging to a third-party. Giving the funds to the third-party complies with this fiduciary duty, but violates the express direction of the client.[9/] The lawyer is faced with a quandary. If he delivers the funds to the client, he can be held liable for a conversion. (*Johnstone*, at pp. 155-156.) If he gives the funds to the payor, he is violating the direct instructions of his client. Under the facts of our hypothetical, we conclude that the third-party payor is entitled to the funds, and therefore, the attorney has a fiduciary duty to advise the payor of the availability of the funds and to turn them over to her.[10/] Cal. State Bar Formal Opn. No. 2008-175 ("An attorney cannot follow a client's direction not to pay a lienholder from settlement proceeds because to do so would be a breach of the attorney's fiduciary duty to the lienholder."). Since the funds in the account belong to the payor, the attorney cannot give the money to the client.[11/]

The issue of who is entitled to the remaining amount can be avoided by the use of carefully drafted agreements with the paying party and the client.

CONCLUSION

When an attorney receives payment for fees from a third-party payor, any refund of excess fees at the conclusion of the case should be paid to the payor, unless the parties have contracted a different result.

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 Trustees, any persons, or tribunals charged with regulatory responsibilities, or any member of the State Bar.

[8/] See http://www.merriam-webster.com/dictionary/refund.

[9/] Cf. *Virtanen v O'Connell* (2006) 140 Cal.App.4th 688 [44 Cal.Rptr.3d 702], where lawyer held property as escrow holder and had duties both to his client and to the opposing party.

[10/] To the extent the facts are such that the payor's entitlement to the refund is less clear than under our hypothetical facts, the lawyer may interplead the funds with the court in order to allow the court to make the determination. In any event, it would not violate the lawyer's ethical duties to interplead the funds under any factual scenario in which he had a good faith basis for questioning the payor's right to the surplus funds. Cal. State Bar Formal Opn. 2008-175.

[11/] The lawyer in this situation may have to face two additional issues: (1) what happens if the client requests that the lawyer retain the money for further services after the completion of the agreed work or the payor requests the refund before the work is completed, and (2) what happens if the payor questions the refund amount? This opinion does not address these additional issues.

APPENDIX 7: "IOLTA-ELIGIBLE" FINANCIAL INSTITUTIONS UNDER CALIFORNIA BUSINESS AND PROFESSIONS CODE SECTION 6212

Under California Business & Professions Code Section 6212, the State Bar of California maintains a list of financial institutions eligible to hold IOLTA accounts, paying interest rates that are at least comparable to similar, non-IOLTA accounts. A list of these financial institutions can be found at:

http://www.calbar.ca.gov/Attorneys/Conduct-Discipline/Client-Trust-Accounting-IOLTA/Financial-Institutions/Eligible-Institutions