

**Rule 1.15 Safekeeping Funds and Property of Clients and Other Persons
(Proposed Rule Adopted by the Board on March 9, 2017)**

- (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or potentially to the lawyer or the law firm,* in which case the portion belonging to the lawyer or law firm* must be withdrawn at the earliest reasonable* time after the lawyer or law firm's interest in that portion becomes fixed.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person* disputes the lawyer or law firm's right to receive a portion of trust funds, the disputed portion shall not be withdrawn until the dispute is finally resolved.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 subparagraph (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 _____, as to what "records" shall be maintained by lawyers and law firms* in accordance with subparagraph (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 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.”) and *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.

PROPOSED RULE OF PROFESSIONAL CONDUCT 1.15
(Current Rule 4-100)
Safekeeping Funds and Property of Clients and Other Persons

EXECUTIVE SUMMARY

The Commission for the Revision of the Rules of Professional Conduct (“Commission”) has evaluated current rule 4-100 (Preserving Identity of Funds and Property of a Client) and considered ABA counterpart, Model Rule 1.15 (Safekeeping Property). The Commission also reviewed relevant California statutes, rules, and case law relating to the issues addressed by the proposed rules. The result of the Commission’s evaluation is proposed rule 1.15 (Safekeeping Property).

Rule As Issued For 90-day Public Comment

Proposed rule 1.15 amends current rule 4-100. In substance, it continues the various requirements of the current rule concerning the holding of client funds and property, including the duty to properly account for such funds and property. Proposed rule 1.15 also continues the existing authorization for the Board to adopt recordkeeping standards (proposed paragraph (e)).

The two main issues considered by the Commission in studying this rule were whether to require that: (i) fees paid in advance, including a flat fee, be held in trust until the fees have been earned; and (ii) the duties owed to a client be extended to other persons, such a statutory lienholder with a claim against funds held by the lawyer. The Commission is recommending that both changes be implemented in the proposed rule.

Fees Paid in Advance. Proposed paragraph (a) requires that fees paid in advance be held in trust similar to the current rule’s requirement on advances for costs and expenses.¹ The Commission also recommends a new paragraph (b) to address the specific issue of a lawyer’s handling of *flat* fees paid in advance, including a protocol that would permit a lawyer to hold such fees in a firm’s operating account rather than a trust account.

As originally circulated for public comment, proposed paragraph (b) provided:

- (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) 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.

¹ Proposed paragraph (a), in relevant part, revises the current rule as follows: “All funds received. . . , including advances for **fees**, costs and expenses, shall be deposited in one or more identifiable [trust accounts].”

Paragraph (b) is intended to balance competing interests: (i) the public protection afforded by a rule intended to assure that unearned fees are available for a refund to a client; and, (ii) the freedom of a lawyer and client by agreement to set the terms of a fee arrangement. The initial public draft provided no exceptions to the requirement that disclosures and client's agreement to placing funds in the lawyer's operating account be in a writing signed by the client.

Reports of insufficient funds in a client trust account are a significant concern in attorney discipline.² At the same time, comments by stakeholders to the first Commission have asserted that a requirement to hold certain fees in a client trust account would be contrary to a client's best interest and would impair a lawyer's ability to focus on a client's representation. In particular, comments from criminal defense lawyers and lawyers who represent clients against the Internal Revenue Service or Franchise Tax Board have expressed concerns that holding advance fees in a trust account creates unnecessary risks of the loss of those funds through government seizure or forfeiture.³

Paragraph (b) seeks to accommodate both of these interests by permitting a flat fee paid in advance to be held in a law firm operating account so long as the lawyer provides a mandatory disclosure to the client and obtains the client's agreement in a writing signed by the client. This permissive option is intended to be limited to a *flat* fee paid in advance rather than all fees paid in advance, in part, because commenters have expressed the view that this particular fee arrangement represents a situation where the fees are earned upon receipt and holding such fees in a client trust account would be inconsistent with the basic fiduciary obligation to segregate funds that belong to a lawyer or law firm. Similarly, paragraph (b) would not apply to a true retainer fee as defined in proposed rule 1.5(d) and (e) [current rule 3-700(D)(2)].

Although proposed paragraph (b) permits a flat fee to be held in a law firm operating account, it does not diminish a lawyer's obligation to account for the funds or to refund any amount owing to a client due to a subsequent unexpected failure of consideration. For example, a situation could arise where a lawyer is unable to complete the contemplated legal services due to accident or illness and a refund would be required in this instance despite the fact that the funds might not have been held in a trust account.

The approach proposed in paragraph (b) builds on the State Bar's prior attempts to implement rule changes in the area of advance fees. This includes a 1992 rule filing that would have amended rule 4-100 to provide that: "Unless a written fee agreement expressly provides that a fee paid in advance is earned when paid or is a true retainer (as set forth in current rule

² The 2015 State Bar Annual Discipline Report indicates that: "The most common action reported by others, accounting for approximately eighty percent of all reports each year, was actions falling under [Bus. & Prof. Code] section 6091.1, which requires financial institutions to report overdrafts from attorney trust accounts." (2015 State Bar Annual Discipline Report at p. 19.)

³ For example, in 2010 the first Commission received a comment from attorney Paul L. Gabbert stating:

In criminal securities litigation involving federal prosecutors and the Securities and Exchange Commission ("SEC") payment of attorney's fees and the relationship of that payment to restraining orders and preliminary injunctions can not only distract the attorney from the case she was hired to defend, it can eclipse the underlying case and result in the attorney having to defend herself in contempt proceedings based on how her fee was paid. Even when the attorney prevails in the litigation, this can result in the functional equivalent of a fee forfeiture because the cost of successfully defending the civil contempt action can greatly reduce or eradicate the fee paid to defend the client in the underlying criminal action. . . .¶ True retainers and other fixed fees are the only way for practitioners to avoid these pitfalls.

3-700(D)(2)), all advance fees received shall be deposited in one or more [client trust accounts].” (See October 1992 State Bar rule filing, Supreme Court Case No. S029270.) It also includes an effort in 1997 by the Committee on Professional Responsibility and Conduct (“COPRAC”) that would have required advance fees to be held in trust unless the lawyer obtained a client’s informed written authorization to deposit those funds in another account. These attempts created issues that precipitated questions and substantial adverse public comment. With respect to the 1992 proposal, the Supreme Court raised a question about an ambiguity as to the use of the term “earned when paid” and the duty to refund “unearned” fees. The 1997 proposal also engendered claims of ambiguity. The proposal was criticized, in part, for creating a new concept of “informed written authorization” that was perceived as more than written disclosure but less than informed consent. The Commission believes that proposed paragraph (b) is responsive to the concerns raised with respect to these prior, unsuccessful attempts at reform.

The Commission also considered whether proposed paragraph (b) would work together with the Commission’s non-refundable and flat fee provisions in proposed rule 1.5 (“Fees for Legal Services”) (see the executive summary of proposed rule 1.5) that include a definition of a “flat fee,” and concluded that it would. In relevant part, proposed rule 1.5 states 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.

(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 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.

Taken together, proposed rules 1.5 and 1.15 would implement enhanced public protection by: (1) prohibiting a “nonrefundable fee” except for a true retainer; (2) generally requiring that advanced fees be held in trust; and (3) providing a limited permissive option for flat fee arrangements.

Extending the Rule to Cover Other Persons. The Commission recommends adding the concept that under certain circumstances a lawyer owes duties to protect funds and property of a third person. This change is comparable to the standard in Model Rule 1.15 and to the rules adopted in some jurisdictions. Most significantly, California case law has held that a lawyer owes such duties to third persons. The Commission is concerned that current rule 4-100 is deficient to the extent that it fails to address the issue of funds and property entrusted by non-clients. By clarifying the rule, lawyer compliance would be facilitated. To explain this new addition to the rule, the Commission drafted proposed Comment [1], which provides:

[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. 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 (“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.”) and *Crooks v. State Bar* (1970) 3 Cal.3d 346, 358 (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).

This explanatory Comment is important because it alerts lawyers to the fact that case law research may be needed to ascertain the nature and extent of a duty owed to a third person.⁴ Other proposed Comments explain what is meant by the term “advances for fees” (see proposed Comment [2]) and caution that paragraph (b)’s protocol for holding a flat fee in a firm operating account does not diminish a lawyer’s duty to account for the fee or the lawyer’s burden to establish that the fee has been earned.

Revisions Following 90-Day Public Comment Period

After consideration of comments received in response to the initial 90-day public comment period, the Commission substituted the preferred spelling “labeled” for “labelled.” The Commission also added the phrase “If the flat fee exceeds \$1,000.00” in paragraph (b)(2) to limit paragraph (b)’s requirement that the disclosures and client agreement to deposit the funds in a lawyer’s operating account be in a writing signed by the client to those matters for which a flat fee exceeds \$1,000.00.

With these changes, the Board authorized an additional 45-day public comment period on the revised proposed rule.

Final Commission Action on the Proposed Rule Following 45-Day Public Comment Period

After consideration of comments received in response to the additional 45-day public comment period, the Commission made only non-substantive grammatical and punctuation revisions.

With these changes, the rule Commission voted to recommend that the Board adopt the proposed rule.

The Board adopted proposed rule 1.15 at its March 9, 2017 meeting. Board consideration of record keeping standards is anticipated to occur following approval of the rule by the Supreme Court.

⁴ In some circumstances, the duty imposed by the proposed rule may be a requirement to communicate and inform a third person concerning that person’s claim to client trust funds (see *In the Matter of Nunez* (Review Dept. 1992) 2 Cal. State Bar Ct. Rptr. 196 [lawyer believed that client’s bankruptcy would nullify a lien and failed to communicate with the lienholder concerning the lien claim]), while in other situations a lawyer might be required to withhold disbursement of funds to the lawyer’s client to protect the rights of a third person (see *In the Matter of Respondent P* (Review Dept. 1993) 2 Cal. State Bar Ct. Rptr. 622 [lawyer’s failure to honor a statutory Medi-Cal lien]).

COMMISSION REPORT AND RECOMMENDATION: RULE 1.15 [4-100]

Commission Drafting Team Information

Lead Drafter: Mark Tuft

Co-Drafters: James Ham, Raul Martinez

I. CURRENT CALIFORNIA RULE

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

- (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 labelled "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.

II. FINAL VOTES BY THE COMMISSION AND THE BOARD

Commission:

Date of Vote: January 20, 2017

Action: Recommend Board Adoption of Proposed Rule 1.15 [4-100]

Vote: 14 (yes) – 0 (no) – 0 (abstain)

Board:

Date of Vote: March 9, 2017

Action: Board Adoption of Proposed Rule 1.15 [4-100]

Vote: 11 (yes) – 0 (no) – 0 (abstain)

III. COMMISSION'S PROPOSED RULE (CLEAN)

Rule 1.15 Safekeeping Funds and Property of Clients and Other Persons

- (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 subparagraph (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 _____, as to what "records" shall be maintained by lawyers and law firms* in accordance with subparagraph (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 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.”) and *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.

IV. COMMISSION'S PROPOSED RULE (REDLINE TO CURRENT RULE 4-100)

Rule ~~4-100 Preserving Identity of~~ 1.15 Safekeeping Funds and Property of ~~a Client~~ Clients and Other Persons

(a) All funds received or held by a lawyer or law firm* for the benefit of ~~clients by a member or law firm~~ 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,” ~~“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~~

(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.

~~(A)-(c)~~ Funds belonging to the memberlawyer or the law firm* shall not be deposited ~~therein~~ or otherwise commingled ~~therewith~~ with funds held in a trust account except as follows:

- (1) Fundsfunds reasonably* sufficient to pay bank charges* ~~;~~ and
- (2) ~~In the case of~~ funds belonging in part to a client or other person* and in part presently or potentially to the memberlawyer or the law firm*, in which case the portion belonging to the memberlawyer or law firm* must be withdrawn at the earliest reasonable* time after the member'slawyer or law firm's interest in that portion becomes fixed. However, ~~when the right of the member~~ if a client or other person* disputes the lawyer or law firm firm's right 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)-(d)~~ A memberlawyer shall:

- (1) Promptlypromptly notify a client or other person* of the receipt of ~~the client's~~ funds, securities, or other ~~properties~~ property in which the lawyer knows* or reasonably should know* the client or other person* has an interest;
- (2) Identifyidentify 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) Maintainmaintain complete records of all funds, securities, and other ~~properties~~ property of a client or other person* coming into the possession of the memberlawyer or law firm ~~and render appropriate accounts to the client regarding them;~~*

- (4) promptly account in writing* to the client or other person* for whom the lawyer holds funds or property;
- (5) preserve ~~such~~-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 ~~properties~~property; ~~and~~
- ~~(3)~~ (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.
- ~~(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)~~ (e) The Board of ~~Governors~~Trustees of the State Bar shall have the authority to formulate and adopt standards as to what “records” shall be maintained by ~~members~~lawyers and law firms* in accordance with subparagraph (Bd)(3). The standards formulated and adopted by the Board, as from time to time amended, shall be effective and binding on all ~~members~~lawyers.

Standards:

Pursuant to ~~rule 4-100(C)~~this rule, the Board of ~~Governors~~Trustees of the State Bar adopted the following standards, effective ~~January 1, 1993~~ _____, as to what “records” shall be maintained by ~~members~~lawyers and law firms* in accordance with subparagraph (Bd)(3).

- (1) A ~~member~~lawyer shall, from the date of receipt of ~~client~~-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 affected by each debit and credit, and
 - (iii) the current balance in such account;
 - (c) all bank statements and ~~canceled~~cancelled checks for each bank account; and
 - (d) each monthly reconciliation (balancing) of (a), (b), and (c).
- (2) A ~~member~~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.”) and *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.

V. RULE HISTORY

Rule 4-100 has its origin in the first rules promulgated in 1928. (The 1928 rules are found at 204 Cal. at p. xci.) Former Rule 9 provided:

A member of the State Bar shall not commingle the money or other property of a client with his own; and he shall promptly report to the client the receipt by him of all money and other property belonging to such client. Unless the client otherwise directs in writing, he shall promptly deposit his client's funds in a bank or trust company, authorized to do business in the State of California, in a bank account separate from his own account and clearly designated as "Clients' Funds Account" or "Trust Funds Account," or words of similar import. Unless the client otherwise directs in writing, securities of a client in bearer form shall be kept by the attorney in a safe deposit box at a bank or trust company authorized to do business in the State of California, which safe deposit box shall be clearly designated as "Clients' Account" or "Trust Account" or words of similar import, and be separate from the attorney's own safe deposit box.

In 1975, Rule 9 was revised and renumbered as 8-101. The rule that ultimately was approved by the Supreme Court differed from the version that appeared in the 1972 Final Report of the Special Committee to Study the ABA Code of Professional Responsibility. As part of the comprehensive revisions to the Rules in the 1972 report, the special committee had proposed rule 9-101, which provided:

Rule 9-101. Preserving Identity of Funds and Property of a Client.

(A) All funds of clients paid to a member of the State Bar or Firm of which he is a member, including advances for costs and expenses, shall be deposited in one or more identifiable bank accounts maintained in the State of California and no funds belonging to the member of the State Bar or firm of which he is a member shall be deposited therein except as follows:

(1) Funds reasonably sufficient to pay bank charges may be deposited therein.

- (2) Funds belonging in part to a client and in part presently or potentially to the member of the State Bar or firm of which he is a member must be deposited therein, but the portion belonging to the member of the State Bar or firm of which he is a member may be withdrawn when due unless the right of the member of the State Bar or firm of which he is a member to receive it is disputed by the client, in which event the disputed portion shall not be withdrawn until the dispute is finally resolved.

(B) A member of the State Bar shall:

- (1) Promptly notify a client of the receipt of his 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 of the State Bar and render appropriate accounts to his client regarding them.
- (4) Promptly pay or deliver to the client as requested by a client the funds, securities, or other properties in the possession of the member of the State Bar which the client is entitled to receive.

Comment

Rule 9-101 originated from ABA Code DR 9-102. The committee amended ABA Code DR 9-102 to include advances by the client to the attorney for costs and expenses as subject to the trust account requirements.

The rule that was ultimately approved in 1975 provided:

Rule 8-101. Preserving Identity of Funds and Property of a Client

(A) All funds received or held for the benefit of clients by a member of the State Bar or firm of which he is a member, 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 such other jurisdiction where there is a substantial relationship between his client or his client's business and the other jurisdiction and no funds belonging to the member of the State Bar or firm of which he is a member shall be deposited therein or otherwise commingled therewith except as follows:

- (1) Funds reasonable sufficient to pay bank charges may be deposited therein.

- (2) Funds belonging in part to a client and in part presently or potentially to the member of the State Bar or firm of which he is a member must be deposited therein and the portion belonging to the member of the State Bar or firm of which he is a member 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 of the State Bar or firm of which he is a member 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 of the State Bar shall:

- (1) Promptly notify a client of the receipt of his 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 of the State Bar and render appropriate accounts to his client regarding them.
- (4) Promptly pay or deliver to the client as requested by a client the funds, securities, or other properties in the possession of the member of the State Bar which the client is entitled to receive. (Amended by order of the Supreme Court, effective January 1, 1975.)

In 1983, rule 8-101 was amended to complement the then new statutory authority of the State Bar to conduct audits of trust accounts upon a State Bar Court determination of reasonable cause to believe that a member has violated rule 8-101. (See Bus. & Prof. Code §§ 6055 and 6086 as amended effective January 1, 1982.) The following underlined language was added to 8-101(B)(3):

Maintain complete records of all funds, securities, and other properties of a client coming into the possession of the member of the State Bar and render appropriate accounts to his 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.

In 1989, rule 8-101 was revised and renumbered as 4-100 as part of the comprehensive revision and renumbering of the entire California Rules of Professional Conduct. Rule 4-100(A) and (B) continued the requirements of rule 8-101, regarding setting up and maintaining client trust accounts and handling client funds and property that come into the possession of the attorney.

Paragraph (C) was added to permit the Board of Governors to adopt specific recordkeeping requirements ("standards") to provide guidance to attorneys in setting up trust accounts and to serve as a basis for discipline if those records were not kept.

The 1989 rule amendments to rule 8-101 are shown in the following legislative blackline:

Rule ~~4-100~~ ~~8-101~~. Preserving Identity of Funds and Property of a Client

(A) All funds received or held for the benefit of clients by a member of the ~~State Bar~~ or law firm, ~~of which he is a member~~, 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 ~~such any~~ other jurisdiction where there is a substantial relationship between ~~his the~~ client or ~~his the~~ client's business and the other jurisdiction, ~~and a~~ No funds belonging to the member of the ~~State Bar~~ or the law firm of ~~which he is a member~~ shall be deposited therein or otherwise commingled therewith except as follows:

- (1) Funds reasonably sufficient to pay bank charges, ~~may be deposited therein.~~
- (2) In the case of ~~F~~ funds belonging in part to a client and in part presently or potentially to the member of the ~~State Bar~~ or the law firm, ~~of which he is a member must be deposited therein and the portion belonging to the member of the State Bar or law firm of which he is a member 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 of the State Bar or law firm of which he is a member 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 of the ~~State Bar~~ shall:

- (1) Promptly notify a client of the receipt of ~~his~~ 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 of the ~~State Bar~~ law firm and render appropriate accounts to ~~his 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, ~~to the client~~ as requested by a the client, the any funds, securities, or other properties in the possession of the member ~~of the State Bar~~ 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.

In 1992, further proposed amendments to rule 4-100 were submitted to the California Supreme Court, together with amendments to rule 3-700 (re termination of employment, including the duty to refund unearned fees paid in advance). The amendments to these rules would have required that all advance fees for legal services received by an attorney be deposited in the attorney's client trust account unless the attorney's written fee agreement with the client expressly provided that the fee paid in advance was earned when paid or was a "true retainer." Although the proposed amendments avoided use of the terms "fixed fee," "flat fee" or "non-refundable fee," such types of retainer fee agreements would have been permissible under the proposed amendments but the fees paid under such agreements would have been required to be placed in the attorney's client trust account unless the attorney's written attorney-client fee agreement expressly provided that such fees, paid in advance of the provision of legal services, were "earned when paid or is a true retainer . . ." (See "Request that the Supreme Court of California Approve Amendments to the Rules 3-700 and 4-100 of the Rules of Professional Conduct of the State Bar of California and Memorandum and Supporting Documents in Explanation," October 1992, Supreme Court file number SO29270.)

In a May 11, 1995 Supreme Court letter from John C. Rossi, Assistant Clerk-Administrator, to Diane Yu, State Bar General Counsel, the court advised the State Bar of a possible ambiguity in the proposal. In relevant part, the letter stated:

If a fee agreement specifies that an advance fee is "earned" when paid, the fee does not fall within rule 3-700(D)(2)'s requirement that members return "unearned" advance fees. Similarly, the new discussion following that rule refers only to an "unearned" fee paid in advance and states that "such fee" may still have to be refunded even if not required to be in a trust account. . . . Thus, the proposed rules appear to exempt advance fees designated as earned when paid from the requirement of refunding fees paid for services that are not performed.

Following receipt of this letter, the State Bar withdrew the request that the Supreme Court approve the proposed amendments to rules 3-700 and 4-100.

While the foregoing submission to the Supreme Court was the last time that the Court considered proposed amendments to rule 4-100, in 1997, a Board Committee

authorized the Standing Committee on Professional Responsibility and Conduct to seek public comment on a proposed new rule 4-110 (re advance payment of fees for legal services) that would have required a lawyer to obtain informed authorization from a client to deposit and hold advance fees in an account other than the lawyer's trust account. Following consideration of public comment received on that proposal, the Committee on Professional Responsibility and Conduct concluded its consideration of a proposed new rule 4-110.

VI. OFFICE OF CHIEF TRIAL COUNSEL / STATE BAR COURT COMMENTS

- **Gregory Dresser, Office of Chief Trial Counsel, 9/27/2016**
(In response to 90-day public comment circulation):

1. OCTC supports this rule and the Comments to this rule. In particular, OCTC supports the amendments to the current rule to require an attorney to maintain advanced fees in a trust account until the fee is earned and requiring the accounting be in writing. This enhances public protection.

Commission Response: No response required.

- **Gregory Dresser, Office of Chief Trial Counsel, 1/9/2017**
(In response to 45-day public comment circulation):

1. OCTC supports this rule and the Comments to this rule. In particular, OCTC supports the amendments to the current rule to require an attorney to maintain advanced fees in a trust account until the fee is earned and requiring the accounting be in writing. This enhances public protection.

Commission Response: No response required.

2. OCTC, however, is concerned with exempting a written agreement to deposit flat fees in the attorney's operating account for fees of \$1,000 or less. There is no good reason for this \$1,000 exemption.

Commission Response: The Commission proposes exempting a flat fee of less than \$1000 from requirement to obtain the client's consent to depositing the funds into the lawyer's operating account in order to address access-to-justice issues raised by commenters who note that it may be impracticable for many low income clients, such as clients seeking immigration advice who are not in the country, to provide a writing.

- **State Bar Court:** No comments were received from State Bar Court.

VII. SUMMARY OF PUBLIC COMMENTS (INCLUDING COMMENTS SUBMITTED BY THE OFFICE OF CHIEF TRIAL COUNSEL AND STATE BAR COURT) & PUBLIC HEARING TESTIMONY

During the 90-day public comment period, nine public comments were received. Four comments agreed with the proposed Rule and five comments agreed only if modified. During the 45-day public comment period, seven public comments were received. Three comments disagreed with the proposed Rule and four comments agreed only if modified. A public comment synopsis table, with the Commission's responses to each public comment, is provided at the end of this report.

VIII. RELATED CALIFORNIA LAW AND ABA MODEL RULE ADOPTIONS

A. Related California Law

State Bar Act. Every member of the State Bar of California is deemed to authorize banks and financial institutions holding client trust fund accounts to disclose records of those accounts to the State Bar, pursuant to Business and Professions Code §§ 6069, 6091.1, and 6091.2, and requires banks to make reports to the State Bar of instances of insufficient funds presented against an attorney's client trust account. §§ 6210-6228 requires IOLTA accounts to be established with the interest to be paid to the State Bar for legal services for the indigent.

Related California law. Under 4-100(A), funds belonging in part to a client and in part presently or potentially to the member must be deposited in the attorney's trust account. The California Supreme Court has declined to resolve the question of whether advance fees must be deposited in the attorney's trust account (See *Baranowski v. State Bar* (1979) 24 Cal.3d 153, 163 [154 Cal. Rptr. 752]). In *Baranowski*, the court did not impose discipline on the attorney for failing to deposit advance fees in a trust account.

The State Bar Court distinguishes a true retainer as a fee paid by a client which is paid solely for the purpose of ensuring the availability of the member for the matter over a given period of time (See *In the Matter of Fonte* (Review Dept. 1994) 2 Cal. State Bar Ct. Rptr. 752).

Separately, California statutory law establishes two areas where advance payment of fees for legal services are strictly prohibited:

Senate Bill No. 94, enacted in 2009, was codified in Business and Professions Code § 6106.3 and California Civil Code § 2944.7(a), and makes it unlawful for any person who offers to negotiate, arrange or perform a mortgage loan modification or forbearance in exchange for a fee paid by the borrower, to claim, demand, charge, collect or receive any compensation until after the person has fully performed each and every service the person contracted to perform or represented that he or she would perform.

Assembly Bill No. 1159, enacted in 2013, was codified in Business and Professions Code §§ 6240 – 6243 and in amendments at §§ 22442, 22442.3 and 22443.1, and prohibits attorneys and immigration consultants from demanding or accepting payment

for any immigration reform act services before enactment, by Congress, of an immigration reform act that authorizes undocumented immigrants to attain lawful status under federal law.

B. ABA Model Rule Adoptions

Model Rule 1.15 Variations. The ABA State Adoption Chart, entitled “Variations of the ABA Model Rules of Professional Conduct, Rule 1.15: Safekeeping Property,” revised September 15, 2016, is available at:

- http://www.americanbar.org/content/dam/aba/administrative/professional_responsibility/mrpc_1_15.authcheckdam.pdf [Last visited 2/7/17]
- Jurisdictions for the most part have not adopted the Model Rule approach, which states only general principles concerning trust accounts. Only one jurisdiction has adopted Model Rule 1.15 verbatim¹ and another fourteen jurisdictions have adopted a slightly modified version of Model Rule 1.15.² However, thirty-six jurisdictions have adopted a version of the rule that is substantially different from Model Rule 1.15.³ Some jurisdictions have adopted more than one rule to regulate lawyer trust accounts. See, e.g., Delaware Rules 1.15 and 1.15A, available at: <http://courts.delaware.gov/rules/DLRPCwithCommentsFeb2010.pdf> [Last visited 3/15/16].

IX. CONCEPTS ACCEPTED/REJECTED; CHANGES IN DUTIES; NON-SUBSTANTIVE CHANGES; ALTERNATIVES CONSIDERED

A. Concepts Accepted (Pros and Cons):

1. Recommend retaining the basic structure of current rule 4-100 but breaking out some paragraphs for clarity and changing the rule title. The title is changed from “Preserving Identity of Funds and Property of a Client” to “Safekeeping Funds and Property of Clients and Other Persons.”
 - Pros: There is no evidence that there is anything wrong with the basic structure of rule 4-100, which in paragraph (A) describes where funds and property subject to the rule must be placed and in paragraph (B) sets forth

¹ The one jurisdiction is: Nebraska.

² The fourteen jurisdictions are: Alaska, Arizona, District of Columbia, Georgia, Iowa, Kentucky, Maryland, Montana, Nevada, New Hampshire, New Jersey, New Mexico, Vermont, and West Virginia.

³ The thirty-six jurisdictions are: Alabama, Arkansas, California, Colorado, Connecticut, Delaware, Florida, Hawaii, Idaho, Illinois, Indiana, Kansas Louisiana, Maine, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Utah, Virginia, Washington, Wisconsin, and Wyoming.

duties a lawyer has regarding notice, accounting, and distribution of the funds and property. However, the Commission recommends that for clarity, (i) the two sentences of paragraph (A) be split into separate paragraphs and (ii) the several clauses of paragraph (B)(3) also be split into separate subparagraphs. The title is derived from the first Commission's version on Rule 1.15, except "Handling" is changed to "Safekeeping" (from the Model Rule) and better describes the rule.

- Cons: By separating the duty to place client funds in a trust account (proposed (a)) from the duty to not commingle funds (proposed (b)), double charging for the same misconduct (such as deposit of client trust funds in a lawyer's personal bank account) could result. Maintaining as a single paragraph current rule 4-100(A), which encompasses both duties, would avoid such a result.

2. Recommend adoption of a requirement that advance fees be placed in the lawyer's trust account.

- Pros: Including this requirement in the rule would be client protective. It is hornbook law that a fee is not earned until the lawyer has completed the agreed services or has otherwise earned the fee. A lawyer should be required to place advance fees in the trust account from which fees may be withdrawn only when the lawyer has earned the fee and the lawyer's interest in the fee has been fixed (i.e., there is no dispute as to the lawyer's entitlement to the fee. This will prevent lawyers from placing the fee in the lawyer's operating account and exhausting the funds before the funds are earned. . In the event the lawyer is discharged, the unearned fees remaining in the trust account will be available for refund. This is the rule in the majority of the states and there is no valid justification for California to provide less public protection. Lawyers have a duty to account for advance fees in any event. To the extent that some lawyers rely upon flat fees paid in advance, a benchmark approach in fee agreements can be used that would accommodate the competing interests of protecting clients and allowing for the freedom to contract.
- Cons: Whether to require that advance fees be placed in the lawyer's trust account, as is required in Model Rule 1.15 and most jurisdictions that have adopted the Model Rules, is a policy issue that has generated substantial controversy among different practice groups (e.g., bankruptcy, criminal defense lawyers) whenever it has been raised. Retaining the language of the current rule would maintain the status quo. To make the revision would effect a significant change in the law. There has been no clear signal since the Supreme Court decided *Baranowski v. State Bar* (1979) 24 Cal.3d 153 that the law should be changed. Moreover, much of the alleged abuse derives from lawyers who purport to charge a nonrefundable or "earned on receipt" fee for fee arrangements other than a true retainer. That issue has been

addressed by this Commission in its proposed Rule 1.5(d) and (e).⁴ Finally, lawyers can be found liable in discipline for failing to refund unearned fees. (See, e.g., *In the Matter of Fonte* (Rev. Dept. 1994) 2 Cal. State Bar Ct. Rptr. 752, 758.)) This should be sufficient incentive for lawyers to place advance fees in the trust account without an express requirement to do so.

3. Recommend adoption of paragraph (b), which excepts from the requirement that advance fees be placed in the trust account when the lawyer has provided written disclosure to the client that the client has a right to have the fees placed in the trust account and is entitled to a refund of any unearned fees, and the client has consent in writing following disclosure.
 - Pros: The paragraph strikes a balance between concern that money in the trust account is subject to government seizure or forfeiture and the interest in the public protection afforded by a rule intended to assure that unearned fees are available for a refund to a client. Although proposed paragraph (b) permits a flat fee to be held in a law firm operating account, it does not diminish a lawyer's obligation to account for the funds or to refund any amount owing to a client due to a subsequent unexpected failure of consideration.
 - Cons: Few jurisdictions have a similar exception to the requirement that advance fees be placed in the trust account for a good reason: it substantially decreases the risk that unearned fees will not be available for return to the client. The concern with seizure or forfeiture should be addressed by a change in the laws that permit such government action, not by tinkering with the client trust account rule.

⁴ Proposed Rule 1.5(d) and (e) provide:

(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 as long as the lawyer performs the agreed upon services. A flat fee is a fee which constitutes complete payment for legal fees to be performed in the future for a fixed sum 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.

4. Recommend that, with respect to the paragraph (b) exception from the requirement that advance fees be placed in a trust account, the written disclosure signed by the client is required only in those lawyer-client matters where the flat fee exceeds \$1,000.00.
- Pros: In consideration of written comments and an oral presentation at a Commission meeting, the Commission concluded that the requirement that the paragraph (b)(1) disclosures be in a writing signed by the client might be too burdensome for low fee engagements, particularly where it is difficult to obtain the client's signature, e.g., in immigration matters where a third person is communicating with the lawyer on the client's behalf and the client is difficult to reach in the client's native country. Regardless, the lawyer must still provide the client with the required disclosures.
 - Cons: Paragraph (b) is an unnecessary exception to the paragraph (b)(2) requirement that the disclosures be provided to the client in a writing signed by the client. Regardless of the alleged burden in obtaining the client's signature, paragraph (b)'s requirement of a written disclosure and client consent to *not* placing advance fees in trust recognizes the importance of the lawyer's duties to maintain client funds in trust. Strictly applying the written disclosure and consent requirement should ensure that the client makes a fully informed decision about the placement of the client's funds. This exception to the paragraph (b) exception serves only to dilute the lawyer's trust accounting duties.
5. Recommend including in the rule the concept that under certain circumstances, a lawyer owes duties to protect funds and property of a third person.
- Pros: This change tracks the first Commission's proposed rule, Model Rule 1.15 and the rule in a number of jurisdictions. California law has held that a lawyer owes duties regarding the funds and property of third persons and the rule should expressly recognize current law. The current rule is deficient because it hides the ball and fails to provide adequate public protection. At the very least, a new comment should reveal that case extends the duties in the rule to non-clients in certain circumstances.
 - Cons: The inclusion of "other person" in the rule may cause confusion as to precisely when a lawyer owes a duty to third persons to protect their funds and property and what that duty entails. A particular problematic consequence of this change is confusion as to a lawyer's duty to honor a lien on client funds (such as statutory liens, contractual liens, medical liens and prior attorney liens) because case law demonstrates that all liens are not treated the same.

6. Recommend retaining term “law firm” in current rule 4-100(A) and throughout the rule. Neither Model Rule 1.15 nor the first Commission proposed Rule 1.15 included the concept.
- Pros: Both “lawyer” and “law firm” should be retained in the rule to protect the public and to make it clear that the rule applies even if the lawyer is not personally in charge of the firm’s trust account. See proposed Rules 5.1 – 5.3. The concerns stated in the Con section below should not materialize because the rule has not proven to have such a negative effect and California neither currently nor in the proposed rules embraces the concept of law firm discipline.
 - Cons: Contrary to the pro argument, retaining "law firm" might continue a negative effect of leading individual lawyers to erroneously believe and claim that their "law firm" is primarily responsible for a trust accounting violation. If current rule 4-100(A) is changed to refer only to a lawyer, then it would no longer suggest that anyone other than an individual lawyer is responsible for compliance.
7. Recommend retaining current rule 4-100(B)(1) as paragraph (d)(1) and adding the "lawyer knows or reasonably should know" standard to the notice requirement. Paragraph (d)(1) provides 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.”
- Pros: With the addition in the rule of an express duty owed to “other persons,” the Commission determined that the duty to give notice to such persons should be qualified by the “knows or reasonably should know” standard.
 - Cons: The current rule’s unqualified duty to notify *a client* should not be qualified by the “knows or reasonably should know” language.
8. Recommend retaining current rule 4-100(B)(2) as paragraph (d)(2). Paragraph (d)(2) provides a lawyer shall: “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.”
- Pros: The paragraph carries forward current paragraph (B)(2) nearly verbatim. There is no indication that this provision has created any problems as currently constituted.
 - Cons: None identified.

9. Recommend retaining the first clause of current rule 4-100(B)(3) as paragraph (d)(3), with the addition of “other person”. Paragraph (d)(3) provides a lawyer shall: “(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.”
- Pros: There is no indication that this provision has created any problems as currently constituted. Further, the rule should expressly recognize that a lawyer owes duties to third persons under appropriate circumstances.
 - Cons: None identified.
10. Recommend retaining the substance of the second clause of current rule 4-100(B)(3) as paragraph (d)(4). There are four changes: (i) the word “account” has been substituted for the phrase “render appropriate accounts,” (ii) the term “other persons” has been added, (iii) the requirement that the lawyer account “in writing” has been added; and the requirement that the lawyer account “promptly” has been added.
- Pros: Paragraph (b)(4) carries forward the substance of rule 4-100(B)(3), but specifies that it also applies to “other persons” to reflect those duties that a lawyer may owe. No substantive change is intended by the substitution of “to account” for the current phrase “render appropriate accounts,” which is considered to be ambiguous. Adding the requirement that the account be in writing is client-protective. The addition of the requirement that the lawyer account “promptly” more accurately describes current law.
 - Cons: None identified.
11. Recommend retaining the third clause of current rule 4-100(B)(3) as paragraph (d)(5). The clause “of all funds and property held by a lawyer or law firm under this Rule” has been added to modify the term “records.”
- Pros: The clause has been added to clarify that the duty to preserve records is limited to funds and property covered by the rule. No change in substance is intended.
 - Cons: None identified. However, paragraphs (b)(3) and (b)(5) could be combined or reordered to follow one another. (see Standards (1) and (2)).
12. Recommend retaining the fourth clause of current rule 4-100(B)(3) verbatim as paragraph (d)(6). Paragraph (d)(6) provides a lawyer shall: “(6) comply with any order for an audit of such records issued pursuant to the Rules of Procedure of the State Bar.”
- Pros: There no indication that this provision has created any problems as currently constituted.
 - Cons: None identified.

13. Recommend retaining current rule 4-100(B)(4) as paragraph (d)(7), as modified, but to add term “undisputed” to modify the term “funds or property”.

- Pros: Although the word “undisputed” does not appear in current rule 1-400(B)(4), it is implied in that provision that the lawyer need only distribute “undisputed” funds given the lawyer’s duties to hold in trust “disputed funds” set forth in current rule 1-400(A)(2) [proposed paragraph (b)(2) of this Rule.] This is a clarifying change intended simply to expressly state what is already implied in the current rule. No change in substance to the rule is intended.
- Cons: The current language relies on the concept of "entitled to receive." This language is adequate to encompass the concept of undisputed funds. If the language is changed, a lawyer's duty may be ambiguous in situations where a client is entitled to receive funds but an alleged dispute by a third party causes a lawyer to improperly delay or withhold disbursement to the client.

14. Recommend retaining current rule 4-100(C) nearly verbatim as paragraph (e). The only changes to the Trustees’ enabling clause is to substitute “lawyers” for “members” and change “Governors” to “Trustees”.

- Pros: This clause is the essential enabling provision that authorizes the Board to promulgate standards regarding what records must be kept pursuant to paragraph (c)(3). It should be retained.
- Cons: None identified.

15. Recommend adding “other persons” to the recordkeeping requirements set forth in Standards (1) and (2).

- Pros: If the lawyer owes duties to safeguard funds and property of a third person, the lawyer should also have duties to keep records regarding those funds. The standards clarify what records must be maintained and for how long.
- Cons: None identified.

B. Concepts Rejected (Pros and Cons):

1. Include more examples in paragraph (b) of exceptions to the rule against commingling as was done by the first Commission.⁵
 - Pros: The added paragraphs would provide important guidance to lawyers in an area that frequently is the subject of discipline.
 - Cons: It is unnecessary to bring the foregoing exceptions into the rule because they are addressed in case law. These exceptions are nothing more than practice pointers. To include them in a rule would constitute micromanagement and conflict with the Commission's Charter. Further, funds deposited to restore entrusted funds are not and never were the lawyer's funds; it is the client's funds that are being restored.
2. Recommend deleting "presently or potentially" as modifiers of lawyer's funds in paragraph (b)(2), which is derived from current rule 4-100(A)(2).
 - Pros: The language unnecessarily injects uncertainty into a disciplinary rule. Moreover, on balance it is confusing because it appears logically inconsistent. Paragraph (b) requires a lawyer to withdraw from the trust account funds that belong to the lawyer. A rule should not permit a lawyer to withdraw funds that "potentially" belong the lawyer.
 - Cons: The current language is helpful and promotes compliance because it alerts lawyers to the fact that the character of funds received are not static. Rather, funds belonging initially to a client (such as advances for costs) may become funds belonging to the client's lawyer once the lawyer's interest becomes fixed.

⁵ The first Commission added the following exceptions to its proposed paragraph regarding commingling:

(2) deposits for overdraft protection that compensate exactly for the amount that the overdraft exceeds the funds on deposit plus any bank charges;

(3) the lawyer's or law firm's funds deposited to restore entrusted funds that have been improperly withdrawn;

(4) funds in which the lawyer claims an interest but which are disputed by the client or other person; or

(5) funds belonging in part to a client or other person and in part, presently or potentially, to the lawyer, but which are claimed by a third party.

3. Include in paragraph (c)(1) the phrase “claims to have” to modify the “interest” of an “other person”.
 - Pros: Including this language will appropriately broaden the rule to require the lawyer to maintain sufficient funds to satisfy claims that have not yet matured.
 - Cons: The concept is ambiguous and would unnecessarily and confusingly broaden the lawyer’s duties. It is not clear how a lawyer would know when a client “claims to have” an interest in funds. It is more definite and clear to impose notice duties on a lawyer only when the lawyer knows or reasonably should know the other person *has* an interest.

This section identifies concepts the Commission considered before the rule was circulated for public comment. Other concepts considered by the Commission, together with the Commission’s reasons for not recommending their inclusion in the rule, can be found in the Public Comment Synopsis Tables.

C. Changes in Duties/Substantive Changes to the Current Rule:

1. Adding the concept of duties owed third persons throughout the rule is a substantive change. (See Section IX.A.2, above.)
2. Qualifying the notice requirement in current rule 4-100(B)(1) by a “knows or reasonably should know” standard is a substantive change. See discussion of proposed paragraph (c)(1) in Section IX.A.7, above.)
3. The addition of the requirement in paragraph (c)(4) that the lawyer account “promptly” to clients and other persons is a substantive change. (See Section IX.A.10, above.)
4. If the Board were to agree that the standards be applied to “other persons” in addition to clients, it would be a substantive change. (See Section IX.A.15, above.) Board action on the standards would follow Court approval of the rule.

D. Non-Substantive Changes to the Current Rule:

1. Substitute the term “lawyer” for “member”.
 - Pros: The current Rules’ use of “member” departs from the approach taken in the rules in every other jurisdiction, all of which use the term lawyer. The Rules apply to all non-members practicing law in the State of California by virtue of a special or temporary admission. For example, those eligible to practice pro hac vice or as military counsel. (See, e.g., rules 9.40, 9.41, 9.42, 9.43, 9.44, 9.45, 9.46, 9.47, and 9.48 of the California Rules of Court.)
 - Cons: Retaining “member” would carry forward a term that has been in use in the California Rules for decades.

2. Change the rule number to conform to the ABA Model Rules numbering and formatting (e.g., lower case letters).
 - Pros: It will facilitate the ability of lawyers from other jurisdictions who are authorized by various Rules of Court to practice in California to find the California rule corresponding to their jurisdiction's rule, thus permitting ease of determining whether California imposes different duties. It will also facilitate the ability of California lawyers to research case law and ethics opinions that address corresponding rules in other jurisdictions, which would be of assistance in complying with duties, particularly when California does not have such authority interpreting the California rule. As to the "Con" that there is a large body of case law that cites to the current rule numbers, the rule numbering was drastically changed in 1989 and there has been no apparent adverse effect. A similar change in rule numbering of the Rules of Court was implemented in 2007, also with no apparent adverse effect.
 - Cons: There is a large body of case law that cites to the current rule numbers and California lawyers are presumed to be familiar with that numbering system.
3. All recommended changes not identified in paragraph IX.C as substantive changes are non-substantive changes. (See paragraphs IX.A.1, 6, 7, 8, 9, and 11-14.)

E. Alternatives Considered:

None.

X. COMMISSION RECOMMENDATION FOR BOARD ACTION

Recommendation:

The Commission recommends adoption of proposed Rule 1.15 [4-100] in the form stated attached to this Report and Recommendation.

Proposed Resolution:

RESOLVED: That the Board of Trustees adopts proposed Rule 1.15 [4-100] in the form attached to this Report and Recommendation.