VIRGINIA:

IN THE SUPREME COURT OF VIRGINIA
AT RICHMOND

IN THE MATTER OF
RULE OF PROFESSIONAL CONDUCT 1.15

PETITION OF THE VIRGINIA STATE BAR

Marni E. Byrum, President
Karen A. Gould, Executive Director
James M. McCauley, Ethics Counsel
Emily F. Hedrick, Asst. Ethics Counsel
Virginia State Bar
1111 East Main Street, Suite 700
Richmond, VA 23219-0026
Phone (804) 775-0500
Fax (804) 775-0501

TABLE OF CONTENTS

VIRGINIA:

IN THE SUPREME COURT OF VIRGINIA
AT RICHMOND

IN THE MATTER OF
RULE OF PROFESSIONAL CONDUCT 1.15

PETITION

TO THE HONORABLE CHIEF JUSTICE AND THE JUSTICES OF THE SUPREME COURT OF VIRGINIA:

NOW COMES the Virginia State Bar, by its president and executive director, pursuant to Part 6, § IV, Paragraph 10-4 of the Rules of this Court, and requests review and approval of proposed amendments to Rule 1.15, as set forth below. The proposed rule amendment was approved by unanimous vote of the Council of the Virginia State Bar on October 25, 2019 (Appendix, Page 1).

I. Overview of the Issues

The Virginia State Bar Standing Committee on Legal Ethics ("Committee") has proposed amendments to Rule 1.15, Safekeeping Property. The proposed changes to the Rule were initially proposed by the Discipline Department based on feedback from investigators that lawyers are frequently confused about the arcane terminology in the current rule, some of which is out of step with the way certain terms are used in the accounting field. The Discipline Department surveyed language used in other states and drafted this proposal to simplify and clarify the

trust account recordkeeping requirements, using terminology that is more easily understood and spelling out in the body of the rule exactly what information must be included in the required records.

The proposed changes to paragraph (c) remove the term “cash” and clarify that a check register can be used as the required journal, if it includes the necessary information. The proposal also removes the term “subsidiary ledger” to clarify that the rule only requires a separate record or ledger page tracking funds received and disbursed for each client.

The same terminology is carried over to paragraph (d)(3), on reconciliations, and paragraphs (d)(3)(ii) and (d)(3)(iii) are revised to include an explanation of exactly what steps must be taken to complete the required reconciliations. The proposed amendments also require all reconciliations to be completed monthly, since that is consistent with the usual bank statement reporting period and will allow lawyers to identify and correct errors more quickly and easily. Under the current rule, some reconciliations are monthly, and some are quarterly; the proposed rule standardizes the requirement so all reconciliations must be done monthly. The proposed amendments retain the requirement that a lawyer must approve all reconciliations and add a requirement in proposed Comment [5] that any discrepancies discovered in the reconciliation process must be explained, and that

explanation must also be approved by the lawyer.

The proposed amendment is included below in Section III.

II. Publication and Comments

The Standing Committee on Legal Ethics approved the proposed amendment at its meeting on June 5, 2019 (Appendix, Page 4). The Virginia State Bar issued a publication release dated June 10, 2019, pursuant to Part 6, § IV, Paragraph 10-2(c) of the Rules of this Court (Appendix, Page 5). Notice of the proposed amendment was also published on the bar's website on the "Actions on Rule Changes and Legal Ethics Opinions" page (Appendix, Page 7), in the bar's E-News on July 2, 2019 (Appendix, Page 12), and in the *Virginia Lawyer's* June 2019, Vol. 68 Issue (Appendix, Page 15).

Two comments were received, one from John C. Blair, II on behalf of the Local Government Attorneys of Virginia (Appendix, Page 16), explaining that they have no comment on the proposed amendment, and one from Cullen Seltzer (Appendix, Page 17), supporting the proposed amendment.

III. Proposed Rule Change

RULE 1.15 Safekeeping Property

(a) Depositing Funds.

(1) All funds received or held by a lawyer or law firm on behalf of a

client or a third party, or held by a lawyer as a fiduciary, other than reimbursement of advances for costs and expenses shall be deposited in one or more identifiable trust accounts; all other property held on behalf of a client should be placed in a safe deposit box or other place of safekeeping as soon as practicable.

(2) For lawyers or law firms located in Virginia, a lawyer trust account shall be maintained only at a financial institution approved by the Virginia State Bar, unless otherwise expressly directed in writing by the client for whom the funds are being held.

(3) No funds belonging to the lawyer or law firm shall be deposited or maintained therein except as follows:

(i) funds reasonably sufficient to pay service or other charges or fees imposed by the financial institution or to maintain a required minimum balance to avoid the imposition of service fees, provided the funds deposited are no more than necessary to do so; or

(ii) funds in which two or more persons (one of whom may

be the lawyer) claim an interest shall be held in the trust account until the dispute is resolved and there is an accounting and severance of their interests. Any portion finally determined to belong to the lawyer or law firm shall be withdrawn promptly from the trust account.

(b) Specific Duties. A lawyer shall:

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

(2) identify and label securities and properties of a client, or those held by a lawyer as a fiduciary, promptly upon receipt;

(3) maintain complete records of all funds, securities, and other properties of a client coming into the possession of the lawyer and render appropriate accountings to the client regarding them;

(4) promptly pay or deliver to the client or another as requested by such person the funds, securities, or other properties in the possession of the lawyer that such person is entitled to receive; and

(5) not disburse funds or use property of a client or of a third party

with a valid lien or assignment without their consent or convert funds or property of a client or third party, except as directed by a tribunal.

(c) Record-Keeping Requirements. A lawyer shall, at a minimum, maintain the following books and records demonstrating compliance with this Rule:

(1) ~~Cash r~~Receipts and disbursements journals for each trust account~~, including entries for receipts, disbursements, and transfers, and also including, at a minimum: an identification of the client matter; the date of the transaction; the name of the payor or payee; and the manner in which trust funds were received, disbursed, or transferred from an account~~. These journals shall include, at a minimum: identification of the client or matter; date and amount of the transaction; name of the payor or payee; manner in which the funds were received, disbursed, or transferred; and current balance. A checkbook or transaction register may be used in lieu of separate receipts and disbursements journals as long as the above information is included.

(2) A ~~subsidiary~~ client ledger ~~containing~~ with a separate ~~entry~~

record for each client, other person, or entity from whom money has been received in trust. Each entry shall include, at a minimum: identification of the client or matter; date and amount of the transaction; name of the payor or payee; source of funds received or purpose of the disbursement; and current balance.

~~The ledger should clearly identify:~~

~~(i) the client or matter, including the date of the transaction and the payor or payee and the means or methods by which trust funds were received, disbursed or transferred; and~~

~~(ii) any unexpended balance.~~

(3) In the case of funds or property held by a lawyer as a fiduciary, the required books and records shall include an annual summary of all receipts and disbursements and changes in assets comparable in detail to an accounting that would be required of a court supervised fiduciary in the same or similar capacity; including all source documents sufficient to substantiate the annual summary.

(4) All records subject to this Rule shall be preserved for at least five

calendar years after termination of the representation or fiduciary responsibility.

(d) Required Trust Accounting Procedures. In addition to the requirements set forth in Rule 1.15 (a) through (c), the following minimum trust accounting procedures are applicable to all trust accounts.

(1) Insufficient Fund Reporting. All accounts are subject to the requirements governing insufficient fund check reporting as set forth in the Virginia State Bar Approved Financial Institution Agreement.

(2) Deposits. All trust funds received shall be deposited intact. Mixed trust and non-trust funds shall be deposited intact into the trust fund and the non-trust portion shall be withdrawn upon the clearing of the mixed fund deposit instrument. All such deposits should include a detailed deposit slip or record that sufficiently identifies each item.

(3) The following ~~R~~reconciliations must be made monthly and approved by a lawyer in the law firm:~~.~~

(i) ~~At least quarterly a~~ reconciliation ~~shall be made that reflects the trust account~~ of the client ledger balance for each client, other person, or

~~other~~ entity on whose behalf money is held in trust;~~.~~

(ii) A ~~monthly~~ reconciliation ~~shall be made~~ of the ~~cash~~ trust account balance, adjusting the ending bank statement balance by adding any deposits not shown on the statement and subtracting any checks or disbursements not shown on the statement. This adjusted balance must equal the balance in the checkbook or transaction register; and ~~that is derived from the cash receipts journal, cash disbursements journal, the trust account checkbook balance and the trust account bank statement balance.~~

(iii) ~~At least quarterly, a~~ reconciliation of the trust account balance ((d)(3)(ii)) and the client ledger balance ((d)(3)(i)). The trust account balance must equal the client ledger balance. ~~shall be made that reconciles the cash balance from (d)(3)(ii) above and the subsidiary ledger balance from (d)(3)(i).~~

~~(iv) Reconciliations must be approved by a lawyer in the law firm.~~

(4) The purpose of all receipts and disbursements of trust funds reported in the trust journals and ledgers shall be fully explained and supported by

adequate records.

Comment

[1] A lawyer should hold property of others with the care required of a professional fiduciary. Securities should be kept in a safe deposit box, except when some other form of safekeeping is warranted by special circumstances. For purposes of this Rule, the term “fiduciary” includes personal representative, trustee, receiver, guardian, committee, custodian, and attorney-in-fact. All property that is the property of clients or third persons should be kept separate from the lawyer's business and personal property and, if funds, in one or more trust accounts. Separate trust accounts may be warranted when administering estate funds or acting in similar fiduciary capacities.

[2] Separation of the funds of a client from those of the lawyer not only serves to protect the client but also avoids even the appearance of impropriety, and therefore commingling of such funds should be avoided.

[2a] In relation to (b)(5), consent can be inferred from the engagement agreement or any consequential agreement between the lawyer and the client regarding the disbursement of fees, i.e., when earned fees are routinely

withdrawn from the lawyer's trust account upon an accounting to the client, when costs and expenses of litigation are routinely withdrawn, or when other fees/costs or expenses are agreed upon in advance.

[3] Lawyers often receive funds from third parties from which the lawyer's fee will be paid. If there is risk that the client may divert the funds without paying the fee, the lawyer is not required to remit the portion from which the fee is to be paid. However, a lawyer may not hold funds to coerce a client into accepting the lawyer's contention. The disputed portion of the funds should be kept in trust and the lawyer should suggest means for prompt resolution of the dispute, such as arbitration or mediation. The undisputed portion of the funds shall be promptly distributed.

[4] Paragraphs (b)(4) and (b)(5) do not impose an obligation upon the lawyer to protect funds on behalf of the client's general creditors who have no valid claim to an interest in the specific funds or property in the lawyer's possession. However, a lawyer may be in possession of property or funds claimed both by the lawyer's client and a third person; for example, a previous lawyer of the client claiming a lien on the client's recovery or a person claiming that the

property deposited with the lawyer was taken or withheld unlawfully from that person. Additionally, a lawyer may have a duty under applicable law to protect such third-party claims against wrongful interference by the client, and accordingly may refuse to surrender the property to the client. For example, if a lawyer has actual knowledge of a third party's lawful claim to an interest in the specific funds held on behalf of a client, then by virtue of a statutory lien (e.g., medical, workers' compensation, attorneys' lien, a valid assignment executed by the client, or a lien on the subject property created by a recorded deed of trust) the lawyer has a duty to secure the funds claimed by the third party. Under the above described circumstances, paragraphs (b)(4) and (b)(5) require the lawyer either to deliver the funds or property to the third party or, if a dispute to the third party's claim exists, to safeguard the contested property or funds until the dispute is resolved. If the client has a non-frivolous dispute with the third party's claim, then the lawyer cannot release those funds without the agreement of all parties involved or a court determination of who is entitled to receive them, such as an interpleader action. A lawyer does not violate paragraphs (b)(4) and (b)(5) if he has acted reasonably and in good faith to determine the validity

of a third-party's claim or lien.

[5] The reconciliations required by paragraph (d)(3) must include an explanation of any discrepancy discovered and how it was corrected. This explanation must be approved by the lawyer who approves the reconciliations.

[~~5~~6] The obligations of a lawyer under this Rule are independent of those arising from activity other than rendering legal services. For example, a lawyer who serves as an escrow agent is governed by the applicable law relating to fiduciaries even though the lawyer does not render legal services in the transaction.

[~~6~~7] Nothing in this Rule is intended to prohibit an attorney from using electronic checking for his trust account so long as all requirements in this Rule are fulfilled. It is the lawyer's responsibility to assure that complete and accurate records of the receipt and disbursement of entrusted property are maintained in accordance with this rule. Many businesses are now converting paper checks to automated clearinghouse (ACH) debits. Authorized ACH debits that are electronic transfers of funds (in which no checks are involved) are allowed provided the lawyer maintains a record of the transaction as required by this

rule. The record, whether consisting of the instructions or authorization to debit the account, a record or receipt from the financial institution, or the lawyer's independent record of the transaction, must show the amount, date, recipient of the transfer or disbursement, and the name of the client or other person to whom the funds belong.

IV. Conclusion

The Supreme Court is authorized to regulate the practice of law in the Commonwealth of Virginia and to prescribe a code of ethics governing the professional conduct of attorneys. Va. Code §§ 54.1-3909, 3910.

Pursuant to this statutory authority, the Court has promulgated rules and regulations relating to the organization and government of the Virginia State Bar. Va. S. Ct. R., Pt. 6, § IV, Paragraph 10 of these rules sets forth the process by which legal ethics advisory opinions and rules of professional conduct are promulgated and implemented. The proposed rule change was developed and approved in compliance with all requirements of Paragraph 10.

THEREFORE, the bar requests that the Court approve the proposed amendment to Rule 1.15 for the reasons stated above.

Respectfully submitted,
VIRGINIA STATE BAR

By: Marni E. Byrum, President

By: Karen A. Gould, Executive Director

Dated this 30th day of October, 2019.