The State Bar of California

Handbook on Client Trust Accounting for California Attorneys

2024

Acknowledgments

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The Handbook contains legal information, not legal advice. Nothing contained in this Handbook is intended to address any specific legal inquiry, nor is it a substitute for independent legal research to original sources or for obtaining the advice of legal counsel with respect to legal problems.

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Foreword

This handbook is intended as a tool to help California attorneys fulfill their statutory and ethical obligations to clients and other persons whose money and other properties they hold in trust. Even if you never hold money or other properties for clients or others, it is imperative that you understand these obligations.

This handbook teaches the basics necessary to properly account for a client's or other person's money. It explains the rules governing client trust accounting duties, the concepts behind client trust accounting, and a simple step-by-step system for accounting for client money and money you are holding for other persons. In the 2024 update, **Section VIII: Reconciliation** was significantly revised and the provisions under the Client Trust Account Protection Program were added.

To focus on the main concepts and requirements, there are minimal citations in the handbook. The relevant authorities and cases are provided as **Appendix 2: Text of Rules and Links to Statutes Cited** and **Appendix 3: Index of Selected Cases and Opinions by Topic**.

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 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 receive assistance by calling 1-800-2-ETHICS or 1-800-238-4427 in California, or 415-538-2150, or by completing the online Ethics Hotline Research Assistance Request Form.

- The State Bar publishes the California Compendium on Professional Responsibility Index which is a comprehensive topical subject matter index with supporting citations to rules, statutes, case law, and ethics opinions.

- 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 State Bar offers two MCLE e-Learning courses on client trust accounting: (1) Fundamentals on Client Trust Accounting; and (2) Practical Trust Account Reconciliation. The Fundamentals of Client Trust Accounting course covers the rules and statutes governing an attorney's client trust accounting duties, the concepts behind client trust accounting, and a simple step-by-step system for accounting clients' money. The Practical Trust Account Reconciliation course teaches about what

records you are required to maintain and how-to perform a three-way reconciliation. Attorneys can access these courses by logging into their My State Bar Profile and selecting "State Bar E-Learning Portal."

- 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 IOLTAs. 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 must 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 canceled 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 common misconceptions about client trust accounting. One 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.

Client trust accounting is a simple set of procedures that is easy to learn and easy to practice; all it requires is consistent, careful application.

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. These duties may also be owed to third parties.

Trust—The willingness of people to trust a 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 client's 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 is the essence of "client trust accounting." Also, the account in which you hold client funds is a trust account, and you owe fiduciary duties to the people who have an interest in those funds. These duties include accounting for the funds held therein. If you follow the procedures explained in this handbook, you will fulfill your fiduciary duties as an attorney.

By agreeing to hold money in trust, you take on a nondelegable, personal fiduciary responsibility to account for all funds, down to the penny, as long as the funds remain in your possession. This responsibility can't be transferred or delegated, 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. You may employ others to help you fulfill this duty, but if you do, you must provide adequate training and supervision and you must take full responsibility for their actions. Failure to live up to this responsibility can result in personal monetary liability, fee disputes, loss of clients, and public discipline.

SECTION II: THE RULES

Understanding the California Rules of Professional Conduct and statutory provisions related to client trust accounts is crucial for attorneys. The requirements and prohibitions contained in these authorities safeguard client funds and maintain the integrity of the legal profession. Adherence to the rules and statutes governing client trust accounts demonstrates an attorney's commitment to professionalism and ethical legal practice and reinforces the trust clients place in their attorneys.

Accurately accounting for your client's money is your personal, nondelegable ethical responsibility, and failure to do so is a violation of the client trust accounting rules.

You are required to know exactly how much of your client's money you have in your client trust account at all times.

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

Finally, if you keep your own money in the client trust account, you are committing a violation known as "commingling," absent limited exceptions.

CALIFORNIA RULE OF PROFESSIONAL CONDUCT 1.15

California's detailed recordkeeping requirements are set forth as minimum standards under rule 1.15(c). (See **Appendix 2: Text of Rules and Links to Statutes Cited**.)

Rule 1.15 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 are able to provide an accounting, upon request.

Rule 1.15 sets forth several obligations:

- 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 account. (Rule 1.15(a).)
- When you receive other properties on behalf of a client, you must identify what you've received in your written records, label the properties to identify the owner, and put them into a safe deposit box or some other place of safekeeping as soon as practicable. (Rule 1.15(a).)
- All client trust accounts must be maintained in California unless there is a substantial relationship between the client or the client's business and the other jurisdiction. In that case, you have to get the client's consent in writing before you can deposit the client's funds outside of California. (Rule 1.15(a).)

- Whenever you receive money or other property on behalf of a client, absent good cause, you must notify that client of that fact no later than 14 days of the receipt of the funds or other property. (Rule 1.15(d)(1).)

- You can't *deposit* any money belonging to you or your law firm into any of your client trust accounts (except for the small amounts of money if necessary to cover bank charges). This is known as commingling. (Rule 1.15(c).)

- You can't *keep* any money belonging to you or your law firm (other than money if necessary for bank charges) in any of your client trust accounts. This is also known as commingling. Once fees are earned from client money held in trust, it must promptly be withdrawn from the account at the earliest reasonable time after your interest in that portion becomes fixed or on a regular basis, such as during monthly reconciliations. (See **Section VIII: Reconciliation**. See rule 1.15(c)(2). See also, **Appendix 5: State Bar Formal Opinion No. 2005-169**.) However, you cannot withdraw disputed fees until the dispute is resolved. Once your interest is clear and undisputed, you must promptly withdraw the funds from the client trust account (refer to **Appendix 3: Index of Selected Cases and Opinions by Topic** for disciplinary cases and **Appendix 5: State Bar Formal Opinion No. 2006-171** on redeposit issues). (Rule 1.15(c).)

- When your clients are entitled to receive money or other properties that you're holding for them, you must promptly deliver the funds or property. For purposes of determining a lawyer's compliance with this requirement, rule 1.15(f) requires distribution within 45 days. Specifically, the rule states that, unless the lawyer and the client or other person agree in writing that the funds or property will continue to be held by the lawyer, there is a rebuttable presumption that a violation of the duty to promptly distribute has occurred if the lawyer, absent good cause, fails to distribute undisputed funds or property within 45 days of the date when the funds become undisputed. "Undisputed" for purposes of the rule is defined in rule 1.15(g).

- 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. Rule 1.15(d)(4) requires that you promptly account in writing.

- 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 report it to the State Bar. (Rule 1.15(d)(6).)

- 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. (Rule 1.15(d)(5).)

Under rule 1.15(d)(3), you must maintain the following types of records:

- **Trust Account Journal.** This is a written journal that you must create and maintain for your client trust account. If you have more than one client trust account, you must maintain a trust account journal for each client trust account. This is where you record every transaction that occurs to keep track of all money going in and out of the client trust account. Most attorneys and law firms have only one client trust account, in which they keep all of their client's funds. This is an IOLTA account, which is further defined below. (See **IOLTAs**.) Occasionally, it will become necessary to open a separate client trust account for one specific client because the funds of that client are large enough to generate interest in excess of the cost to maintain the account (or because the funds will be held for an extended period of time and will generate that much interest). This would be a non-IOLTA account, and it would only hold the funds of that particular client. If this other account is opened, you will be required to create and maintain a trust account journal for that account, separate from the one you maintain for your IOLTA account, which holds the funds of all of your other clients.

- **Individual Ledgers.** There are two types of individual ledgers that you must create and maintain. One is the "Client Ledger", and the other is the "Bank Charges Ledger."

- **Client Ledger.** Rule 1.15(d)(3) and (e) require you to keep a written ledger for each person or entity for whom you hold trust funds. The client ledger must include the name of the client and detail every monetary transaction made on behalf of that client (or other person if holding funds for a third party). If you have a client trust account in which the funds of more than one client are deposited (i.e., an IOLTA), you will create a separate client ledger for each client. This is where you keep track of each individual client's money.

- **Bank Charges Ledger.** This is a written ledger that you must create and maintain if your bank assesses fees against the client trust account. The bank charges ledger is where you record all bank fees that are not chargeable to a client but are paid for by a nominal amount of firm funds held in the account to cover these fees (e.g., fees for buying checks).[1] For example, the bank may charge you for printing checks. You cannot bill any client for that expense; it is an operating expense. That is why you are permitted to deposit your or your firm's funds into the trust account to cover bank charges. In the bank charges ledger, you will record all deposits that you or your law firm make to cover bank charges, and all debits the bank makes when charging the account for bank fees.

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[1] If your bank does not charge any fees, or you have established that all trust account fees, including fees to order checks, etc., will be paid from your operating account, then you do not need to maintain a bank charges ledger since no bank fees will be withdrawn from your trust account. You also would not put firm funds into the trust account to cover those fees.

- **Bank Statements and Canceled Checks.** These records can be obtained from the bank where your client trust account is kept. You must keep all bank statements and canceled checks or check imaging for each client trust account, whether it is an IOLTA or non-IOLTA. These records will be used when you perform your monthly reconciliation to ensure that the entries in your trust account journal, and individual ledgers are accurate.

- **Reconciliation.** You must keep a written record showing that every month you completed a three-way reconciliation where you "reconciled" or balanced the account journal against the individual ledgers and the bank statement with canceled checks. You must perform this three-way reconciliation for each client trust account you keep.

- **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 a client.

An attorney's duty might not end with payment to the client of the client's ultimate share of the recovery after settling a case. One instance is when there is a statutory lien applicable to the funds received by the attorney on behalf of the client. 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, or settlement of a dispute between the lienholder and the client, if there is a dispute as to the validity, extent, or amount of the lien.

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 are not limited to, notifying DHS when a matter has been settled prior to the distribution of the settlement proceeds. (*In the Matter of Respondent P* (Review Dept. 1993) 2 Cal. State Bar Ct. Rptr. 622.)

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 dispute is resolved.

CALIFORNIA RULE OF PROFESSIONAL CONDUCT 1.4

An attorney has a general duty to communicate with a client. Rule 1.4 requires, among other things, that an attorney keep a client reasonably informed about significant developments relating to the client's representation (rule 1.4(a)(3)). Comment [1] to rule 1.4, in part, provides that: "Whether a particular development is significant will generally depend on the surrounding facts and circumstances. For example, a lawyer's receipt of funds on behalf of a client requires communication with the client pursuant to rule 1.15, paragraphs (d)(1) and (d)(4) and ordinarily is also a significant development requiring communication with the client pursuant to this rule."

BUSINESS AND PROFESSIONS CODE SECTIONS 6211–6213

There are two types of client trust accounts. Both types of accounts must be interest-bearing. The difference is what happens to the interest accruing in each account.

IOLTAs

Often client or third-party funds held by an attorney are either nominal or deposited for a short period of time and, therefore, do not earn more interest than it costs to cover bank fees or to pay out the earned interest. In such instances, Business and Professions Code section 6211 requires that these funds be deposited into an aggregate client trust account, called an "Interest on Lawyers' Trust Account" (IOLTA). An IOLTA can only be opened at an IOLTA-eligible financial institution. For an IOLTA, the bank automatically provides the accrued and collected interest to the State Bar. Business and Professions Code section 6213 allows the State Bar to distribute these funds to support efforts to provide legal representation and assistance to those who cannot afford it, thereby promoting access to justice and ensuring fair legal proceedings for all Californians, regardless of financial status. (See **Appendix 2: Text of Rules and Links to Statutes Cited** and the State Bar IOLTA rules, Title 2, Division 5 of the Rules of the State Bar of California.)

For purposes of this handbook, all references to client trust accounts mean IOLTA.

Non-IOLTAs

When the interest collected from a client's funds is greater than the cost to maintain those funds in a non-IOLTA, you have a fiduciary duty to collect that interest for the benefit of the client and distribute it to the client. (Bus. & Prof. Code, § 6211, subd. (b).) These client funds should be placed into an individual client trust account, a non-IOLTA. For example, if your client has given you either a significant amount of money or if the money needs to be held for an extended period of time, those funds should be deposited in a non-IOLTA. Generally, multiple clients' funds should not be held in a non-IOLTA; however, under limited circumstances, such as representing a class action or holding funds on behalf of multiple clients that are a single party, it is permitted.

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 also fundamental to the attorney-client relationship. 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: Other Regulations Relating to Clients and Money**, and the text of these rules can be found in **Appendix 2: Text of Rules and Links to Statutes Cited**.

SECTION III: KEY CONCEPTS IN CLIENT TRUST ACCOUNTING

There are seven key concepts that you need to understand regarding 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 one IOLTA, 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.

To distinguish one client's money from another's, you must maintain separate client ledgers of each individual client's funds (rule 1.15(d)(3), (e), & Std. (1)(a)). The client ledgers tell you how much money you have 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 IOLTA. If you are holding money in your IOLTA for ten clients, you must maintain ten separate client ledgers. If you keep each client's ledger properly, you will always know exactly how much of the money in your IOLTA belongs to each client. If you do not, you will lose track of how much money each client has, and when you make payments out of your client trust account, you will not know which client's money you are using, resulting in possible misappropriation of client funds.

If one of 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 that client's funds in an IOLTA. (See **IOLTA and Non-IOLTA Accounts** and **What MUST Be Held in Your IOLTA or in a Non-IOLTA?**.) Instead, you must open a separate client trust account for that particular client, which is a non-IOLTA type account that is maintained in accordance with all the other requirements of rule 1.15.

KEY CONCEPT 2: YOU CAN'T SPEND WHAT YOU DON'T HAVE

Each client has only their own funds available to cover their expenses, no matter how much money belonging to other clients is in your IOLTA. Your IOLTA 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 misappropriating some other client's money.

Assume you are holding a total of $5,000 for four clients in your IOLTA 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 IOLTA 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"

In client trust accounting, writing checks against funds not yet deposited or cleared by the bank can lead to a "negative balance," which may indicate negligence or even theft. You cannot evade your responsibilities by relying on automatic overdraft protection for your client trust account. Writing a check that does not bounce does not absolve you of violating your client trust accounting duties. 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** (known as a "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 are not 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 account. (This is especially true when you receive an insurance company's settlement draft—which cannot clear until the company 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 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 the funds. Every bank has different procedures, so when you open your client trust 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. Until the bank has credited a client's deposit to your client trust 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, 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 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.

A client may ask you to do them a favor by writing a check to them for settlement proceeds before the settlement check clears. Even if you know there is money belonging to other clients in your client trust account to cover this client's check, you must not write a check to the client because doing so would be using other clients' money—which constitutes misappropriation. No matter how expedient, kind, or convenient it seems, you must not make payments on your client's behalf before their deposited funds have cleared.

Some banks offer "provisional" credit where the bank agrees to immediately credit accounts for deposits while the bank waits for the funds from another financial institution. "Provisional" credit is essentially a loan to the attorney that is deposited in the client trust account, and thus a commingling of funds. You should not use or rely on "provisional" credit. Instead, you are encouraged to wait ten days to ensure the money has cleared and to confirm with the bank before any disbursement.

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 the *client trust 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 in the client ledger, and the running balance for *each client trust account* is kept in the trust account journal. (A sample client ledger and a sample trust account journal are provided in **Appendix 4: Client Trust Account Templates**.)

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.

The running balance for the client trust account is calculated in the same way. Every time you make a deposit to the client trust account, you write the amount of the deposit in the trust account journal and *add* it to the previous balance. Every time you make a payment from the client trust account, you write the amount in the trust account journal and *subtract* it from the previous balance. The result is the running balance. That's how much money is in the client trust 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 account checks for that client. This will ensure that you avoid disbursing more money than the client has in the trust 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 accounts. Sometimes these balances are the result of a mathematical error, sometimes they are part of a fee you forgot to take, and sometimes it is a check you wrote that never cleared or wasn't cashed.

You are responsible for any funds left in the client trust account. 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 has not 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: Text of Rules and Links to Statutes Cited**.)

KEY CONCEPT 7: ALWAYS MAINTAIN AN AUDIT TRAIL

An "audit trail" is a series of bank-created records, like canceled checks, bank statements, check images, electronic transfer information, 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 the funds. An audit trail will enable you to show that you have taken proper care of your clients' money or to answer any questions that may come up. The audit trail is also an important tool for tracking down accounting errors. Maintaining an audit trail can help you correct the small mistakes, like errors in addition or subtraction, and the big mistakes, like miscredited deposits.

The key to creating a good audit trail is being descriptive. For example, if you are filling out a deposit slip for five checks relating to three separate clients, the bank only requires you to write in the bank identification code for each check and the check amounts. This does not identify which client the money belongs to. By including the name of the client and keeping copies of the checks, you will know which client the check was for, which is the purpose of an audit trail. You will be able to answer any questions that come up, even years later.

By the same token, every check you write from your client trust account should indicate which client it's being written for, so that it is easy to match up the money with the client. That means you should **NEVER** make out a client trust account check to "CASH," because you will not be able to identify who 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, may require 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 are not in bold are important for keeping track of your client's money but are not required as part of the recordkeeping standards under rule 1.15(e).

A good audit trail should include copies of:

- The deposit slip**,** duplicate copy or bank receipt, or other deposit documentation. This should show the deposit date; 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 or other bank confirmation showing the day the deposit was received.
- Front and back of deposited checks, including bank checks, cashier's checks, money orders, or any other type of deposit instrument.
- The checkbook stub, accounting software report, or other payment confirmation that shows 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 **bank statement** that shows the dates deposits were posted and disbursements were withdrawn from the trust account.
- In a good audit trail, the **canceled check** should show the date the check was drawn; the amount of payment; to who the check was made out; 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 canceled checks, see **Section VII: Recordkeeping, What Bank-Created Records Do You Have to Keep?**)
- Wire transfer confirmations, electronic payment confirmations, or any other type of disbursement instrument.
- 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 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 . . . .

Rule 1.15(a) requires that if you receive or hold money for clients—or any other persons with whom you have a fiduciary relationship—you must deposit the money into a specifically labeled client trust account. When you first open your client trust account, you should work with a banker who has experience in setting up and administering client trust accounts properly.

GENERAL DOS AND DON'TS

Client trust accounts:

- **Must** be identified as a client trust 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 account. You can avoid many problems by displaying the name of the account prominently on all your client trust account checks, deposit slips, and other documents, and by ensuring that all the documents for your client trust account look different than your personal or general office account documents. For example, you can have your client trust account checks printed on paper that is a different color than your other checks.

- **Must** be established and maintained with an eligible institution. Under Business and Professions Code sections 6211–6213, IOLTAs must be established and maintained with a bank, savings and loan, or other financial institution regulated by a federal or state agency that pays interest or dividends on the IOLTA account and carries deposit insurance from an agency of the federal government or any other type of financial institution authorized by the Supreme Court. (See **Appendix 6: "IOLTA-Eligible" Financial Institutions Under California Business and Professions Code Section 6212** for the State Bar's list of IOLTA-eligible institutions. This list is continuously updated so you should check the State Bar's website for the most current list of IOLTA-eligible institutions. Funds held in a non-IOLTA must be held in an interest-bearing bank trust deposit account or dividend-paying trust investment account with the interest or dividends earned on the accounts payable to the client or other person.

- **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 (1) where there is a

substantial relationship between the client or the client's business and the other jurisdiction and (2) if you obtain the written consent of your client. Unless you meet these requirements, your client trust account must be maintained in California.

- **Should** be maintained in a financially stable bank. As your client's fiduciary, you are responsible for protecting your client's funds. Non-IOLTAs should be maintained in a bank that is regulated by a federal or state agency and that carries deposit insurance from an agency of the federal government. Note that FDIC insurance coverage differs depending on the type of account that you use. If you use a non-IOLTA, 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. You should check with your bank or the FDIC to determine any applicable deposit insurance.

  When selecting a bank, you should thoughtfully consider all relevant factors with the basic goal of keeping your client trust accounts in banks that you are reasonably sure are financially secure.

- **Should** limit the accessibility of funds. Exercise due care in authorizing signatories to your trust account or otherwise authorizing others to sign client trust account checks or to pay out client funds. Some practitioners designate another attorney or a trusted member of their staff as an authorized signatory and reasonably supervise them. This might be prudent if you lack bookkeeping skills, if acting as the sole signatory on your trust account detracts from your focus on providing legal services to your clients, or in case of an unexpected occurrence that makes you unable to handle client funds. However, you are individually and personally accountable for all client funds you receive or hold in trust, and, since this accountability cannot be delegated to anyone else, allowing other people access to your client trust account does not absolve you of your responsibility to supervise the management of your trust account. In addition, you should never pre-sign client trust account checks and leave them for employees to issue.

- **Should NOT** have ATM access. Your fiduciary responsibility is to account for your client's money. When you write a client trust 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 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 is very hard to account for cash. You are unable to create a record for which client's money was withdrawn, who withdrew the money, or to who the money was paid. An ATM receipt only shows the date and the amount of the withdrawal. Even if you put all the descriptive information on an ATM receipt, it will not prove to your clients or a State Bar investigator what the money was used for. This

also applies to withdrawing your earned fees, since you are unable to indicate which client's funds are being used to pay your fee.

- **May** include "automatic overdraft protection," provided that the bank's terms do not result in a commingling violation. (Refer to the discussion of commingling on page 11.) Automatic overdraft protection can benefit your clients by assuring that the important checks you have written on a client's matter will not bounce if a bank error or delay causes an unanticipated shortfall in your client trust 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." (See **Appendix 5: State Bar Formal Opinion No. 2005-169**.) 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 a "provisional 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 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 account in the first place; if you do, you are 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. Regardless of whether you have overdraft protection to keep a check from bouncing, the bank will notify the State Bar if checks are rejected for insufficient funds or if they are paid against insufficient funds. Business and Professions Code section 6091.1 requires financial institutions to report these transactions to the State Bar. (See **Appendix 2: Text of Rules and Links to Statutes Cited**.) 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 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 account. Do not assume that your bank has or will provide an explanation to the State Bar. When an overdraft of a client trust 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 does not 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 account if the check is returned unpaid from the maker's bank. These charges should be handled like any other bank charges.

KNOW YOUR BANK

From the moment you make the first deposit into your client trust 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 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 intervals 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)(c) require that you maintain all bank statements and canceled checks for each bank account for a period ending five years from the date of disbursement. Also, rule 1.15(d)(3) and recordkeeping standard (1)(d) require you to do monthly reconciliations of your client trust accounts to make sure that your records match the bank's records. (See **Step 2: Reconcile the Trust Account Journal with the Bank Statement**.) If you know your bank's practice in providing or posting records of account activity, you can schedule a regular time every month to perform the required reconciliations.

  By knowing what day each month bank statements are mailed, you can ensure that someone is not concealing incriminating statements to cover up a crime. Be sure to review both the bank statements and canceled 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?** 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. (See **Bank Charges**.)

IOLTA AND NON-IOLTA ACCOUNTS

You will always hold your clients' funds in a client trust account. Which type of trust account should be used is governed by statute. Business and Professions Code section 6211 states that 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 you must hold the money in a single, unsegregated client trust account called an Interest on Lawyers Trust Account (IOLTA).

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 collectively held in one client trust account, they collectively can generate substantial interest. The IOLTA statute requires that this aggregate interest, which would otherwise benefit only the bank, be used to fund legal services programs.

Under Business and Professions Code section 6212, attorneys may hold IOLTA accounts only at eligible financial institutions. (Check the State Bar's website for the most current list of IOLTA-eligible institutions.)

When you open an IOLTA, the bank will code the account with the State Bar's taxpayer identification number. 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. (See **Reporting Required by the Client Trust Account Protection Program (CTAPP)**.)

Under Business and Professions Code section 6212, subdivision (c), reasonable fees may be deducted from the interest remitted to an IOLTA. 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 and will not be deducted from the interest remitted to the account.

If your client has given you either a significant amount of money or if the money needs to be held for an extended period of time, those funds should be deposited in a non-IOLTA, with the interest or dividends earned on the account payable to the client. You have a fiduciary duty to collect that interest for the benefit of the client and distribute it to the client when the interest collected from a client's funds is greater than the cost to maintain those funds in a non-IOLTA. (Bus. & Prof. Code, § 6211, subd. (b).) Generally, multiple clients' funds should not be held in a non-IOLTA; however, under limited circumstances, such as representing a

class action or holding funds on behalf of multiple clients that are a single party, it is permitted.

IOLTA ACCOUNTS AND FDIC INSURANCE

Business and Professions Code section 6213 defines an "IOLTA" 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 a California Supreme Court rule or order. The statute 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 is subject to FDIC insurance limits. For more information, visit the FDIC website.

While the presence of FDIC insurance is important, a lawyer should note that even if all of a client's funds are insured, by the time the FDIC disburses 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 account records need to be retrieved from that bank.

UNPRODUCTIVE IOLTAS

Normally, the bank will deduct reasonable service charges for holding an IOLTA 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. If 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 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 **Bank Charges**.)

REPORTING REQUIRED BY THE CLIENT TRUST ACCOUNT PROTECTION PROGRAM (CTAPP)

The Client Trust Account Protection Program (CTAPP) is a State Bar program designed to increase public protection. The program focuses on proactive regulation of attorneys responsible for complying with any of the requirements or prohibitions in rule 1.15. A goal of this program is to promote compliance and avoid misconduct before a client is harmed by mismanagement of entrusted funds or property. (See Cal. Rules of Court, rule 9.8.5 and State Bar Rule 2.5, **Appendix 2: Text of Rules and Links to Statutes Cited**.)

Each year by the deadline, licensees are required to report to the State Bar if they are responsible for complying with the duties related to handling trust funds under rule 1.15.[2] Those responsible attorneys must then register each trust account online through their My State Bar Profile or comply with the trust account registration requirement by having their firm or organization register the trust accounts through the State Bar's agency billing system, associating the accounts to the responsible attorneys.[3] If there is a change in trust account information, that change must be reported to the State Bar no later than 30 days after the change (see State Bar Rule 2.2, subparagraph (B)(8) and paragraph (C)) through My State Bar Profile or the agency billing platform.

Those responsible attorneys must also complete an annual self-assessment questionnaire about the duties and practices for the proper handling of entrusted funds. This self-assessment helps attorneys to identify potential compliance issues and take corrective action as needed.

Responsible attorneys must certify that they are knowledgeable about, and in compliance with, applicable rules and statutes governing client trust accounts and the safekeeping of funds. All licensees who are not except from the CTAPP reporting obligations must submit a declaration that the information provided to meet these reporting obligations is true.

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[2] See the definition of a "licensee responsible for client funds and funds entrusted by others under the provisions of rule 1.15 of the Rules of Professional Conduct." (Rules of the State Bar, rule 2.5(A)(1) and (A)(2).) This definition is broad and encompasses more than simply those lawyers who are bookkeepers or signatories for an account. However, at the same time, the definition does not encompass every lawyer in every practice setting. For example, a new associate in a large firm who only does document review, never interacts with any client, and does not discharge any of the duties in rule 1.15 (e.g., the duties to consult with a client about advanced fees, give notice of receipt of funds, or resolve disputes over entrusted funds) is not a lawyer who falls under the definition. Similar to a government lawyer or a law professor who does not represent clients that involve any entrusted funds, the new associate is not a "licensee responsible for client funds" under the definition.

[3] This account registration requirement will satisfy the prior annual trust account reporting requirement that applied only to IOLTA accounts (see rule 2.114 of the Rules of the State Bar of California).

Under State Bar Rule 2.5(K), a licensee who was not on active status at any point during the reportable time period is exempt from the above requirements.

Beginning in 2025, the State Bar will also be conducting compliance reviews. A compliance review evaluates an attorney's or firm's adherence to the Rules of Professional Conduct regarding entrusted funds. Depending on the outcome and findings of the compliance review, an investigatory audit may be required. An investigatory audit will focus on targeted areas that require further investigation. More information about CTAPP, including a FAQ, is available on the State Bar's website.

SECTION V: DEPOSITING MONEY INTO YOUR CLIENT TRUST 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 to these requirements. Failure to differentiate among these different types of funds may result in commingling or misappropriation.

WHAT MUST GO INTO YOUR CLIENT TRUST 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 include 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 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 attorney 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 account, must be properly recorded in the trust account journal for your client trust account, and a special "bank charges" ledger. (See **What Records Do You Have to Create?**.) If the bank charges are assessed against your general office account, or if your client trust account does not have bank fees, you should not hold any law firm funds in the client trust account.

WHAT MUST BE HELD IN YOUR IOLTA OR IN A NON-IOLTA?

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. (See **IOLTAs**.) Client funds that can earn revenue for the client in excess of the costs to hold those accounts must be deposited in a non-IOLTA so that the interest can be collected for the benefit of the client and disbursed to the client. (See **Non-IOLTAs**.)Thus, you are required to make the practical determination of whether your clients' money must be held in an IOLTA or a non-IOLTA client trust 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 an IOLTA: 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 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-IOLTAs for the client or third party's benefit, including service charges, the costs of the licensee's services, and the costs of preparing any tax reports required for income earned on the funds;
- The capability of eligible institutions or the licensee 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 $50.00 in interest. (The chart assumes the account is paying an interest rate of 1.75%, compounded daily. Since interest rates change constantly and vary from bank to bank, this chart is for illustrative purposes only.) However, if your bank charges $8.00 a month to keep a separate account open, by the time your client earns $50.00, the bank will have charged your client about $56.00. Therefore, the $5,000.00 must be deposited into your IOLTA 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 Earn $50.00 Interest (At 1.75% Compounded Daily)
$ 5,000	209 days
$10,000	106 days
$15,000	71 days
$20,000	54 days
$25,000	43 days

If the amount you are holding for your client is not nominal in amount or not being held for a short period of time, and if the funds would generate interest income for the client if held in a separate interest-bearing account, as the fiduciary for your client you should place the funds in an interest-bearing account for the benefit of the client. (Bus. & Prof. Code, § 6211, subd. (b); Rules of the State Bar, rule 2.111.) Tell the bank to code the account with your client's taxpayer identification number. In addition, make sure the type of account you choose does not limit access to your client's money in any way that will harm your client.

If you need assistance, your banker may be able to help you determine whether the amount of money a client has given you could generate net income for that client in a separate interest-bearing client trust account. Under State Bar Rule 2.110(B), the State Bar will not bring disciplinary charges against an attorney for determining in good faith whether to place funds in an IOLTA. However, State Bar Rule 2.112 requires an attorney to review IOLTAs at reasonable intervals to determine whether changed circumstances warrant moving the funds out of the IOLTA and placed in an interest-bearing non-IOLTA.

SECTION VI: PAYING MONEY OUT OF YOUR CLIENT TRUST ACCOUNT

Before you write your first client trust 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 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. if there are sufficient funds on behalf of the client and available for disbursement. You may also pay bank charges for the account. Those are the *only* payments you are allowed to make out of your client trust account.

Bank charges. For non-IOLTA client trust accounts, paying bank charges is simple: since all 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 IOLTAs, paying bank charges is a little more complicated. Under the amended Business and Professions Code section 6212, subdivision (c), reasonable fees may be deducted from the interest remitted to an IOLTA. 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 and will not be deducted from the interest remitted to the account. That is why rule 1.15(c)(1) allows you to keep a nominal amount of money—an amount reasonably sufficient to cover bank charges—in your client trust accounts if you have these types of charges 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 expense for a client and pay for it out of the money that you are holding for that client in the IOLTA.

WHAT PAYMENTS CAN'T YOU MAKE?

You *cannot* make payments out of your client trust account to cover your expenses, personal or business, or for any other purpose that is not directly related to carrying out your duties to an individual client. Even if the funds represent amounts the client owes you for earned fees, you cannot do this, because that would constitute commingling. Instead, issue the disbursement to you or your law firm, in accordance with the fee agreement, as a lump sum for the amount of undisputed earned fees owed at the time of the disbursement.

You also cannot pay money out of your client trust account on behalf of a client if the client does not 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 cannot pay yourself legal fees that your client is disputing. Once a client disputes your fees, the disputed amount must remain in your client trust 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 account as soon as you reasonably can.

HOW SHOULD YOU MAKE PAYMENTS?

You should always pay out money from your client trust 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 that leaves no evidence of payment, the recipient, or the purpose. (See **Key Concept 7: Always Maintain an Audit Trail**.) If you do make a payment in cash (or another instrument that does not give you a record of the transaction), you *must* get a receipt, or you have violated your professional responsibilities. A cash receipt should be signed by both the attorney and the party paying or receiving the funds and should include the date, purpose, and related client on whose behalf the cash payment is received or paid.

You should not carry any blank client trust account checks around to pay client expenses when you are out of the office. Doing so could result in checks being written out of numerical order (i.e., lower-numbered checks being dated later than higher-numbered checks), and checks disappearing altogether. This can make it difficult to keep organized records and reconcile your books. If you are 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 account check to reimburse yourself, and document that transaction with all the details required by rule 1.15. You may delay writing yourself the check until you issue a bill to the client for fees and costs for that period, and you make the disbursement from the client's funds held in trust for that bill. Just remember to properly document the expense you advanced for the client.

WHO SHOULD MAKE PAYMENTS?

Your clients have entrusted *you* with their money, and *you* are personally accountable for it. Some practitioners designate another attorney or a trusted member of their staff as an authorized signatory and reasonably supervise them. Allowing other people access to your client trust account does not absolve you of your responsibility to supervise the management of your trust account. If your clients' money is stolen because you trusted your employees to sign client trust account checks, you can lose your clients' money, your professional reputation, and even your license to practice law. *Do not* make a signature block or stamp for your client trust account checks; *do not* pre-sign blank client trust account checks.

WHEN CAN YOU MAKE PAYMENTS?

You can only pay out money from your client trust account when the client you are 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, subparagraph (d)(7) provides that you must "promptly distribute any undisputed funds or property in the possession of the lawyer or law firm that the client or other person is entitled to receive." Unless the lawyer, and the client or other person agree in writing that the funds or property will continue to be held by the lawyer, there is a rebuttable presumption affecting the burden of proof in a disciplinary action that a violation has occurred if the lawyer, absent good cause, fails to distribute undisputed funds or property within 45 days of the date when the funds become undisputed. (Rule 1.15(f).)

Undisputed funds or property refers to funds or property, or a portion of any such funds or property, in the possession of a lawyer or law firm where the lawyer knows or reasonably should know that the ownership interest of the client or other person in the funds or property, or any portion thereof, has become fixed and there are no unresolved disputes as to the client's or other person's entitlement to receive the funds or property. (Rule 1.15(g).)

Note that, you can only delay the distribution of the portion of funds that are in dispute. For example, if you have settled a case for $100,000 and your client only disputes a $1,000 medical lien, you would only hold that $1,000 in your trust account until that lien is resolved, but all other portions of the settlement funds that are not in dispute must be disbursed, without waiting for the $1,000 dispute to resolve.

Comment [7] to rule 1.15 provides examples of disputes that would need to be resolved before the clock starts ticking on the 45-day deadline. The examples include medical liens; statutory liens; prior attorney liens; and any legal proceeding on the entitlement to funds, such as an interpleader action.

However, the 45-day clock ticks for all other portions of funds that are not in dispute, from the moment you can determine who is entitled to receive what. For example, consider the following scenario. On March 1st, you settle a case for $100,000 and deposit those funds into your client trust account. The same day, the client only signs off on part of your proposed disbursement sheet, by stating that they agree that out of the $100,000 settlement, you are entitled to $33,000 for fees and $10,000 for other litigation costs and that only Doctor A is entitled to a $5,000 lien, but Doctor B, who claims a $1,000 lien, is not entitled to that lien. You must disburse and hold funds as follows:

- Disburse to yourself the $33,000 within 45 days of March 1st.
- Disburse to yourself the $10,000 within 45 days of March 1st.

- Disburse to Dr. A the $5,000 within 45 days of March 1st.
- Disburse to the client $51,000 of the remaining funds, the undisputed portion, within 45 days of March 1st.
- Hold in your client trust account, the $1,000 until the dispute over Dr. B's lien is resolved. If resolved in favor of Dr. B disburse to Dr. B within 45 days of that resolution. If resolved in favor of the client, disburse to the client within 45 days of that resolution.

Comment [4] clarifies that the presumption does not apply to the release of a client's file or a refund of a fee paid in advance as those situations are governed by rule 1.16(e)(1) and (e)(2), respectively.

Comment [6] clarifies that lawyers have a general duty to act diligently in resolving disputes that are delaying the distribution of funds or property.

The presumed violation is rebuttable, and paragraph (f) provides that it may be rebutted by proof by a preponderance of the evidence that there was good cause for not distributing the funds by the 45-day deadline. In addition, Comment [5] provides that if the presumption is rebutted, then a violation of subparagraph (d)(7) must be established by the State Bar by clear and convincing evidence and without the benefit of the rebuttable presumption.

Attorney fees. When you are holding client money that includes your undisputed fees, you must take those fees out of the client trust account promptly after you have 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. The timing requirements for the distribution of undisputed funds to a third party are the same as those for a client. (Rule 1.15(d)(7).) 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 that 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. In this situation, you must attempt to resolve the dispute. You should start by 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 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 or disburse the disputed funds, which would constitute misappropriation.

SECTION VII: RECORDKEEPING

The next two sections describe a simple, effective system for accounting for your client's money. For mandatory requirements, applicable rules, statutes, or cases are cited in this handbook. There are also useful recordkeeping practice tips.

Rule 1.15(e) does not mandate any particular client trust accounting system. However, an absence of records will subject you to discipline because the rule mandates that you keep certain records. You can hire consultants to set up a system, buy computer accounting software, maintain paper records—whatever works for you—as long as you get the results and keep the records that the rules require. This handbook explains everything you need to do to account for your client's funds.

This section describes a client trust accounting system designed for sole practitioners and attorneys in small law firms. It assumes that you will be directly involved in every aspect of handling your client's 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.

Recordkeeping must be done consistently. Keeping incomplete records is just as great a breach of your professional responsibility as keeping no records at all.

Rule 1.15(d)(3) and (e) require you to keep two kinds of records: records created by the *bank* that show what went into and out of your client trust 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 the disbursement of the money the records refer to. It is good practice to 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 Business and Professions Code section 6068, subdivision (*I*) to cooperate and participate in a State Bar investigation.

WHAT BANK-CREATED RECORDS DO YOU HAVE TO KEEP?

Rule 1.15(d)(3) and (e) require you to keep two kinds of bank-created records: bank statements and canceled checks. Although your bank can produce copies of the client trust account statement and canceled checks upon request, it is a violation of rule 1.15(d)(3) and (e) if you do not possess the required bank-created records. If your bank fails, or merges with, or is acquired by another bank, copies of old canceled client trust account checks may no longer be available. Therefore, you should download or save the bank statements and canceled checks as soon as they become available, or at least at monthly intervals.

As previously noted, finding a bank that still offers "canceled checks" may take some searching and, if you are unable to find such a bank, be sure to access and maintain "canceled check" information by requesting check imaging or other electronic or online accessible statement documentation from your bank. On the Federal Reserve Board website, they post 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."

While it is not required by the rule, you should also keep your client trust account deposit slips, checkbook stubs, deposited check copies, wire transfer confirmations, or other documents confirming the details of deposits or payments, in order to maintain a complete audit trail. (See **Key Concept 7: Always Maintain an Audit Trail** for a detailed list of documents.) These records will make it much easier to balance your books and show what you did with your client's 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. You should keep separate electronic folders or hardcopy binders for each of your client trust accounts. Each electronic folder or binder should have one section for bank statements; one section for checkbook stubs; one section for canceled checks; one section for copies of all other types of disbursements, including wire transfer confirmations and electronic transfer confirmations; one section for deposit slips; and one section for all deposits, including deposited check images, wire transfer confirmations and electronic transfer confirmations. File each record in chronological order in the appropriate section of the binder for the account they refer to. Label each electronic folder or hardcopy binder with the name of the client trust account and the time period it covers, and you should be able to locate any record easily.

WHAT RECORDS DO YOU HAVE TO CREATE?

Rule 1.15(d)(3) and (e) require you to create three kinds of records to show that you know at all times what you are doing with your clients' money: the written ledger for each client or other person on whose behalf funds are held ("client ledger"), which may also require a bank charges ledger; the written journal for each bank account ("trust account journal"); and each monthly reconciliation that balances the client ledgers, account journal, and bank-provided statements and canceled checks ("reconciliation"). We will 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) require you to 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.
- All deposits and payments should be recorded in the trust 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 are not up-to-date and that you might be spending money your clients do not have. (See **Key Concept 5: You Can't Play the Game Unless You Know the Score**.)

Client Ledger. Maintaining a client ledger is like keeping a separate checkbook for each client, regardless of whether the client's money is being held in your IOLTA or non-IOLTA client trust 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 disbursement 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 disbursement, you must list the date, the amount, the payee (who the payment went to), and the 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 several 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 trust account journal. If you do not, it will be harder to reconcile your books and answer any questions that may come up later.

You must maintain a separate ledger for each client. If you are handling more than one case for the same client, it may be helpful to maintain a separate client ledger for each matter. If you do not, make sure that it is 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 $1,500.00 as an advance against costs and expenses. The first question is whether you should open an individual client trust account for KB, where it will earn interest for KB, or deposit this money into your IOLTA, where it will earn interest for State Bar legal services programs.

When you apply the requirements of Business and Professions Code section 6211, you decide that the $1,500.00 couldn't earn interest for KB after costs are deducted. (See **What MUST Be Held in Your IOLTA or in a Non-IOLTA?**.) Therefore, you do not open a separate client trust account for KB, but instead deposit KB's money into your IOLTA and create a new client ledger for KB. 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 required by rule 1.15(d)(3) and (e), you record the date you receive KB's money, who the money came from, the amount of money, and the balance you are 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 disbursement 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 will not clear KB's check until the third working day after the deposit, you wait until then to hire a private investigator. (If the matter required immediate attention, you could have paid the private investigator with a check drawn on your general office account, then reimbursed yourself for the expense after KB's check had cleared.)

On Tuesday, July 14, you confirm that the check has cleared and that KB's balance is sufficient, and then write a check for an investigator. You make out a check from the client trust account, check, #437, for $510.64 to FS, a private investigator. You record the payment in KB's client ledger, subtract the amount of the check from the 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
7/09/23	KB			1,500.00	1,500.00
7/14/23		FS, #437 Investigation	510.64		989.36

As required by rule 1.15(d)(3) and (e), you have 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 are holding for KB. You also recorded the number of the checks 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 did not 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, you 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 are still holding for her, you can tell her immediately. 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
7/09/23	KB			1,500.00	1,500.00
7/14/23		FS, #437 Investigation	510.64		989.36
7/15/23	KB			325.00	1,314.36
7/15/23		SF Superior Court, #446 Filing Fee	370.00		944.36
7/19/23	KB			225.00	1,169.36
8/01/23		Self, #448 Legal Fee	1,000.00		169.36

This client ledger gives you a complete, clear record to account for the funds you held in trust for your client. In the course of keeping this client ledger, you have completely fulfilled the client ledger requirements of rule 1.15(d)(3) and (e). You have also fulfilled six of the seven key concepts. You have kept KB's money separate from all your other clients' money, even though it is being held in one client trust account, an IOLTA (**Key Concept 1: Separate Clients Are Separate Accounts**); you have not 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 were

able to tell at all times exactly how much of KB's money you were holding (**Key Concept 5: You Can't Play the Game Unless You Know the Score**); and you have 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 **Section VIII: Reconciliation**).

Bank charges ledger. Rule 1.15(d)(3) and (e) require you to record every bank charge against your client trust account in the trust account journal and permit you to keep limited amounts of your own money in your IOLTA to pay these bank charges. If you keep your own money in the IOLTA to pay these charges, you should create a separate ledger where this money and all the bank charges you pay with it are recorded. This is 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
6/30/23	CORRECTED MONTH ENDING BALANCE				50.00
7/01/23	Self			100.00	150.00
7/31/23		Check printing	10.00		140.00

Trust account journal. Rule 1.15(d)(3) and (e) require you to keep a "written journal" for each client trust account, which sets forth the name of the account, the date, amount, and client affected by each debit and credit to the account, and the account balance. This means you must detail all money you receive and pay out, and identify the client on whose behalf you received or paid the funds. You must also calculate the total balance in the account, after every receipt or payment.

Maintaining a trust account journal is very similar to keeping a client ledger, but it is for the entire account, and not just a single client whose money is in the account. For your IOLTA, where you hold the funds of various clients, keeping the trust account journal is the only way you can know how much you have in the account at any given time. If you maintain the trust account journal properly, you will never bounce a client trust account check unless there has been a bank error. Note that for all client trust accounts, the trust account journal is required, even if only one client's money is in the IOLTA or non-IOLTA.

In the trust account journal, you must record every deposit into and disbursement out of the client trust 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 must add the amount to the account's old balance and write in the new total. For every disbursement, you must list the client for whom you paid out the money, the date, and the amount of the payment. Also, although it is not required by the rule, recording the number of the check and the payee or source of the money will make it easier to balance your books. After you record each disbursement, you must subtract the amount from the account's old balance and write in the new total. As with the client ledger, leave several 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 trust account journal. If you do not, you will not be able to indicate how much was deposited for each client, and you will not be in compliance with rule 1.15(d)(3) and (e).

The trust account journal must record every transaction made therein. Therefore, 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 debited to the account. Also, for non-IOLTA accounts, where interest accrues for the benefit of the client whose money is held there, you must record any interest that the bank credits to the account, in the trust account journal.

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

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

DATE	CLIENT	SOURCE OF DEPOSIT	PAYEE, # & PURPOSE	CHECKS (SUBTRACT)	DEPOSITS (ADD)	RUNNING BALANCE
7/09/23	DS		FB, #423 Prof. Fee	1,800.00		13,000.00
7/09/23	KB	KB			1,500.00	14,500.00
7/09/23	GC	Insurance Co.			3,500.00	18,000.00
7/09/23	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 trust account journal *does not* show you how much of this money belonged to each client. To find that out, you must look in the client ledgers for those clients. What the trust account journal *does* tell you is exactly how much was in your common client trust account at any given time.

As required by rule 1.15(d)(3) and (e), for each transaction you have 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 account balance was after each deposit or payment. As with the client ledger, you have 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 account checks 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.

Monthly Reconciliation. Rule 1.15(d)(3) and (e) require you to reconcile your client trust account records monthly by balancing the individual ledgers, the trust account journal, and the bank statements and canceled checks. The monthly requirement for this reconciliation helps ensure that any errors in your recordkeeping are identified and corrected. Attorneys must also maintain a written record that documents this reconciliation (balancing) that you perform each month. (Rule 1.15, Std. (1)(d).) More information about the monthly reconciliation process is provided in the next section.

WHAT RECORDS DO YOU HAVE TO KEEP OF OTHER PROPERTIES?

Rule 1.15(d)(3) and (e) also require you to keep a written journal of all securities and other properties you hold in trust for clients. Just like client money, you must maintain a written record, often known as an other properties journal, from the day you receive the properties until five years after the day you disburse them unless it becomes the subject of a disciplinary investigation, in which case you have to keep the records until the investigation is completed. As with the other records, it is good practice 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 is a sample of such a journal:

OTHER PROPERTIES JOURNAL

CLIENT/ CASE#	ITEM	DATE RECEIVED	DATE DISBURSED	DISBURSED TO
KB/920137	Emerald Brooch	7/09/23	8/01/23	KB
DS/920123	AT&T stock	7/16/23		

Rule 1.15(d)(2) requires you to 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 safekeeping as soon as practicable.

SECTION VIII: RECONCILIATION

The client trust account reconciliation is a three-way reconciliation process that cross-checks the three records you are required to keep—the trust account journal, the individual ledgers (i.e., client ledgers and, if applicable, bank charges ledger), and the bank statements with canceled checks—against each other to find and correct any mistakes. Rule 1.15(d)(3), (e), and Standard (1)(d) require the monthly reconciliation process, but there are also several benefits to performing monthly reconciliations. The benefits include:

- Confirming your client trust accounting records are accurate;
- Avoiding financial harm to you, your practice, and your clients;
- Providing timely, professional monthly ledgers (statements) to your clients; and
- Providing timely, proper recordkeeping to regulators and other parties as needed.

Monthly reconciliations are required for both IOLTA and non-IOLTA client trust accounts. Let's look at an example of how the reconciliation process can help you find an error in your recordkeeping:

You deposit a check for $1,000.00 into your IOLTA but mistakenly record the deposit as $10,000.00 in your client ledger, which incorrectly increases your client's running balance by $10,000.00 – instead of the correct amount of $1,000.00. In your IOLTA account journal, you recorded the check correctly, adding $1,000.00 to your IOLTA account's running balance. So how do you find the mistake? You must compare the amount recorded in your IOLTA account journal to the amount recorded in your client ledger. Once you identify two different amounts for the same transaction, you must check the bank statement to determine which entry is correct—$10,000.00 or $1,000.00—and then correct the error that was recorded in your trust account journal or client ledger.

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

In addition to monthly reconciliation, rule 1.15(d)(3) and (e) require that you create a written record of the reconciliation process. Reconciliations can be handwritten on paper or completed using Excel, accounting software applications, or any other format that allows for a three-way reconciliation process. The State Bar has developed both Excel and fillable PDF templates for you to use. Hiring a properly trained and supervised bookkeeper or the equivalent, especially if you lack accounting skills, is allowed; however, you are still personally responsible for accounting to your clients and the State Bar for the money in your client trust accounts. Therefore, even if you do not personally perform the monthly account reconciliations, you must understand the process and exercise supervisorial oversight. (See rule 5.3.) The State Bar provides a Monthly Reconciliation Supervisory Review for you to

consult when conducting your supervisory review of your trust account bookkeeping, including monthly reconciliations.

It is important to note that you cannot perform a reconciliation for a specific month until your trust account journal and individual ledgers have the correct and matching balances at the end of the previous month. If you have not reconciled your trust account for the previous month, or if you believe your recordkeeping balances are incorrect, you may want to hire a professional to help you accurately update your trust account records before you begin the monthly reconciliations yourself. Once you have corrected the balances for the previous month, you are ready to reconcile for the current month.

Learning how to reconcile your client trust account takes time; however, any attorney can and must learn how to perform monthly reconciliations efficiently and effectively for accurate and complete recordkeeping. In addition to the guidance in this Handbook, the State Bar provides practical how-to materials and courses to assist in your learning process. (See the State Bar's Client Trust Accounting Resources webpage.)

STEP 1: RECONCILE THE TRUST ACCOUNT JOURNAL WITH THE CLIENT LEDGERS

The first step in the reconciliation process is to compare the trust account journal with the individual ledgers (i.e., client ledgers and, if applicable, bank charges ledger). The purpose of this step is to make sure the transactions in your trust account journal correctly match the entries in your individual ledgers. Every entry in your trust account journal must have one corresponding entry in one of the individual ledgers, and every entry in your individual ledgers must have one corresponding entry in the trust account journal.

The trust account journal is the place where you record each and every transaction that occurs in the trust account. The client ledger records only those transactions specific to the client named in the client ledger. For example, assume you have four clients, including (1) Kate Jones; (2) Fred Smith; (3) Sylvester Gonzalez; and (4) ABC, Inc. You will keep four separate client ledgers. One client ledger will record all transactions involving funds you hold in trust for Kate Jones; a second client ledger will record all transactions involving funds you hold in trust for Fred Smith; a third client ledger will record all transactions involving funds you hold in trust for Sylvester Gonzalez; and a fourth client ledger will record all transactions involving funds you hold in trust for ABC, Inc.

In addition to your client ledgers, (because this account would have to be an IOLTA, as it holds the funds of multiple clients), you may also need to keep a bank charges ledger. A bank charges ledger is utilized to record all bank fees that are not chargeable to a client, but rather, are your responsibility and paid for by you or your firm (for example, fees for buying checks). If you keep a nominal amount of your own firm funds in an IOLTA to pay for bank fees, you must still account for them so that you can accurately account for every penny in your trust account. If your bank does not charge any fees, or if you have established an arrangement with your bank to charge all fees to your operating account, then you should not hold any law

firm funds in the IOLTA and you will not need to maintain a bank charges ledger since no bank fees will be withdrawn from your IOLTA.

For non-IOLTAs, you will not maintain a bank charges ledger because non-IOLTAs are only opened and maintained for the benefit of one client, who is responsible for paying all bank charges in addition to receiving all interest earned in the account. It is important to note that since all bank charges in a non-IOLTA are paid by the client, no law firm funds should be deposited in a non-IOLTA for any reason.

To complete Step 1, place a mark next to each transaction in the trust account journal that reconciles to the corresponding entry in the client ledgers and bank charges ledger (if applicable), demonstrated in the sample trust account journal, client ledger, and bank charges ledger below. The "Client" column of the trust account journal indicates which ledger contains the corresponding entry.

Trust Account Journal

TRUST ACCOUNT JOURNAL

Firm Name	Expert Law Firm	**Current Month and Year**	**January**	**2024**	
Bank Name	Friendly Bank	**Account Open Date**	01/03/24		
***Account Name**	**Expert Law Firm IOLTA**	**Account Close Date**	Enter close date		
Account #	123456789				

***REQUIRED BY STANDARD (1)(b) IN ACCORDANCE WITH PARAGRAPHS (d)(3) and (e) OF RULE 1.15.**

*Date	Payor or Payee	Check #	Purpose	*Deposit	*Disbursement	*Running Balance	*Client	Reconciled to Ledgers?	Reconciled to Bank Stmt?
01/03/24	Expert Law Firm	3889	Firm funds for bank fees	200.00		200.00	Law Firm Bank Charges	x	
01/03/24	Friendly Bank		Fee for ordering checks		25.00	175.00	Law Firm Bank Charges	x	
01/08/24	R&W Development	6101	Advance fee payment	25,000.00		25,175.00	R&W Development	x	
01/19/24	Dr. Linh Tran		Advance fee payment	7,500.00		32,675.00	Dr. Linh Tran	x	
01/30/24	South County Superior Court	1000	Filing fee		320.00	32,355.00	R&W Development	x	
01/31/24	Darius Bryant	1001	Case research fee		1,850.00	30,505.00	R&W Development	x	

***Note:** In the client trust account documents provided as examples, the information that is specifically required by recordkeeping standard (1)(b) of rule 1.15(d)(3) has an asterisk (*) next to those fields and columns; the other fields and columns without an asterisk (*) are included as best practice.*

There are six transactions during the month of January 2024 in the trust account journal above. In the "Client" column the first two transactions are related to opening the account. These two transactions also appear in our bank charges ledger (below), where we record any activity that involves our firm's funds used to pay for bank fees not chargeable to any client. The third and fifth transactions are related to R&W Development, a client, and the fourth and sixth transactions are related to Dr. Linh Tran, another client.

Let's focus on the client-related transactions in our trust account journal, as we look at our client ledgers, to reconcile each transaction to the trust account journal. We will begin with the client ledger we maintain for our client, R&W Development.

Client Ledger

CLIENT LEDGER

*Client Name	R&W Development	Month and Year	January	2024	
Matter Name	Subcontractor Dispute	Matter Open Date	01/08/24		
		Matter Close Date			

*REQUIRED BY STANDARD (1)(a) IN ACCORDANCE WITH PARAGRAPHS (d)(3) and (e) OF RULE 1.15.

*Date	*Payor or Payee	Check #	*Purpose	*Deposit	*Disbursement	*Running Balance	Reconciled to Account Journal?
01/08/24	R&W Development	6101	Advance fee payment	25,000.00		25,000.00	x
01/30/24	South County Superior Court	1000	Filing fee		320.00	24,680.00	x
01/31/24	Darius Bryant	1001	Case research fee		1,850.00	22,830.00	x

When we look at the client ledger, we see both transactions related to R&W Development that appear in the trust account journal have been recorded in R&W Development's client ledger, and that they are consistent with what we see in the trust account journal; therefore, a mark is placed next to both entries in the "Reconciled to the Account Journal" column. Likewise, a mark is placed next to both entries in the trust account journal related to R&W Development in the "Reconciled to Ledger" column.

Next, let's look at Dr. Tran's client ledger.

CLIENT LEDGER

*Client Name	Dr. Linh Tran	Month and Year	January	2024	
Matter Name	Patent Matter	Matter Open Date	01/19/24		
		Matter Close Date			

*REQUIRED BY STANDARD (1)(a) IN ACCORDANCE WITH PARAGRAPHS (d)(3) and (e) OF RULE 1.15.

*Date	*Payor or Payee	Check #	*Purpose	*Deposit	*Disbursement	*Running Balance	Reconciled to Account Journal?
01/19/24	Dr. Linh Tran		Advance fee payment	7,500.00		7,500.00	x

There is one transaction in Dr. Tran's client ledger, and it matches the trust account journal entry. Therefore, a mark is placed next to the entry in the "Reconciled to the Account Journal" column. Likewise, a mark is placed next to the entry in the trust account journal related to Dr. Tran in the "Reconciled to Ledger" column.

Next, let's look at the bank charges ledger.

Bank Charges Ledger

BANK CHARGES LEDGER

Firm Name	**Expert Law Firm**	**Month and Year**	**January**	**2024**	
Purpose	Firm funds for nonchargeable bank fees	**Case Open Date**	01/03/24		
		Case Close Date			

***SEE PARAGRAPH (c)(1) OF RULE 1.15.**

Date	Payor or Payee	Check #	Purpose	Deposit	Disbursement	Running Balance	Reconciled to Account Journal?
01/03/24	Expert Law Firm	3889	Firm funds for bank fees	200.00		200.00	x
01/03/24	Friendly Bank		Fee for ordering checks		25.00	175.00	x

The bank charges ledger is almost identical in format to the client ledger. This example shows an IOLTA account for which the law firm is responsible for all nonchargeable bank fees. You should maintain a bank charges ledger for IOLTAs to account for funds deposited into and disbursed from the account to pay for your firm's nonchargeable bank fees.

In this example, both transactions in our bank charges ledger match the trust account journal entries. Therefore, a mark is placed next to both entries in the "Reconciled to the Account Journal" column. Likewise, a mark is placed next to both entries in the trust account journal related to the bank charges ledger in the "Reconciled to Ledger" column.

Performing this reconciliation between the trust account journal, the client ledgers, and the bank charges ledger, if applicable, will allow you to catch errors. For example, if funds were deposited into your IOLTA, but you forgot to record the transaction in the correct client ledger, this reconciliation process will help you discover that error. Also, if the trust account journal shows a disbursement, but none of your client ledgers or bank charges ledger contain a record of that disbursement, this will flag to you that you must review your other records to determine on whose behalf the disbursement was made and record the entry in the correct client's ledger so that your accounting for that client will be accurate.

Why do I need to record much of the same information in two places—the trust account journal and the individual ledgers? There are a few reasons:

1. The trust account journal and client ledgers are required by rule 1.15.
2. If you only keep a trust account journal, you will not have an individual record for each client. If your client asks for an accounting, you will not have an individual ledger to provide them.
3. If you only keep client ledgers, you will not have a record showing you how much money is in your trust account at any given time (so, if you make an error, it will be nearly impossible to find it). Also, the bank statement alone is insufficient to give you that information due to the delay in processing of certain transactions, which may not appear in your most recent bank statement. Also, all the transactions you make between the issuance of one bank statement and

the next must be recorded somewhere. The trust account journal is the place where all transactions are recorded, which is why it is required.

The trust account journal and the client ledgers serve two different purposes; you must maintain both of them in order to keep complete and accurate financial records at all times, and in order to comply with rule 1.15.

Step 1 is complete. However, if you found errors during Step 1, you must correct them before proceeding to Step 2. How do you correct errors identified during Step 1?

Correcting Entries

If there are any items found missing or amounts that are inconsistent between the trust account journal or client ledgers, you must make an adjusting entry to correct the error as of the date you perform the reconciliation. This difference could be the result of a single mistake, or several mistakes; it could be in a client ledger, the trust account journal, or both. It could be that you forgot to record a deposit or disbursement, or that you recorded the amounts incorrectly. For example, if the amount of client R&W Development's check is $25,000.00, which was recorded correctly in the trust account journal, but was recorded incorrectly as $24,000.00 in the client ledger, then you must add two entries in the client ledger to correct the error.

CLIENT LEDGER

*Client Name	R&W Development			Month and Year	January	2024	
Matter Name	Subcontractor Dispute			Case Open Date	01/08/24		
				Case Close Date			

*REQUIRED BY STANDARD (1)(a) IN ACCORDANCE WITH PARAGRAPHS (d)(3) and (e) OF RULE 1.15.

*Date	*Payor or Payee	Check #	*Purpose	*Deposit	*Disbursement	*Running Balance	Reconciled to Account Journal?
01/08/24	R&W Development	6101	Advanced Fee Payment	24,000.00		24,000.00	incorrect
01/31/24	Our Law Firm Business Account	1000	Firm Fee - Jan 2024		3,800.00	20,200.00	x
02/05/24	R&W Development	6101	Reverse 1/8/24 entry		24,000.00	(3,800.00)	adjusting
02/05/24	R&W Development	6101	Corrected 1/8/24 entry	25,000.00		21,200.00	x

The first entry reverses the original incorrect entry and the second entry adds the corrected entry, on the date you perform the reconciliation. In the example above, we are completing the January 2024 reconciliation on February 5, 2024. The transaction we are correcting was recorded on January 8, 2024, when the deposit was made. We incorrectly recorded the amount of the deposit as $24,000.00 instead of the correct amount of $25,000.00. You should not erase the original entry so that you maintain a good audit trail, which allows the specific error to be understood if documents or evidence are needed in the future. If you look at the two entries made on February 5, 2024, you will see how this is properly recorded in the client ledger.

The first entry we made, on February 5, 2024, is listed in the "Payor or Payee" column, R&W Development, and in the "Check #" column, 6101 (i.e., the same payor and check number at issue in the incorrect entry from January 8, 2024, that we are fixing). In the "Purpose"

column, this entry describes the purpose as “Reverse 1/8/24 entry,” and it places the erroneous amount in the “Disbursement” column because we are backing that out of the accounting (i.e., reversing it out of the accounting). Furthermore, we adjust the running balance to account for this subtraction of the erroneous amount from the running balance.

The second entry we made, on February 5, 2024, also lists the same payor and check number information, but it describes the purpose as “Corrected 1/8/24 entry.” It then places the correct amount in the Deposit column and adjusts the running balance to add that correct amount back into the accounting. Having made these adjustments (reversing/subtracting the erroneous amount, then adding the correct amount, and adjusting the running balance accordingly), the client’s running balance is now updated from an incorrect amount of $20,200.00 to the correct amount of $21,200.00.

Note: The markings we use in the “Reconciled to Account Journal” column indicate that we have completed the reconciliation for these entries. First, we identify the original incorrect entry as “incorrect” in the “Reconciled to Account Journal” column. Then, the corresponding reversal entry is identified as “adjusting” in the “Reconciled to Account Journal” column. Neither of these entries will appear in the trust account journal since the original transaction was properly recorded with the correct deposit amount. We then place a mark in the “Reconciled to Account Journal” column for the entry where we added the correct amount because it is this amount that accurately corresponds to the trust account journal.

Note also that if you encountered the opposite situation, where the error was in the trust account journal instead of the client ledger, then you would utilize this same process, but place the correction entries and markings in the trust account journal where the error was made.

Once all errors are corrected between the trust account journal and the ledgers, proceed to Step 2.

STEP 2: RECONCILE THE TRUST ACCOUNT JOURNAL WITH THE BANK STATEMENT

Now that the trust account journal has been reconciled with all the client ledgers and bank charges ledger (if applicable), you are ready to reconcile the trust account journal transactions with the bank statement, checking each entry in the trust account journal that matches the corresponding entry in the bank statement. This process is similar to Step 1, where you reconcile each trust account journal transaction to each corresponding entry in one of the ledgers. Since you have already confirmed the trust account journal and ledgers match and have already corrected any discrepancies between them in Step 1, you now only need to reconcile the trust account journal to the bank statement in Step 2.

Let’s look at the bank statement.

Bank Statement with Canceled Checks

FRIENDLY BANK
123 Main Street
Your town, California 90001

Bank Statement

Account Number	123456789
Statement Period	Jan 1, 2024 – Jan 31, 2024
Ending Balance	$32,675.00

Our Law Firm IOLTA
Attorney Client Trust Account California IOLTA
789 West Coast Avenue
Anytown, California 90001

IOLTA Account

Account Summary

Date	Description	Amount
01/03/24	**Beginning Balance**	**$0.00**
	Deposits & Credits	$32,700.85
	Debits & Withdrawals	$25.85
01/31/24	**Ending Balance**	**$32,675.00**

Interest

Interest Paid this Year	$0.85

Detail Transactions

Date	Transaction	Credit	Debit	Balance	
01/03/24	OPENING BALANCE			$0.00	✓
01/03/24	Deposit Check 3889	200.00		$200.00	✓
01/03/24	Order Bank Checks		25.00	$175.00	✓
01/08/24	Deposit Check 6101	25,000.00		$25,175.00	✓
01/19/24	Wire Transfer	7,500.00		$32,675.00	✓
01/31/24	Interest Earned	.85		$32,675.85	✓
01/31/24	Interest transfer to IOLTA Program		.85	$32,675.00	✓

Daily Balances

Date	Amount	Date	Amount	Date	Amount
01/03/24	175.00	01/08/24	25,175.00	01/19/24	32,675.00
01/31/24	32,675.00				

Every monthly reconciliation must be performed as of a specific date, which for our purposes is called the reconciliation date. Think of this as the cut-off date, or the date that shows a snapshot of the trust account on a specific date. You must use the correct reconciliation date. The bank statement provides the reconciliation date that you will use for your monthly reconciliations. The date will always be the last day of the bank statement period. In our example, the reconciliation date is January 31, 2024. You can find this by looking in the top right of the bank statement above, where it lists the “Statement Period.” Some bank

statements will list this date as the "period ending" date. Because you are reconciling your internal financial records to the bank statement, you must use the bank statement's period ending date, (i.e., the last date of the statement period), as your reconciliation date. Therefore, each time you perform your monthly reconciliation, find that date in your bank statement to determine your reconciliation date.

The first entry in the detailed transactions section of the bank statement in our example is not a "transaction," but rather, reflects that the account was opened on January 3, 2024, with a $0.00 beginning balance. However, the next two entries take place on the same day—a $200.00 credit from a deposited check #3889 and a $25.00 withdrawal for bank checks. When we look at our trust account journal, we see both transactions recorded as firm funds to pay for bank fees. Since both transactions can be matched to the bank statement, a mark is placed next to both entries in the bank statement. Likewise, a mark is placed next to both entries in the trust account journal as "Reconciled to Bank."

The following two transactions are both deposits—one on January 8, 2024, a deposited check #6101 in the amount of $25,000.00, and one on January 19, 2024, a wire transfer in the amount of $7,500.00. We see both transactions recorded in our trust account journal related to our two clients, R&W Development and Dr. Linh Tran, respectively. Since both transactions can be matched to the bank statement, a mark is placed next to both entries in the bank statement. Likewise, a mark is placed next to both entries in the trust account journal as "Reconciled to Bank."

Let's see what the trust account journal looks like after placing a mark next to the entries matched to the bank statement:

TRUST ACCOUNT JOURNAL

Firm Name	Expert Law Firm	**Current Month and Year**	**January**	**2024**	
Bank Name	Friendly Bank	**Account Open Date**	01/03/24		
***Account Name**	**Expert Law Firm IOLTA**	**Account Close Date**	Enter close date		
Account #	123456789				

***REQUIRED BY STANDARD (1)(b) IN ACCORDANCE WITH PARAGRAPHS (d)(3) and (e) OF RULE 1.15.**

*Date	Payor or Payee	Check #	Purpose	*Deposit	*Disbursement	*Running Balance	*Client	Reconciled to Ledgers?	Reconciled to Bank Stmt?
01/03/24	Expert Law Firm	3889	Firm funds for bank fees	200.00		200.00	Law Firm Bank Charges	x	x
01/03/24	Friendly Bank		Fee for ordering checks		25.00	175.00	Law Firm Bank Charges	x	x
01/08/24	R&W Development	6101	Advance fee payment	25,000.00		25,175.00	R&W Development	x	x
01/19/24	Dr. Linh Tran		Advance fee payment	7,500.00		32,675.00	Dr. Linh Tran	x	x
01/30/24	South County Superior Court	1000	Filing fee		320.00	32,355.00	R&W Development	x	
01/31/24	Darius Bryant	1001	Case research fee		1,850.00	30,505.00	R&W Development	x	

Returning to our bank statement above, we see the last two transactions contain information about the interest earned and remitted to the State Bar each month. Because this money does not belong to you or your clients at any time, you do not need to record the interest deposited and disbursed from the IOLTA in your trust account journal or any ledger. You may simply place a mark next to these two entries in your bank statement to demonstrate you have reviewed both transactions. However, if you are accounting for a non-IOLTA, you must record the interest earned in both the trust account journal and client ledger because the

interest earned belongs to your client and must be added to the running balance of both the trust account journal and the client's ledger.

If there is a transaction in the bank statement that you do not recognize, check to see if the transaction is a check. If so, review the canceled check copies to see who issued the payment, payment amount, and other details. If the transaction was not made by check, call your bank to inquire about the transaction. They will have additional transaction details not provided in your bank statement. However, keep in mind the bank (and your bank statement) should be able to provide you with sufficient detail to match the transaction to your trust account journal and client ledgers, but some of the information required to be recorded in the trust account journal and client ledgers may be missing. For example, if the deposit is made by a third party on behalf of a client, the third-party check may or may not identify the client on whose behalf the payment was made. Additionally, the purpose of the transaction will likely not be provided or known by your banker. This is why the attorney must maintain a trust account journal and client ledgers with all information detailed in Standard (1)(a) and (b) of rule 1.15, along with your bank statement with canceled checks so that all required information is recorded and maintained.

Now that we have reconciled the trust account journal to the bank statement, there are two transactions in the trust account journal that remain unreconciled to the bank statement. One transaction was disbursed on January 30, 2024, and the other was disbursed on the last day of the month, January 31, 2024. Both checks are related to client R&W Development. The first is check #1000 in the amount of $320.00, made payable to South County Superior Court for the purpose of a filing fee payment. The second is check #1001 in the amount of $1,850.00, made payable to Darius Bryant for the purpose of case research. The reason these two checks do not appear in the bank statement is because they have not yet cleared the bank. We will account for both unreconciled transactions in Step 3 of the reconciliation process.

If you found errors during Step 2, you must correct them before proceeding to Step 3. How do you correct errors identified during Step 2?

If there are any transactions in your trust account journal that are not in your bank statement, the transactions will be accounted for during Step 3. However, if any transactions in the bank statement are not in your trust account journal and client ledgers, you must further research the transactions because this is either a bank error (which happens but is rare) or you mistakenly did not record the transactions in your trust account journal and corresponding ledger. Review your canceled checks and any other supporting documentation to understand the transactions. You may also contact your banker if you need additional information. If you discover a transaction was mistakenly not recorded, you will need to make an adjusting entry to both the trust account journal and the appropriate client ledger for the transaction. You must also confirm that no inadvertent misappropriation has taken place due to the recording error. If a misappropriation occurs, you should take corrective action as soon as possible and document it.

Let's say you forgot to record the January 3, 2024, disbursement to Friendly Bank in the amount of $25.00 for ordering checks. If you did not record this transaction in either the trust account journal or bank charges ledger, your Step 1 reconciliation matching the trust account journal and the ledgers would still reconcile. However, in Step 2, as we reconcile the trust account journal to the bank statement, we see the $25.00 debit on January 3, 2024, for ordering checks. Since we did not record this transaction at the time it occurred, we must now add it to our trust account journal and bank charges ledger so that our records are complete and the running balances are correct.

Adjust the trust account journal by adding a correcting entry on the date you perform the reconciliation, which is February 5, 2024, in our example. Include the purpose of the transaction, noting this is a correcting entry, and identify the date of the original transaction.

TRUST ACCOUNT JOURNAL

Firm Name	Expert Law Firm	**Current Month and Year**	**January**	**2024**	
Bank Name	Friendly Bank	**Account Open Date**	01/03/24		
***Account Name**	**Expert Law Firm IOLTA**	**Account Close Date**	Enter close date		
Account #	123456789				

***REQUIRED BY STANDARD (1)(b) IN ACCORDANCE WITH PARAGRAPHS (d)(3) and (e) OF RULE 1.15.**

*Date	Payor or Payee	Check #	Purpose	*Deposit	*Disbursement	*Running Balance	*Client	Reconciled to Ledgers?	Reconciled to Bank Stmt?
01/03/24	Expert Law Firm	3889	Firm funds for bank fees	200.00		200.00	Law Firm Bank Charges	x	x
01/08/24	R&W Development	6101	Advance fee payment	25,000.00		25,200.00	R&W Development	x	x
01/19/24	Dr. Linh Tran		Advance fee payment	7,500.00		32,700.00	Dr. Linh Tran	x	x
01/30/24	South County Superior Court	1000	Filing fee		320.00	32,380.00	R&W Development	x	
01/31/24	Darius Bryant	1001	Case research fee		1,850.00	30,530.00	R&W Development	x	
02/05/24	Friendly Bank		Fee for ordering checks		25.00	30,505.00	Law Firm Bank Charges	x	x

If your client trust account is an IOLTA, you should also adjust the bank charges ledger by adding the correcting entry on the date you perform the reconciliation, which is February 5, 2024, in our example. Include the purpose of the transaction, noting this is a correcting entry, and identify the date of the original transaction.

BANK CHARGES LEDGER

Firm Name	**Expert Law Firm**	**Month and Year**	**January**	**2024**	
Purpose	Firm funds for nonchargeable bank fees	**Case Open Date**	01/03/24		
		Case Close Date			

***SEE PARAGRAPH (c)(1) OF RULE 1.15.**

Date	Payor or Payee	Check #	Purpose	Deposit	Disbursement	Running Balance	Reconciled to Account Journal?
01/03/24	Expert Law Firm	3889	Firm funds for bank fees	200.00		200.00	x
01/03/24	Friendly Bank		Fee for ordering checks - add missing 1/3/24 entry		25.00	175.00	x

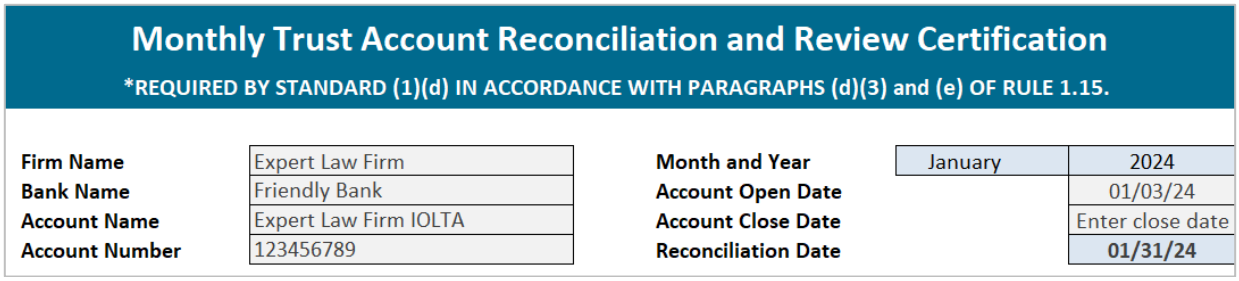
The running balances of both the trust account journal and the bank charges ledger are now complete and accurate as a result of the reconciliation process.

Step 2 is now complete.

STEP 3: COMPLETE A MONTHLY RECONCILIATION

After reconciling the trust account journal to the client ledgers, bank charges ledger (if applicable), and the bank statement, Step 3 is to complete a monthly reconciliation. The purpose of the monthly reconciliation is to confirm and document that the balances of all three trust account documents—the trust account journal, all the ledgers, and the bank statement—all agree with each other after accounting for all outstanding transactions as of the reconciliation date. Because you are reconciling three documents, you are performing a three-way reconciliation of the trust account. Each trust account you or your firm maintains must be reconciled each month, and you must document your monthly reconciliations.

The State Bar provides an optional monthly reconciliation form (available in Excel and a fillable PDF format), noting the rule 1.15 requirements, that you may use to perform and document your monthly reconciliations. (See **Appendix 4: Client Trust Accounting Templates**.) We will review how to use the State Bar's form, but you may perform the three-way reconciliation in any manner you choose. What is important is that you reconcile your trust account journal, all the individual ledgers, and the bank statement each month.



Monthly Trust Account Reconciliation and Review Certification

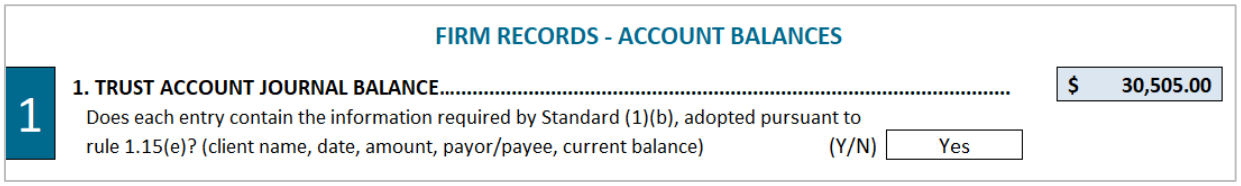
*REQUIRED BY STANDARD (1)(d) IN ACCORDANCE WITH PARAGRAPHS (d)(3) and (e) OF RULE 1.15.

Firm Name	Expert Law Firm	**Month and Year**	January	2024
Bank Name	Friendly Bank	**Account Open Date**		01/03/24
Account Name	Expert Law Firm IOLTA	**Account Close Date**		Enter close date
Account Number	123456789	**Reconciliation Date**		**01/31/24**

At the top of the reconciliation document, identify the month and year of the reconciliation period, and the reconciliation date. The reconciliation date is the last day of the bank statement period (which is usually, but not always the last day of the month). This reconciliation date is important because you will compare the three trust account documents (the trust account journal, all the individual client ledgers, and the bank statement) as of this specific date.

Section 1—Trust Account Journal Balance

In the first section of the reconciliation form, record the trust account journal balance. This is the running balance of the trust account journal as of the reconciliation date, which in our example is January 31, 2024.



FIRM RECORDS - ACCOUNT BALANCES

1 **1. TRUST ACCOUNT JOURNAL BALANCE**..... $ 30,505.00

Does each entry contain the information required by Standard (1)(b), adopted pursuant to rule 1.15(e)? (client name, date, amount, payor/payee, current balance) (Y/N) Yes

The trust account journal in our example shows the balance as of January 31, 2024, as $30,505.00, so that is the amount entered in Section 1 of the reconciliation form.

TRUST ACCOUNT JOURNAL

Firm Name	Expert Law Firm	**Current Month and Year**	**January**	**2024**	
Bank Name	Friendly Bank	**Account Open Date**	01/03/24		
***Account Name**	**Expert Law Firm IOLTA**	**Account Close Date**	Enter close date		
Account #	123456789				

***REQUIRED BY STANDARD (1)(b) IN ACCORDANCE WITH PARAGRAPHS (d)(3) and (e) OF RULE 1.15.**

*Date	Payor or Payee	Check #	Purpose	*Deposit	*Disbursement	*Running Balance	*Client	Reconciled to Ledgers?	Reconciled to Bank Stmt?
01/03/24	Expert Law Firm	3889	Firm funds for bank fees	200.00		200.00	Law Firm Bank Charges	x	x
01/03/24	Friendly Bank		Fee for ordering checks		25.00	175.00	Law Firm Bank Charges	x	x
01/08/24	R&W Development	6101	Advance fee payment	25,000.00		25,175.00	R&W Development	x	x
01/19/24	Dr. Linh Tran		Advance fee payment	7,500.00		32,675.00	Dr. Linh Tran	x	x
01/30/24	South County Superior Court	1000	Filing fee		320.00	32,355.00	R&W Development	x	
01/31/24	Darius Bryant	1001	Case research fee		1,850.00	30,505.00	R&W Development	x	

The State Bar template includes a related compliance question in Section 1: "Does each entry contain the information required by Standard (1)(b), adopted pursuant to rule 1.15(e)?" Since all items required by Standard (1)(b) were recorded for each transaction in the trust account journal (the columns with an *asterisk), "Yes" is selected. When you perform your monthly reconciliation, check to make sure that each entry contains the information required by Standard (1)(b). If it does not, review your records to complete the entries so that you can check "Yes" when answering this question.

Section 2—Total Individual Ledgers Balance

In the second section of the reconciliation form, you will enter two balances: the total client ledger balance and the bank charges ledger balance, if applicable.

2

2. TOTAL OF ALL INDIVIDUAL LEDGER BALANCES

A. Total Individual Client Ledger Balances, including all undisbursed funds pursuant to rule 1.15(c)(2) ..... $ 30,330.00

Do all of the client ledgers have a positive or zero balance? (Y/N) Yes
— If no, attach an explanation, including any corrective action taken.

Does each entry contain the information required by Standard (1)(b), adopted pursuant to rule 1.15(e)? (date, amount, payor/payee, purpose, current balance) (Y/N) Yes
— If no, attach an explanation, including any corrective action taken.

B. Total Bank Charges Balance in Trust Account ..... + $ 175.00

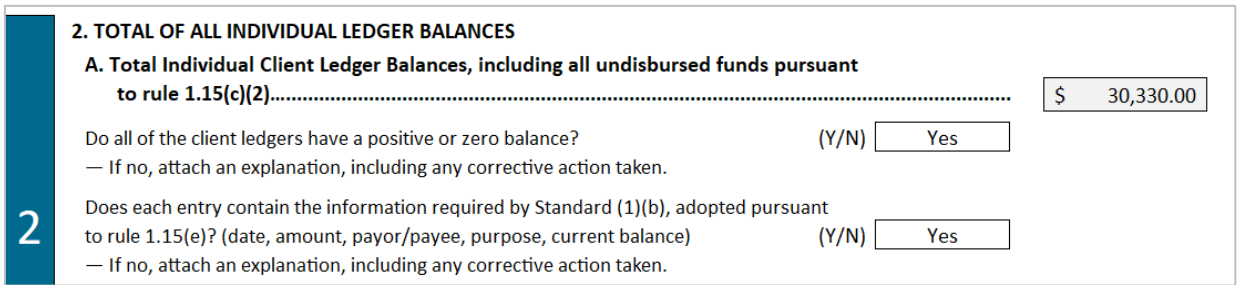
In compliance with rule 1.15(c)(1), are the firm funds in the account no more than reasonably sufficient to pay bank charges? (Y/N) Yes

TOTAL 2. INDIVIDUAL LEDGERS (A+B) (automatically calculated) ..... = **$ 30,505.00**

In Section 2A of the reconciliation form, record the total client ledger balances. To calculate the total of all client ledger balances for Section 2A, prepare a client ledger summary that lists every client with their running balances as of the date of reconciliation. The two clients in our example have the following running balances:

Client Ledger Summary with Balances	
January 2024	
Individual Clients	**Balance**
R&W Development	$ 22,830.00
Dr. Tran	$ 7,500.00
	$ 30,330.00

The total balance of both clients is $30,330.00, which we enter in the client ledger balances, Section 2A, in the reconciliation form below.



2. TOTAL OF ALL INDIVIDUAL LEDGER BALANCES

A. Total Individual Client Ledger Balances, including all undisbursed funds pursuant to rule 1.15(c)(2) ..... $ 30,330.00

2

Do all of the client ledgers have a positive or zero balance? (Y/N) Yes
— If no, attach an explanation, including any corrective action taken.

Does each entry contain the information required by Standard (1)(b), adopted pursuant to rule 1.15(e)? (date, amount, payor/payee, purpose, current balance) (Y/N) Yes
— If no, attach an explanation, including any corrective action taken.

The State Bar template includes two compliance questions related to Section 2A.

The first question is, “Do all the client ledgers have a positive or zero balance?” Since both of our clients have a positive balance, “Yes” is selected. If the answer is “No,” then you would attach an explanation of the negative balance and include a summary of any corrective action taken. A negative balance could indicate a calculation error or, worse, that a client’s funds have been misappropriated. In all circumstances, take appropriate corrective action, document the problem, and summarize the corrective action.

The second question is, “Does each entry contain the information required by Standard (1)(a), adopted pursuant to rule 1.15(e)?” Since all items required by Standard (1)(a) were recorded for each transaction in the client ledgers (the columns with an *asterisk, “Yes” is selected).

In Section 2B record the bank charges balance. The running balance of the bank charges ledger in our example is $175.00.

BANK CHARGES LEDGER

Firm Name	Expert Law Firm		Month and Year	January	2024
Purpose	Firm funds for nonchargeable bank fees		Case Open Date	01/03/24	
			Case Close Date		

*SEE PARAGRAPH (c)(1) OF RULE 1.15.

Date	Payor or Payee	Check #	Purpose	Deposit	Disbursement	Running Balance	Reconciled to Account Journal?
01/03/24	Expert Law Firm	3889	Firm funds for bank fees	200.00		200.00	x
01/03/24	Friendly Bank		Fee for ordering checks - add missing 1/3/24 entry		25.00	175.00	x

Enter this amount into Section 2B of the reconciliation form.

B. Total Bank Charges Balance in Trust Account ..... + $ 175.00

In compliance with rule 1.15(c)(1), are the firm funds in the account no more than reasonably sufficient to pay bank charges? (Y/N) Yes

The State Bar template includes one compliance question related to Section 2B. “In compliance with rule 1.15(c)(1), are the firm funds in the account no more than reasonably sufficient to pay bank charges?” “Yes” is selected in the example.

The total of Section 2A and 2B represents the total amount of all ledgers as of the date of reconciliation, which in our example is $30,505.00.

2

2. TOTAL OF ALL INDIVIDUAL LEDGER BALANCES

A. Total Individual Client Ledger Balances, including all undisbursed funds pursuant to rule 1.15(c)(2)..... $ 30,330.00

Do all of the client ledgers have a positive or zero balance? (Y/N) Yes
— If no, attach an explanation, including any corrective action taken.

Does each entry contain the information required by Standard (1)(b), adopted pursuant to rule 1.15(e)? (date, amount, payor/payee, purpose, current balance) (Y/N) Yes
— If no, attach an explanation, including any corrective action taken.

B. Total Bank Charges Balance in Trust Account ..... + $ 175.00

In compliance with rule 1.15(c)(1), are the firm funds in the account no more than reasonably sufficient to pay bank charges? (Y/N) Yes

TOTAL 2. INDIVIDUAL LEDGERS (A+B) (automatically calculated) ..... = **$ 30,505.00**

Compare the total of Section 1, trust account journal balance, and Section 2, individual ledgers balance; they should match.

FIRM RECORDS - ACCOUNT BALANCES

1

1. TRUST ACCOUNT JOURNAL BALANCE ..... **$ 30,505.00**

Does each entry contain the information required by Standard (1)(b), adopted pursuant to rule 1.15(e)? (client name, date, amount, payor/payee, current balance) (Y/N) Yes

2

2. TOTAL OF ALL INDIVIDUAL LEDGER BALANCES

A. Total Individual Client Ledger Balances, including all undisbursed funds pursuant to rule 1.15(c)(2) ..... $ 30,330.00

Do all of the client ledgers have a positive or zero balance? (Y/N) Yes
— If no, attach an explanation, including any corrective action taken.

Does each entry contain the information required by Standard (1)(b), adopted pursuant to rule 1.15(e)? (date, amount, payor/payee, purpose, current balance) (Y/N) Yes
— If no, attach an explanation, including any corrective action taken.

B. Total Bank Charges Balance in Trust Account ..... **+** $ 175.00

In compliance with rule 1.15(c)(1), are the firm funds in the account no more than reasonably sufficient to pay bank charges? (Y/N) Yes

TOTAL 2. INDIVIDUAL LEDGERS (A+B) (automatically calculated) ..... **=** **$ 30,505.00**

If they do, then continue to Section 3. If they do not, then go back and identify the error between the trust account journal and the individual ledgers.

All transactions in the trust account journal must have a corresponding entry in one of the ledgers, and all transactions in the ledgers should have a corresponding entry in the trust account journal. Make any adjusting entries in the trust account journal, client ledgers, or bank charges ledger, as needed, and update the client ledger summary with balances (the worksheet calculating the total of all client ledger balances), if adjustments were made to any of the client ledger amounts.

Only move on to the third section of the State Bar reconciliation form if the total balances of Section 1 and Section 2 agree.

Section 3—Adjusted Bank Statement Balance

In Section 3, we record amounts related to the bank statement and outstanding transactions.

First, enter the bank statement ending balance as of the date of reconciliation in Section 3A. You can find the bank statement ending balance at the top of your bank statement.

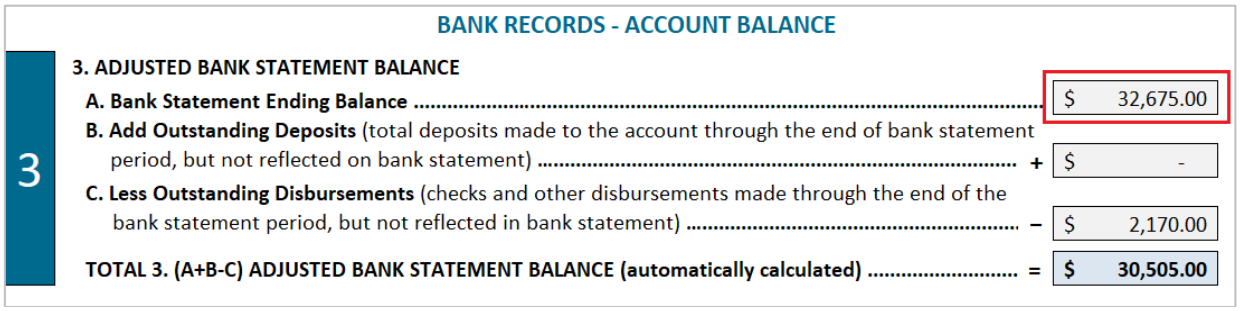
FRIENDLY BANK
123 Main Street
Your town, California 90001

Bank Statement

Account Number	123456789
Statement Period	Jan 1, 2024 – Jan 31, 2024
Ending Balance	$32,675.00

Expert Law Firm IOLTA
Attorney Client Trust Account California IOLTA
789 West Coast Avenue
Anytown, California 90001

Enter the ending balance in Section 3A of the reconciliation form.



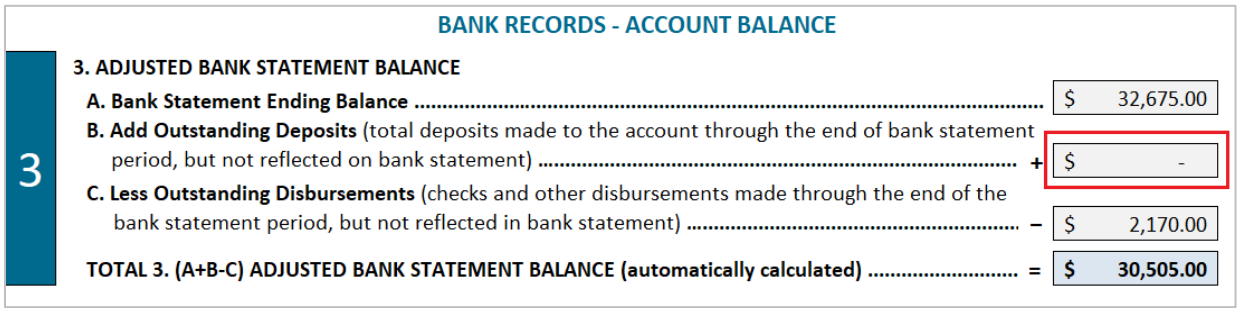
BANK RECORDS - ACCOUNT BALANCE

3

3. ADJUSTED BANK STATEMENT BALANCE

A. Bank Statement Ending Balance		$ 32,675.00
B. Add Outstanding Deposits (total deposits made to the account through the end of bank statement period, but not reflected on bank statement)	+	$ -
C. Less Outstanding Disbursements (checks and other disbursements made through the end of the bank statement period, but not reflected in bank statement)	–	$ 2,170.00
TOTAL 3. (A+B-C) ADJUSTED BANK STATEMENT BALANCE (automatically calculated)	=	**$ 30,505.00**

Next, total all outstanding deposits that are not reflected in the bank statement. This will include all funds that have been received and deposited by the attorney or firm that have not yet cleared the bank, and therefore, do not appear on the bank statement. (These transactions should have already been recorded in the trust account journal and client ledgers, but will not appear in the bank statement.) In this example, there are no outstanding deposits, so zero is entered in 3B.



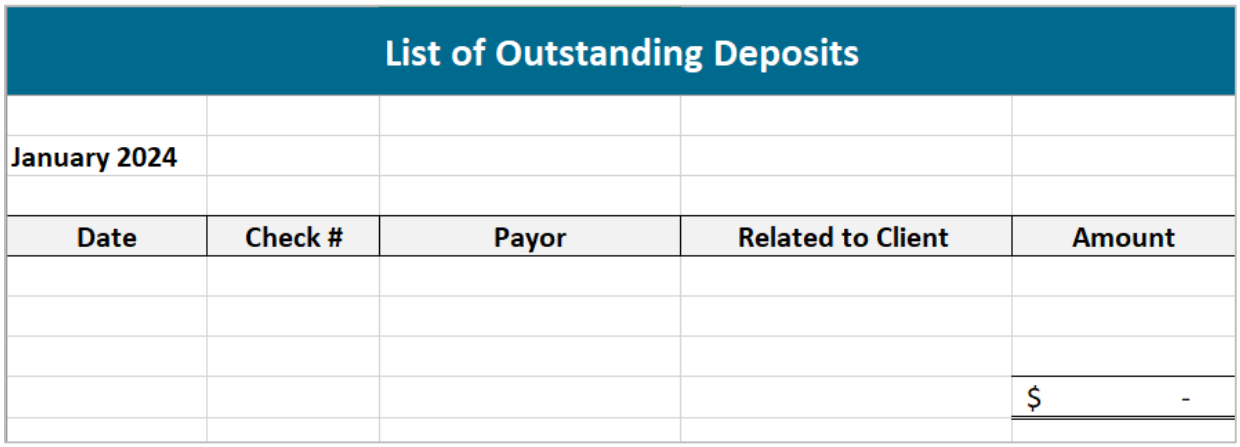
BANK RECORDS - ACCOUNT BALANCE

3

3. ADJUSTED BANK STATEMENT BALANCE

A. Bank Statement Ending Balance		$ 32,675.00
B. Add Outstanding Deposits (total deposits made to the account through the end of bank statement period, but not reflected on bank statement)	+	$ -
C. Less Outstanding Disbursements (checks and other disbursements made through the end of the bank statement period, but not reflected in bank statement)	–	$ 2,170.00
TOTAL 3. (A+B-C) ADJUSTED BANK STATEMENT BALANCE (automatically calculated)	=	**$ 30,505.00**

If there had been outstanding deposits, you would prepare a summary of all of them and total the amount. Below is an example of a worksheet to calculate outstanding deposits.



List of Outstanding Deposits

January 2024

Date	Check #	Payor	Related to Client	Amount
				$ -

Next, total all outstanding disbursements, which are all funds that have been disbursed from the trust account, but have not yet cleared the bank and therefore do not appear on the bank statement. (These transactions should have already been recorded in the trust account

journal and client ledgers, but will not appear in the bank statement.) In the example, there are two outstanding disbursements, check #1000, dated January 31, 2024, and made payable to South County Superior Court in the amount of $320.00, and check #1001, also dated January 31, 2024, and made payable to Darius Bryant in the amount of $1,850.00.

Prepare a summary of all outstanding disbursements and total the amount.

List of Outstanding Disbursements

January 2024

Date	Check #	Payee	Related to Client	Amount
01/30/24	1000	South County Superior Court	R&W Development	$ 320.00
01/31/24	1001	Darius Bryant	R&W Development	$ 1,850.00
				$ 2,170.00

The total amount of all outstanding disbursements, which is $2,170.00 in our example, is entered in Section 3C of the reconciliation form.

BANK RECORDS - ACCOUNT BALANCE

3

3. ADJUSTED BANK STATEMENT BALANCE

A. Bank Statement Ending Balance		$ 32,675.00
B. Add Outstanding Deposits (total deposits made to the account through the end of bank statement period, but not reflected on bank statement)	+	$ -
C. Less Outstanding Disbursements (checks and other disbursements made through the end of the bank statement period, but not reflected in bank statement)	–	$ 2,170.00
TOTAL 3. (A+B-C) ADJUSTED BANK STATEMENT BALANCE (automatically calculated)	=	**$ 30,505.00**

To calculate the total adjusted bank statement balance, add all outstanding deposits and subtract all outstanding disbursements from the bank statement ending balance. The adjusted balance in the example is $30,505.00.

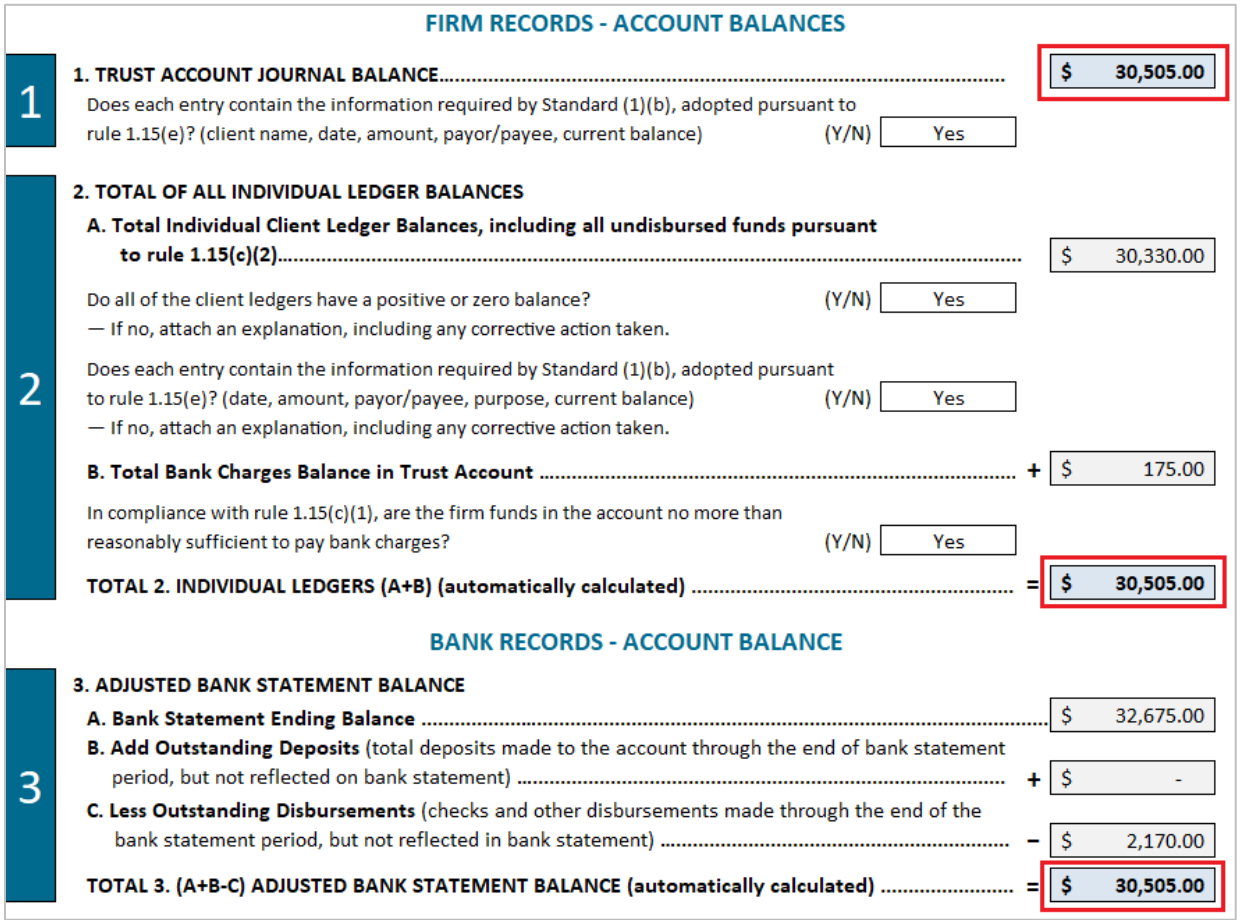
BANK RECORDS - ACCOUNT BALANCE

3

3. ADJUSTED BANK STATEMENT BALANCE

A. Bank Statement Ending Balance		$ 32,675.00
B. Add Outstanding Deposits (total deposits made to the account through the end of bank statement period, but not reflected on bank statement)	+	$ -
C. Less Outstanding Disbursements (checks and other disbursements made through the end of the bank statement period, but not reflected in bank statement)	–	$ 2,170.00
TOTAL 3. (A+B-C) ADJUSTED BANK STATEMENT BALANCE (automatically calculated)	=	**$ 30,505.00**

The total adjusted balance of Section 3 in the reconciliation form should match Sections 1 and 2.



FIRM RECORDS - ACCOUNT BALANCES

1

1. TRUST ACCOUNT JOURNAL BALANCE ..... $ 30,505.00

Does each entry contain the information required by Standard (1)(b), adopted pursuant to rule 1.15(e)? (client name, date, amount, payor/payee, current balance) (Y/N) Yes

2

2. TOTAL OF ALL INDIVIDUAL LEDGER BALANCES

A. Total Individual Client Ledger Balances, including all undisbursed funds pursuant to rule 1.15(c)(2) ..... $ 30,330.00

Do all of the client ledgers have a positive or zero balance? (Y/N) Yes
— If no, attach an explanation, including any corrective action taken.

Does each entry contain the information required by Standard (1)(b), adopted pursuant to rule 1.15(e)? (date, amount, payor/payee, purpose, current balance) (Y/N) Yes
— If no, attach an explanation, including any corrective action taken.

B. Total Bank Charges Balance in Trust Account ..... + $ 175.00

In compliance with rule 1.15(c)(1), are the firm funds in the account no more than reasonably sufficient to pay bank charges? (Y/N) Yes

TOTAL 2. INDIVIDUAL LEDGERS (A+B) (automatically calculated) ..... = $ 30,505.00

BANK RECORDS - ACCOUNT BALANCE

3

3. ADJUSTED BANK STATEMENT BALANCE

A. Bank Statement Ending Balance ..... $ 32,675.00

B. Add Outstanding Deposits (total deposits made to the account through the end of bank statement period, but not reflected on bank statement) ..... + $ -

C. Less Outstanding Disbursements (checks and other disbursements made through the end of the bank statement period, but not reflected in bank statement) ..... – $ 2,170.00

TOTAL 3. (A+B-C) ADJUSTED BANK STATEMENT BALANCE (automatically calculated) ..... = $ 30,505.00

If Section 3 does not match, identify the error between the trust account journal and the bank statement. (Remember, you have already confirmed that your trust account journal and ledgers agree. Therefore, you may identify the error by comparing the bank statement and the trust account journal.) Diligently look at each transaction on the bank statement and match it to the corresponding transaction in the trust account journal and vice versa. If there is any transaction in your trust account journal that is not in the bank statement, the item must be added to either the outstanding deposits list or th0065 outstanding disbursements list. If there is a transaction in the bank statement that is not in your trust account journal, you must further research the transaction because this is either a bank error (which is rare, and your banker can help) or you failed to record the transaction in your trust account journal and corresponding client ledger or bank charges ledger at the time of the transaction. If it is the latter, you must make an adjusting entry to both the trust account journal and the appropriate ledger to add any mistakenly omitted transactions.

Once the balance of Sections 1, 2, and 3 match, you have successfully reconciled your trust account for the month. Select “Yes” to the final question, “Do total balance of 1, 2, and 3 agree?”.

DO TOTAL BALANCE OF 1, 2 and 3 AGREE?	(Y/N)	Yes
— If no, your account is not reconciled. Identify the error(s) and re-reconcile the account.		

If you as the attorney are performing the reconciliation yourself, simply save your reconciliation documentation and trust accounting records detailed in Standard (1) of rule 1.15 and you are done.

If someone other than you maintains the trust account bookkeeping and performs the monthly reconciliation, you will need to review their work by performing a supervisory review. This review is required to fulfill your nondelegable, ethical duty to safeguard your client’s funds. (See rule 5.3.) The State Bar offers a Monthly Reconciliation Supervisory Review for you, as the supervising attorney, to review the bookkeeping and monthly reconciliation work of someone performing these functions on your behalf.

Afterword

If you have read all the way through this handbook, you should now know everything you need to properly receive, pay out, and account for money you hold for your clients, as well as perform your required monthly reconciliation. However, your professional responsibility is not to know client trust accounting, it is 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. Do not 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 also fundamental to the attorney-client relationship. (The text of these rules can be found in **Appendix 2: Text of Rules and Links to Statutes Cited**.)

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 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 $1,000.00, 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 do not apply if you render legal services in an emergency, if the services are of the same general kind you have 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 is not 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 twenty-five percent of the dollar amount recovered if the recovery is pursuant to settlement agreement and release of all claims executed by all parties thereto prior to a civil complaint or demand for arbitration being filed, or thirty-three percent of the dollar amount recovered if the recovery is pursuant to settlement, arbitration, or judgment after a civil complaint or demand for arbitration is filed. 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 ground 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 $10,000.00 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

The rules provided in Appendix 2 are current as of January 1, 2023. Please refer to the State Bar's website for the current and former Rules of Professional Conduct.

Rule 1.4 Communication with Clients

(Approved by order of Supreme Court, effective November 1, 2018. Amended by the Supreme Court, effective January 1, 2023)

(a) A lawyer shall:

(1) promptly inform the client of any decision or circumstance with respect to which disclosure or the client's informed consent is required by these rules or the State Bar Act;

(2) reasonably consult with the client about the means by which to accomplish the client's objectives in the representation;

(3) keep the client reasonably informed about significant developments relating to the representation, including promptly complying with reasonable requests for information and copies of significant documents when necessary to keep the client so informed; and

(4) advise the client about any relevant limitation on the lawyer's conduct when the lawyer knows that the client expects assistance not permitted by the Rules of Professional Conduct or other law.

(b) A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation.

(c) A lawyer may delay transmission of information to a client if the lawyer reasonably believes that the client would be likely to react in a way that may cause imminent harm to the client or others.

(d) A lawyer's obligation under this rule to provide information and documents is subject to any applicable protective order, non-disclosure agreement, or limitation under statutory or decisional law.

Comment

[1] A lawyer will not be subject to discipline under paragraph (a)(3) of this rule for failing to communicate insignificant or irrelevant information. (See Bus. & Prof. Code, § 6068, subd. (m).) Whether a particular development is significant will generally depend on the surrounding facts and circumstances. For example, a lawyer's receipt of funds on behalf of a client requires

communication with the client pursuant to rule 1.15, paragraphs (d)(1) and (d)(4) and ordinarily is also a significant development requiring communication with the client pursuant to this rule.

[2] A lawyer may comply with paragraph (a)(3) by providing to the client copies of significant documents by electronic or other means. This rule does not prohibit a lawyer from seeking recovery of the lawyer's expense in any subsequent legal proceeding.

[3] Paragraph (c) applies during a representation and does not alter the obligations applicable at termination of a representation. (See rule 1.16(e)(1).)

[4] This rule is not intended to create, augment, diminish, or eliminate any application of the work product rule. The obligation of the lawyer to provide work product to the client shall be governed by relevant statutory and decisional law.

Rule 1.5 Fees for Legal Services

(Approved by order of Supreme Court, effective 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 1.8.1 Business Transactions with a Client and Pecuniary Interests Adverse to a Client

(Approved by order of Supreme Court, effective 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 1.15 Safekeeping Funds and Property of Clients and Other Persons

(Approved by order of Supreme Court, effective November 1, 2018. Amended by the Supreme Court, effective January 1, 2023)

(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) absent good cause, notify a client or other person no later than 14 days 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 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.

(f) For purposes of determining a lawyer's compliance with paragraph (d)(7), unless the lawyer, and the client or other person agree in writing that the funds or property will continue to be held by the lawyer, there shall be a rebuttable presumption affecting the burden of proof as defined in Evidence Code sections 605 and 606 that a violation of paragraph (d)(7) has occurred if the lawyer, absent good cause, fails to distribute undisputed funds or property within 45-days of the date when the funds become undisputed as defined by paragraph (g). This presumption may be rebutted by proof by a preponderance of evidence that there was good cause for not distributing funds within 45 days of the date when the funds or property became undisputed as defined in paragraph (g).

(g) As used in this rule, "undisputed funds or property" refers to funds or property, or a portion of any such funds or property, in the possession of a lawyer or law firm where the lawyer knows or reasonably should know that the ownership interest of the client or other person in the funds or property, or any portion thereof, has become fixed and there are no unresolved disputes as to the client's or other person's entitlement to receive the funds or property.

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 canceled 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.

[4] Subparagraph (d)(7) is not intended to apply to a fee or expense the client has agreed to pay in advance, or the client file, or any other property that the client or other person has agreed in writing that the lawyer will keep or maintain. Regarding a lawyer's refund of a fee or expense paid in advance, see rule 1.16(e)(2). Regarding the release of a client's file to the client, see rule 1.16(e)(1).

[5] Upon rebuttal by proof by a preponderance of the evidence of the presumption set forth in paragraph (f), a violation of paragraph (d)(7) must be established by clear and convincing evidence without the benefit of the rebuttable presumption.

[6] Whether or not the rebuttable presumption in paragraph (f) applies, a lawyer must still comply will all other applicable provisions of this rule. This includes a lawyer's duty to take diligent steps to initiate and complete the resolution of disputes concerning a client's or other person's entitlement to funds or property received by a lawyer.

[7] Under paragraph (g), possible disputes requiring resolution may include, but are not limited to, disputes concerning entitlement to funds arising from: medical liens; statutory liens; prior attorney liens; costs or expenses; attorney fees; a bank's policies and fees for clearing a check or draft; any applicable conditions on entitlement such as a plaintiff's execution of a release and dismissal; or any legal proceeding, such as an interpleader action, concerning the entitlement of any person to receive all or a portion of the funds or property.

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

§ 1632 Fee Agreements Negotiated in Languages Other than English

§ 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 Licensees

Division 1. Licensee Record

Rule 2.5 Client Trust Account Protection Program Annual Reporting, Account Registration and Self-Assessment Completion Requirements

As authorized by California Rule of Court, rule 9.8.5, a licensee must comply with certain annual reporting requirements under the Client Trust Account Protection Program (CTAPP).

(A) Definitions

(1) A licensee "responsible for client funds and funds entrusted by others under the provisions of rule 1.15 of the Rules of Professional Conduct" is:

(a) a licensee who: (i) represents a client in a matter in which funds have been received by the licensee or licensee's firm on behalf of the client during the reportable time period; and (ii) has responsibility for complying with any of the requirements or prohibitions in rule 1.15 of the Rules of Professional Conduct—such requirements and prohibitions are not limited to recordkeeping duties and include, for example, the responsibility for giving notice to the client that funds were received on behalf of the client under rule 1.15(d)(1) of the Rules of Professional Conduct; or

(b) a licensee who acted as a signatory on a trust account or a licensee who exercised managerial or primary administrative oversight for a trust account.

(2) A "trust account" is the bank account or accounts opened to comply with rule 1.15(a) of the Rules of Professional Conduct and includes: (a) an IOLTA account under Business and Professions Code section 6211, subdivision (a) where the interest is paid to the State Bar; and (b) any interest bearing bank trust deposit accounts, or dividend-paying trust investment accounts established under Business and Professions Code section 6211, subdivision (b) where the interest is payable to a client.

(3) An "annual self-assessment" is a survey about client trust accounting duties and practices and includes, but is not limited to, questions and affirmations regarding a licensee's trust account recordkeeping under rule 1.15(d)(3) of the Rules of Professional Conduct and the recordkeeping standards adopted by the Board under rule 1.15(e) of the Rules of Professional Conduct.

(4) A "firm" means a law partnership; a professional law corporation; a lawyer acting as a sole proprietorship; an association authorized to practice law; or lawyers employed

in a legal services organization or in the legal department, division or office of a corporation, of a government organization, or of another organization.

(5) The "reportable time period" for the information to be annually reported under paragraph (B) of this rule is the calendar year immediately preceding a licensee's due date for paying their annual license fees under Title 2, Division 2, rule 2.11 of the State Bar Rules.

(B) CTAPP Reporting Requirements

Unless a licensee is exempt under paragraph (K), a licensee must annually comply with the following reporting requirements:

(1) Annual Trust Account Certification—A licensee must annually (a) report whether or not, at any time during the reportable time period, they were a licensee responsible for client funds and funds entrusted by others under the provisions of rule 1.15 of the Rules of Professional Conduct and (b) if they were a licensee responsible for client funds and funds entrusted by others under the provisions of rule 1.15 of the Rules of Professional Conduct, then those licensees must also certify that they are knowledgeable about, and in compliance with, applicable rules and statutes governing a trust account and the safekeeping of funds entrusted by clients and others;

(2) Annual Trust Account Registration—A licensee who was responsible for client funds and funds entrusted by others under the provisions of rule 1.15 of the Rules of Professional Conduct must, annually, register each and every trust account in which the licensee held such funds at any time during the reportable time period by identifying account numbers and financial institutions in a manner prescribed by the State Bar for such reporting. A licensee will be considered in compliance with this subparagraph if the licensee's firm submits account registration information on behalf of one or more licensees affiliated with the firm that identifies the licensee as one on whose behalf the registration information is submitted; and

(3) Annual Self-Assessment—A licensee responsible for client funds and funds entrusted by others under the provisions of rule 1.15 of the Rules of Professional Conduct must complete an annual self-assessment and report the completion of the self-assessment in a manner prescribed by the State Bar for such reporting.

(C) CTAPP Reporting Deadline

The deadline for submitting the information to be annually reported under paragraph (B) of this rule is the licensee's due date for paying their annual license fees under Title 2, Division 2, rule 2.11 of the State Bar Rules.

(D) CTAPP Reporting Required Even if a Licensee is Not Responsible for Trust Funds at the Time of Reporting

The annual reports required under paragraph (B)(1) and paragraph (B)(3) of this rule must be submitted when a licensee, at any time during the reportable time period, has been a licensee responsible for client funds or funds entrusted by others under the provisions of rule 1.15 of the Rules of Professional Conduct, and this includes circumstances where the licensee at the time of submitting their report is no longer responsible for client funds or funds entrusted by others under the provisions of rule 1.15 of the Rules of Professional Conduct. The registration of a trust account under paragraph (B)(2) of this rule also is required even if a licensee is not responsible for funds held in the trust account at the time of reporting so long as the licensee remains in practice with the firm that controls the trust account. A licensee is not required to register a trust account controlled by a firm with which the licensee no longer practices.

(E) Reporting that is Required by a Licensee Who is Not Responsible for Client Funds and Funds Entrusted by Others under the Provisions of Rule 1.15 of the Rules of Professional Conduct

Under paragraph (B)(1), a licensee who is not exempt under paragraph (K) must report whether or not, at any time during the reportable time period, they were a licensee who was responsible for client funds and funds entrusted by others under the provisions of rule 1.15 of the Rules of Professional Conduct. To comply with paragraph (B)(1), a licensee who was not responsible for client funds and funds entrusted by others under the provisions of rule 1.15 of the Rules of Professional Conduct must submit a report indicating that fact.

(F) Noncompliance

Noncompliance with the requirements of this rule is failure to:

(1) complete annual trust account certification, registration, or self-assessment requirements under paragraph (B); or

(2) pay fees for noncompliance.

(G) Notice of CTAPP Reporting Noncompliance

A licensee who is sent a notice of noncompliance with any reporting required by this rule must comply as instructed in the notice or be involuntarily enrolled as inactive. An inactive licensee is not eligible to practice law.

(H) Enrollment as Inactive for Noncompliance

A licensee who fails to comply with a notice of CTAPP reporting noncompliance is enrolled as inactive and is not eligible to practice law. The enrollment is administrative and no hearing is required.

(I) Reinstatement Following Noncompliance

Enrollment as inactive for CTAPP reporting noncompliance terminates when a licensee submits proof of compliance and pays noncompliance and reinstatement fees.

(J) Fees for Noncompliance

Fees for noncompliance with any of the requirements in paragraph (B), including a reinstatement fee to terminate CTAPP inactive enrollment, are set forth in the Schedule of Charges and Deadlines.

(K) Licensees Who are Exempt from Compliance with this Rule

The following category of licensees are exempt from compliance with the reporting requirements in paragraph (B):

(1) A licensee who was not on active status for the entirety of the reportable time period; or

(2) A licensee who is not entitled to practice law at the time of the reporting deadline for any reason other than voluntary inactive enrollment.

Rule 2.5 adopted effective January 1, 2023.

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 licensee 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 "licensee" is a licensee and a licensee's law firm.

(J) A "licensee business expense" is an expense that a licensee 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. Licensees' duties

Rule 2.110 Funds to be held in an IOLTA account

(A) Licensees 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 licensee 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 cost of establishing and administering non-IOLTA accounts for the client or third party's benefit, including service charges, the costs of the licensee'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 licensee 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 licensee for determining in good faith whether or not to place funds in an IOLTA account.

APPENDIX 2

Rule 2.111 Funds not to be held in an IOLTA account

(A) If a licensee 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 licensee should not designate an exempt account as an IOLTA account.[4]

Rule 2.112 Review of funds in an IOLTA account

A licensee 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 licensee may allow an IOLTA-eligible institution to deduct chargeable fees permitted by Business and Professions Code 6212(c) from IOLTA funds. A licensee must pay any licensee business expense and may not allow the bank to deduct such expenses from IOLTA funds. If the State Bar becomes aware that a licensee 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 licensee must report compliance with these rules.

Rule 2.115 Consent to reporting

By establishing funds in an account, a licensee 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.

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[4] As defined in rule 2.100(D).

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 licensee 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 licensee

Nothing in these rules shall be construed as affecting or impairing the duties and obligations of a licensee pursuant to the statutes and rules governing the conduct of licensees of the State Bar including, but not limited to, provisions of Rule 1.15 of the Rules of Professional Conduct requiring a licensee 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 licensee 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.

APPENDIX 2

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.

CALIFORNIA RULES OF COURT

Title 9. Rules on Law Practice, Attorneys, and Judges

Chapter 2. Attorney Admissions

Rule 9.8.5 State Bar Client Trust Account Protection Program

(a) Client trust account protection program requirements

The State Bar of California must establish and administer a Client Trust Account Protection Program for the protection of client funds held in trust by a licensee that facilitates the State Bar's detection and deterrence of client trust accounting misconduct.

(1) The State Bar must impose the following requirements under this program:

(A) Annual Trust Account Certification—All licensees must annually (1) report whether or not, at any time during the prior year, they were responsible for client funds and funds entrusted by others under the provisions of rule 1.15 of the Rules of Professional Conduct and (2) if they were responsible, certify that they are knowledgeable about, and in compliance with, applicable rules and statutes governing client trust accounts and the safekeeping of funds entrusted by clients and others; and

(B) Annual Trust Account Registration—All licensees who were responsible for client funds and funds entrusted by others under the provisions of rule 1.15 of the Rules of Professional Conduct must, annually, register each and every trust account in which the licensee held such funds at any time during the prior year by identifying account numbers and financial institutions in a manner prescribed by the State Bar for such reporting that will securely maintain the information submitted.

(2) Among the other requirements the State Bar may impose under this program are the following:

(A) Annual Self-Assessment—All licensees who were responsible, at any time during the prior year, for a client trust account under the provisions of rule 1.15 of the Rules of Professional Conduct must complete an annual self-assessment on client trust accounting duties and practices;

(B) Compliance Review—If selected by the State Bar, a licensee must complete and submit to the State Bar a client trust accounting compliance review to be conducted by a certified public accountant at the licensee's expense; and

(C) Additional Actions—If selected by the State Bar, an additional action or actions based on the results of a compliance review may include an investigative audit, a notice of mandatory corrective action, and a referral for disciplinary action.

(b) Authorization for the Board of Trustees of the State Bar to adopt rules and regulations

The Board of Trustees of the State Bar is authorized to formulate and adopt such rules and regulations as it deems necessary and appropriate to comply with this rule, including a rule or regulation that defines a licensee who is responsible for client funds and funds entrusted by others under the provisions of rule 1.15 of the Rules of Professional Conduct.

(c) Failure to comply with program

A licensee who fails to satisfy the requirements of this program must be enrolled as an inactive licensee of the State Bar under the rules to be adopted by the Board of Trustees of the State Bar. Inactive enrollment imposed for noncompliance with the requirements of this program is cumulative and does not preclude a disciplinary proceeding or other actions for violations of the State Bar Act, the Rules of Professional Conduct, or other applicable laws.

(d) Fees and penalties

The State Bar has the authority to set and collect appropriate fees and penalties.

Rule 9.8.5 adopted effective January 1, 2023.

APPENDIX 3: INDEX OF SELECTED CASES AND OPINIONS BY TOPIC

Duties, In General

In the Matter of Shahbaz (Review Dept. 2022) 2022 WL 6973369. Client ledgers and associated fraudulent checks were created to deceive OCTC and misrepresent that the settlement funds in the Kambiz and Soloki matters were timely disbursed when in fact they were not.

In the Matter of Sariol (Review Dept. 2022) 2022 WL 3584820. Reasonable reliance on a partner, associate, or responsible employee to handle client trust accounting duties does not relieve an attorney from the professional responsibility to properly maintain funds in a client trust account.

In the Matter of Robinson (Review Dept. 2021) 2021 WL 518133. Robinson has failed to rebut this presumption. His argument that culpability cannot be established since the seven clients did not testify and chief trial counsel cannot prove the existence of an attorney-client relationship is not a defense to the misappropriation charges. Even if no such relationship had been created, Robinson, being entrusted with the funds, listed as “attorney” payee on the checks, and having deposited the checks into his client trust account, is still held to a fiduciary duty.

In the Matter of Bolanos (Review Dept. 2017) 2017 WL 2772192. Inference of misappropriation if client trust account drops below amount attorney should maintain in trust for client.

In the Matter of Wells (Review Dept. 2006) 4 Cal. State Bar Ct. Rptr. 896. While practicing outside of California, the attorney violated rule 4-100 (current rule 1.15) by not depositing into a client trust account settlement benefits that were received for the benefit of the client. A finding that the attorney was culpable of unauthorized practice of law compels a conclusion that the attorney charged and collected illegal fees under rule 4-200(A) (current rule 1.5).

In the Matter of Robins (Review Dept. 1991) 1 Cal. State Bar Ct. Rptr. 708. The duty to keep the 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 [205 Cal.Rptr. 834]. Misappropriation of client funds constitutes professional misconduct warranting discipline, emphasizing the attorney's duty of honesty and integrity.

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

APPENDIX 3

Advanced Fees

In the Matter of Rubin (Review Dept. 2021) 5 Cal. State Bar Ct. Rptr. 797. Failure to return unearned advance fees.

In the Matter of Deaguilera (Review Dept. 2021) 2021 WL 5344567. DeAguilera could not ethically consider his fixed retainer fee to be a true retainer rather than advanced legal fees which were accountable under rule 4-100(B)(3) (current rule 1.15(d)(3)–(6)). As concluded by the hearing judge, DeAguilera had not perfected a limited, permissible, true retainer agreement supported by proof that he had set aside blocks of time and refused business which would conflict with the time needed to perform the contracted services.

In the Matter of Seltzer (Review Dept. 2013) 5 Cal. State Bar Ct. Rptr. 263. Failure to return unearned advanced fees where client receives nothing of value from attorney.

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 1.15) 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 as it is earned.

Settlement Drafts

In the Matter of Robert Steven Kaplan (Review 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) (current rule 1.15(d)(7)).

Maintain Actual Records of Trust Account Activity

In the Matter of Sariol (Review Dept. 2022) 2022 WL 3584820. Reasonable reliance on a partner, associate, or responsible employee to handle client trust accounting duties does not relieve an attorney from the professional responsibility to properly maintain funds in a client trust account.

In the Matter of Rae Blum (Review Dept. 2002) 4 Cal. State Bar Ct. Rptr. 403. The attorney's reliance on her husband/law partner to manage the client's trust account does not relieve the attorney of her personal, nondelegable duty to monitor the client's funds and 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 (Review 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 [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 [193 Cal.Rptr. 896]. An attorney's failure to keep adequate records warrants discipline.

Weir v. State Bar (1979) 23 Cal.3d 564 [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 Rubin (Review Dept. 2021) 5 Cal. State Bar Ct. Rptr. 797. Failure to provide accounting under 4-100(B)(3) (current rule 1.15(d)(3)–(6)).

In the Matter of Deaguilera (Review Dept. 2021) 2021 WL 5344567. Attorney had not perfected a limited, permissible, true retainer agreement supported by proof that he had set aside blocks of time and refused business which would conflict with the time needed to perform the contracted services.

In the Matter of Greer (Review Dept. 2021) 2021 WL 5176470. Attorney stipulated he did not maintain journals or monthly reconciliations for his client trust accounts, stating he solely relied on bank statements to manage the account.

In the Matter of Khakshooy (Review Dept. 2019) 5 Cal. State Bar Ct. Rptr. 681. Client entitled to receive an accounting clearly identifying how the settlement money was disbursed and he did not receive it.

In the Matter of Brockway (Review Dept. 2006) 4 Cal. State Bar Ct. Rptr. 944. An attorney must satisfy the accounting requirements of rule 4-100 (current rule 1.15) even in the absence of a demand for such an accounting from the client.

In the Matter of Cacioppo (Review Dept. 1992) 2 Cal. State 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 the 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 (Review 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) (current rule 1.15(d)(3)–(6)), 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 [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 Deaguilera (Review Dept. 2021) 2021 WL 5344567. Attorney had not perfected a limited, permissible, true retainer agreement supported by proof that he had set aside blocks of time and refused business which would conflict with the time needed to perform the contracted services.

In the Matter of Brockway (Review 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 a "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 rendered.

In the Matter of Respondent F (Review Dept. 1992) 2 Cal. State Bar Ct. 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 (Review Dept. 1991) 1 Cal. State Bar Ct. 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 [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 [193 Cal.Rptr. 896].)

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

Grossman v. State Bar (1983) 34 Cal.3d 73 [192 Cal.Rptr. 397]. The attorney misappropriated client funds when 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 that violate the canons of professional ethics of an attorney may for that reason be void.

Brody v. State Bar (1974) 11 Cal.3d 347 [113 Cal.Rptr. 371]. An attorney may not unilaterally determine his 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 [90 Cal.Rptr. 60].)

All Statements to Clients Showing Disbursements

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

Attorney's Liens

Rescap Liquidating Trust v. First California Mortgage Company (N.D.Cal. 2018) 2018 WL 5310795. The lien Rescap holds is sufficient to state a claim for conversion against FCMC.

McInerney & Dillon, P.C. v. Hermann (2018) 2018 WL 4501549. A charging lien was included in the retainer agreement between the parties, but the complaint does not allege and no evidence was presented that Hermann was advised to seek the advice of an independent lawyer and given a reasonable opportunity to do so. Thus, McInerney failed to comply with rule 3-300, and therefore the charging lien is void and unenforceable.

Shopoff & Cavallo LLP v. Hyon (2008) 167 Cal.App.4th 1489, 1522–25 [85 Cal.Rptr.3d 268]. Issue presented was whether rule 3-300 (current rule 1.8.1) applies to a contingency fee agreement coupled with a lien on a client's prospective recovery in the same proceeding. Client argued that since the attorney violated 3-300 (current rule 1.8.1) by acquiring attorney's lien on recovery proceeds without disclosure/consent, that neither the liens nor the contingency fees provided for in the contract could be enforced. The court cited to Fletcher v. Davis (2004) 14 Cal.Rptr.3d 58 (holding that attorney must comply with rule 3-300 (current rule 1.8.1) to secure payment of hourly legal fees by obtaining a charging lien), and held that even if the Fletcher rule applies, only the liens attached to the contingency fee agreement would be invalidated, not the contingency agreement itself. This result is also consistent with the notion of severability of contracts.

In re Popov (N.D.Cal. 2007) 2007 WL 1970102. The district court affirmed a bankruptcy court order finding that the attorney did not violate rule 3-300 (current rule 1.8.1) 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 interest and triggers the requirements of rule 3-300 (current rule 1.8.1), 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 (Review Dept. 1997) 3 Cal. State 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) (current rule 1.15(d)(7)) 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 (Review 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 a contractual relationship, and conversion.

Copies of all bills

In the Matter of Oliveri (Review Dept. 2024) 2024 WL 2153573. Failing to provide client with an accounting of loan proceeds after disbursement began.

Dreyfus v. State Bar (1960) 54 Cal.2d 799 [8 Cal.Rptr. 469]. No receipt was given to the client for monies deposited with the 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.

APPENDIX 3

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

In the Matter of Respondent F (Review 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 [205 Cal.Rptr. 834]; *Guzzetta v. State Bar* (1987) 43 Cal.3d 962 [239 Cal.Rptr. 675].)

Maintain Books And Account To Third Parties

In the Matter of Kaplan (Review 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 [239 Cal.Rptr. 675]. An attorney's fiduciary obligation to account and pay funds extends to both parties claiming an interest therein. The duty extends to the opposing party's spouse.

Maintain a Separate Ledger Page or Card for Each Client

In the Matter of Yagman (Review 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) (current rule 1.15(c)(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 [152 Cal.Rptr. 921]. The fee ledger sheet was used as evidence that all fees and costs had been paid by clients.

Vaughn v. State Bar (1972) 6 Cal.3d 847 [100 Cal.Rptr. 713]. The attorney's records failed to show receipt of client funds. Holding the client's funds in cash or cashier's checks is disapproved without the 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 (Review 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 (Review 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 1.15(d)(7)) by distributing the settlement funds to the client. An attorney has a duty to notify DHS when a matter has been settled prior to the distribution of the settlement proceeds.

In the Matter of Dyson (Review 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 (Review Dept. 1990) 1 Cal. State Bar Ct. Rptr. 1. An attorney must keep sufficient funds in a trust account to pay the undisputed portion of the 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 [100 Cal.Rptr. 713].)

Simmons v. State Bar (1969) 70 Cal.2d 361 [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 Robinson (Review Dept. 2021) 2021 WL 518133. 27 checks issued from client trust account for personal or business purposes, clearly violating rule 4-100(A)) (current rule 1.15(a)).

In the Matter of Koehler (Review Dept. 1991) 1 Cal. State Bar Ct. 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 (Review Dept. 1990) 1 Cal. State Bar Ct. 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 [193 Cal.Rptr. 896]. The attorney's failure to give the client receipts for attorney's fees was disapproved.

Reconciliation (monthly/quarterly)

Friedman v. State Bar (1990) 50 Cal.3d 235 [266 Cal.Rptr. 632]. The 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 [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 (Review 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 [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. An attorney who has properly withdrawn fees from a client trust account in compliance with rule 4-100(A)(2) (current rule 1.15(c)(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 (Review 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 "willful" for disciplinary purposes, even if there was no deliberate wrongdoing. (See also *Palomo v. State Bar* (1984) 36 Cal.3d 785 [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 the absence of billing records.

In re Silverton (2005) 36 Cal.4th 81 [29 Cal.Rptr.3d 766]. The attorney violated rule 4-100 (current rule 1.15) 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 (current rule 1.8.1) and 4-200 (current rule 1.5) 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 (Review 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 the 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 (Review 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 (Review Dept. 1992) 2 Cal. State Bar Ct. Rptr. 17. An attorney is permitted to keep in a client trust account their own funds reasonably sufficient to cover bank charges.

In the Matter of Bleeker (Review Dept. 1990) 1 Cal. State Bar Ct. 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 [169 Cal.Rptr. 581].)

In the Matter of Trillo (Review 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 [158 Cal.Rptr. 869]. The attorney engaged in the practice of depositing personal funds and unearned fees into their client trust account to provide a "margin" against overdraft is a violation.

APPENDIX 3

Signatories on Client Trust Account

In the Matter of Malek-Yonan (Review 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, the 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. The 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 (Review 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 the attorney delegated the responsibility of supervising the client trust account to his legal assistant and the legal assistant became a signatory on the attorney's general and client trust account. The 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 [249 Cal.Rptr. 110]. The attorney gave the secretary/office manager a general power of attorney to handle the 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 [224 Cal.Rptr. 101]. Supreme Court disapproved the use of pre-signed checks left with the secretary.

APPENDIX 4: CLIENT TRUST ACCOUNTING TEMPLATES

The following templates and guides for client trust accounting were created by the State Bar to assist attorneys with bookkeeping and client trust account reconciliation. These materials are taught in the State Bar of California's Practical Trust Account Reconciliation e-Learning course which is offered to attorneys for MCLE credit through the State Bar's learning management system (which can be access through the My State Bar Profile) and for nonattorneys and anyone not seeking MCLE credit on the State Bar's Practical Trust Account Reconciliation Course webpage.

Document	Downloadable Template	Video Guide (YouTube video)
Account Journal	Excel | PDF	Using the Account Journal Template
Individual Ledgers Client Ledger Bank Charges Ledger	 Excel | PDF Excel | PDF	Using the Individual Ledgers Template
Bank Statement with Check Copies	N/A	Reconciling Bank Statements with Check Copies
Reconciliation Form	Excel | PDF	Using the Reconciliation Form Template

Trust account bookkeeping guides

- Monthly Reconciliation Preparer Instructions
- Monthly Reconciliation Supervisory Review
- Trust Account Bookkeeping Best Practices

APPENDIX 5: 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.

APPENDIX 5

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 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

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[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).

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

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 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

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[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."

[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.

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

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

consequences to a client resulting from a dishonored check. Therefore, rather than violating an attorney's fiduciary duties to a client under rule 4-100, overdraft protection is a recognized method of protecting the client's funds from loss.[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/]

[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.

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 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

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[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 pp. 978-979.

[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.

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 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.

[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.

APPENDIX 5: 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 stating 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 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

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;

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

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, 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.

[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).]

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.

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.

[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* (Review Dept. 1998) 3 Cal. State Bar Ct. Rptr. 871; and *In the Matter of Bleecker* (Review 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* (Review Dept. 1991) 1 Cal. State Bar Ct. Rptr. 716.)

APPENDIX 5

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 5: 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 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

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[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.)

[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.

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 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.

[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.

[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).

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

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[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.

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.

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 p. 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

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

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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*.

[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.

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 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.

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

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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APPENDIX 5: STATE BAR FORMAL OPINION NO. 2008-175

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.

APPENDIX 5

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 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.

[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].

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

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

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

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[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.

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 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 5: 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.

APPENDIX 5

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* (Review 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* (Review 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 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* (Review 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

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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.)

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* (Review 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

[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).

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 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

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[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.

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.

APPENDIX 5: STATE BAR FORMAL OPINION NO. 2013-187

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

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

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 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

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[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 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

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." The dictionary defines it as "to <u>return</u> (money) in restitution, repayment, or balancing of accounts."[8/] [Emphasis

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(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].

[8/] See http://www.merriam-webster.com/dictionary/refund.

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.

[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 5

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.

APPENDIX 6: "IOLTA-ELIGIBLE" FINANCIAL INSTITUTIONS UNDER CALIFORNIA BUSINESS AND PROFESSIONS CODE SECTION 6212

Under California Business and Professions Code section 6212, the State Bar of California maintains a list of financial institutions eligible to hold IOLTAs, paying interest rates that are at least comparable to similar, non-IOLTAs. A list of these financial institutions can be found on the State Bar's website.