“THE DEVIL WORE GREEN”

an interactive trust accounting primer

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TRUST ACCOUNTING

HANDLING CLIENT FUNDS AND PROPERTY

I. INTRODUCTION

Today, virtually all lawyers in private practice render legal services to clients which either routinely or occasionally require that the lawyer receive and exercise at least temporary control over other people’s money. This is as true for the lawyer engaged in criminal defense, corporate law, intellectual property or immigration law as it is for the general practitioner, the trust and estates lawyer or the lawyer doing plaintiff’s personal injury litigation. Hence, these escrow account rules and regulations will have application to virtually every lawyer engaged in private practice.

The need to scrupulously handle funds entrusted to a lawyer by a client should be self-evident. Nonetheless, cases continue to arise where practicing attorneys, whether inadvertently or intentionally, mishandle the money of their clients, subjecting them inexcusably to economic hardship and seriously undermining public confidence in the legal profession. Our purpose here is threefold:

1. To develop a full understanding of the rules for handling client funds and property;
2. To illustrate circumstances under which mistakes are often made; and
3. To demonstrate proper trust account procedures.

II. RULES

The requirements and procedures governing the holding of client funds by Virginia lawyers are found in the Rules of Court, Part 6, § II: Rule 1.15, and § IV, Para. 20.

Rule 1.15 defines the obligations of every lawyer engaged in the practice of law in Virginia regarding the management of escrow accounts and funds
which are or which should be held in a lawyer’s escrow account (See Exhibit A). Paragraph 20 of Part 6, Section IV, (See Exhibit B) defines a lawyer’s obligations and responsibilities regarding the generation of interest on funds maintained in the lawyer’s escrow accounts and the technical requirements with which escrow accounts maintained by lawyers engaged in the practice of law in the Commonwealth of Virginia must comply. Unlike other provisions of Virginia’s ethics rules which may be subject to differing interpretations and philosophical debate, these rules and regulations require literal and strict compliance.

III. "TRUST” and “ESCROW” ACCOUNTS

The word "trust" is used to reflect the fiduciary role in which a lawyer receives or holds funds on behalf of a client, an estate or a ward and is an important label to distinguish these accounts from accounts containing a lawyer's operating funds. These funds are now termed “escrow funds” which include “[A]ll funds received or held by a lawyer or law firm on behalf of a client, … other than reimbursement of advances for costs and expenses….” Rule 1.15(a). The types of funds required to be held in the lawyer’s escrow account are:

1. all funds given to the lawyer by the client which are to be applied against future legal fees.
2. all funds placed with the lawyer for present or future use on the client’s behalf or at the client’s direction;
3. all funds received by the lawyer for future litigation expenses; and
4. all funds received by the lawyer for the benefit of the client or his designees.

Note that the term "attorney escrow account" means an account maintained in a financial institution for the deposit of funds received or held by an attorney or law firm on behalf of a client. Rule 1.15(f)(1)(vi).

Funds which, at the time they are in the hands of the lawyer, belong to the lawyer or law firm are not escrow funds. Such funds may not be held in the escrow account unless they have been placed there “to pay bank charges….”
Rule 1.15(a)(2) or the lawyer’s entitlement them “is disputed by the client….” Rule 1.15(a)(2).

Frequently a lawyer will receive funds which belong in part to the lawyer and in part to the client. Examples include personal injury or real estate settlement checks from which the lawyer will draw legal fees and costs. These funds, referred to as “mixed escrow and non-escrow funds”, must be deposited in the escrow account. Rule 1.15(a)(2). However, once the deposit has cleared the bank, the “portion belonging to the lawyer or law firm must be withdrawn.” Rule 1.15(a)(2). This includes all earned legal fees and all costs expended or accrued.

Notwithstanding the utter clarity of this language, lawyers often deposit their own funds into the escrow account or allow the "non-escrow portion" to remain in the escrow account. Rationalizations offered for this obvious violation include: the need for a buffer in the event a check deposited into escrow is returned for insufficient funds; the need to hide money from creditors, the I.R.S., or a spouse; the use of the escrow account as a "personal" or office savings account or as a mechanism for budgeting and managing cash flow; and even the desire to maintain a high enough escrow account balance to qualify for the bank’s offer of interest payments or free checking. None of these reasons override the clear and unequivocal ethical prohibition against commingling client's and lawyer's funds.

The use of a label such as “escrow” or “trust” should constitute notice to the depositary financial institution that the account is special in nature. The financial institution cannot lawfully set off against such a special account for liabilities owed it by the lawyer. Use of the term "trust account" meets the requirement that client funds be deposited in an "identifiable trust account."

A. Maintenance of Interest Bearing Trust Account Generally

All escrow accounts maintained by Virginia licensed attorneys must comply with both Para. 20 of the Rules of Court, Part 6: §IV and DR 9-102 and 9-103 of the Rules of Court, Part 6: § II. Paragraph 20 relates specifically to the generation of interest on escrow accounts and is referred to commonly as "IOLTA." Rule 1.15 relates to all escrow accounts and applies irrespective of whether one participates in "IOLTA."
B. IOLTA

It is a general rule that a lawyer cannot earn interest on his/her trust account for his/her benefit. The rationale is that the money in the trust account does not belong to the lawyer; therefore, interest earned on the trust account cannot belong to the lawyer. An exception to this general principle is "IOLTA," a program approved by the Supreme Court as Para. 20, Part 6: § IV of its Rules. In this program, the lawyer may designate his trust account with his financial institution as a participant and all interest earned on the account, less administrative costs, will be paid to the Legal Services Corporation of Virginia ("LSCV"); Key features of the program are:

1. The lawyer must "opt out" of the program; that is, advise the Legal Services Corporation of Virginia if the lawyer chooses not to participate in the program. "LSCV" provides notice of election forms for this purpose.

2. Interest paid to LSCV shall be used for funding
   a. civil legal services to the poor;
   b. the administrative expenses of LSCV; and
   c. the creation and augmentation of a reserve fund for the same purposes.

3. The depositing financial institution agrees to remit, at least quarterly, the interest or dividends on the average monthly balance of each such account to LSCV.

C. The Financial Institution

Unless the client expressly directs the lawyer to do otherwise, lawyer escrow accounts may be maintained only in financial institutions approved by the Virginia State Bar. Rule 1.15(f)(1)(i). To be approved by the Virginia State Bar as an entity qualified to hold lawyer escrow funds, the entity must:
a) be a regulated state or federally chartered bank, saving institution or credit union;

b) have its deposits insured by an agency of the Federal Government;

c) have signed an agreement with the Virginia State Bar (in a form provided by the Bar) that the bank will file a timely report with the Virginia State Bar in the event of an overdraft on an lawyer’s escrow account ¹ (see Exhibit C);

d) agree to cooperate with the bar and produce lawyer escrow account records upon receipt of a subpoena therefore." Rule 1.15(f)(1)(ii).

In maintaining an escrow account in an "approved" financial institution, the depositing lawyer or law firm is also "conclusively deemed to have consented" to the reporting requirements of the disciplinary rule. Rule 11.15(f)(1)(v).

Limiting lawyer escrow accounts to those institutions approved by the Bar enhances the Bar’s ability to oversee lawyer compliance with escrow account requirements and to act swiftly in the event of a breach of the rules. Limiting escrow accounts to approved financial institutions also permits the Bar to establish effective procedures for the enforcement of the "insufficient funds" reporting requirements discussed below.

D. The Properly Identified Account

Each account must be "clearly identified" as a escrow account. Also, the financial institution must be informed "in writing of the purpose and identity of such account." Rule 1.15(f)(1).

E. “Insufficient Funds” Reporting Requirement

The term "insufficient funds" is defined as "an overdraft in the commonly accepted sense of there being an insufficient balance as shown on the bank's accounting records . . . “ Rule 1.15(f)(1)(vi).

¹ “No escrow account shall be maintained in any financial institution which does not agree to make such reports.” Rule 1.15(f)(1)(ii)
In the past, the State Bar's rules required a bank to report an overdraft on a lawyer escrow account only when the check drawn on that account was returned for insufficient funds and only if the lawyer and bank were unable to resolve the matter within three banking days (i.e., if the lawyer had not made the check good within three days). This allowed the lawyer to cover the overdraft without a report going to the Bar. The current rule is quite different.

Under Rule 1.15, whenever "any instrument" (i.e., check) is presented against a lawyer's escrow account which has insufficient funds on deposit to cover payment of the instrument, the bank or financial institution must report that event to the Virginia State Bar, and this obligation to report applies whether or not the bank honors the instrument. Rule 1.15(f)(1)(ii). If the bank "dishonors" the instrument, the bank must file the insufficient funds report with the State Bar "within the time provided by law for notice of dishonor to the depositor . . . ." Id. If the bank "honors" the instrument, the report must be made to the Bar “within five (5) banking days of the date of presentation for payment . . . “ Rule 1.15(f)(1)(iii)(a). In either case, the bank has agreed that in consideration of it being an institution “approved” for maintaining lawyer trust accounts, it will make such reports and the lawyer will not be able to avoid such a report (and the adverse consequences that might result therefrom) by covering the bad check.

IV. INTEREST ON ESCROW FUNDS

A. Background

As noted above, the rules governing interest on lawyer escrow accounts are found in Part 6, Section IV, Paragraph 20 of the Rules of the Virginia Supreme Court.2 By way of background, Virginia's Interest on Lawyers' Trust Accounts (IOLTA) program was initiated in 1983 as a voluntary program in which lawyers who chose to do so could enroll their pooled escrow accounts, with the interest income on the aggregate balances in these accounts being paid to the Virginia Law Foundation for use in making charitable grants in those activities approved by the Internal

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2 Part 6, § IV, Para. 20, was adopted on May 1, 1995, and became effective July 1, 1995.
Revenue Service for use of IOLTA proceeds. In 1989, the Virginia Supreme Court converted the program to one allowing lawyers to opt-out, and thereby decline to participate.

In 1991, the program was made mandatory, requiring Virginia lawyers with offices in Virginia to enroll their pooled escrow accounts in the IOLTA program. However, following complaints about the mandatory program from bar members and financial institutions, the Virginia Supreme Court amended its rules and the General Assembly has enacted legislation which has returned the program to "opt-out" status.

Nevertheless, the program remains true to the goals which gave rise to its creation, i.e., to provide economic support to the legal aid societies operating in Virginia. Accordingly, both the revised court rule and the legislation provided that effective July 1, 1995, all IOLTA proceeds would be remitted by participating financial institutions directly to the Legal Services Corporation of Virginia for distribution to the legal aid programs only.

B. The Lawyer’s Options

Under these rules, unless the lawyer specifically opts out of participation in the IOLTA program, the lawyer must deposit client escrow funds into "an interest-bearing trust (IOLTA) bank account . . . ." As an alternative to participation in the IOLTA program, a lawyer may "opt out" and deposit funds of clients in "one or more interest-bearing accounts," provided the lawyer has established and maintains strict procedures for accounting and paying to each client "the interest on such client's funds . . . ." Para. 20(A). However, to opt out, the lawyer must satisfy the provisions of Paragraph 20(F) by filing the appropriate "election form" with the Legal Services Corporation of Virginia within the time provided for under the rules.

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3 The Virginia Law Foundation is a charitable, educational and research foundation established by the Virginia State Bar to improve the administration of justice, study of law, legal reform, and accessibility of legal services. The IOLTA funds previously received by the Foundation through the IOLTA program were used to further the purposes and goals of the Foundation.
C. Rules Governing IOLTA Accounts

To qualify for establishing an IOLTA account, the lawyer must reasonably expect that the interest generated from these funds "would equal or exceed the pro rata interest on such client's funds . . . ." Para. 20(B)(1). In addition, the bank must agree to:

a) Remit no less than quarterly to the Legal Services Corporation of Virginia (LSCV) all interest or dividends paid on the average monthly balance of the IOLTA account [Para. 20(B)(2)(a)]; and

b) Transmit to LSCV and to the lawyer with each remittance, a statement identifying the lawyer or law firm, the rate of interest applied, and other details concerning the remittance. Para. 20(B)(2)(b).

To participate in the IOLTA program, the bank must also agree:

a) To provide an interest rate "not . . . less than the rate paid by such bank to regular, non-attorney depositors;

b) "Charge no fees against an IOLTA trust account that are greater than the fees charged to non-attorney depositors" except a fee to defray the bank's administrative costs attributable to calculating and remitting the interest to LSCV;

c) "Collect no fees from the principal deposited in the IOLTA trust account"; and

d) "Pay all or part of the funds deposited in such interest-bearing trust account upon demand or order." Para. 20(B)(2).

D. Client Consent

As long as a lawyer maintains an IOLTA escrow account that complies with Paragraph 20, client consent for the collection of interest is not required, nor is the lawyer required to report to the client the collection of IOLTA interest and the payment of that interest to LSCV. Para. 20(C).
E. Other Interest Bearing Trust Accounts

A lawyer may maintain funds of a client in a separate interest bearing account for clients if

1. the lawyer has a program which allows for the computation of
   a. the interest earned
   b. the administrative costs of maintaining the account

2. the lawyer remits to the client, at least quarterly, the interest earned.

In the event that client funds exceeding $5,000 will be held in trust for a period of time that exceeds 30 days those funds must be held in a separate fiduciary account and not commingled with the assets in the attorney’s common trust account. See Rule 1.15(d)(1)(i) and (ii).

F. Commingling

A general prohibition exists against commingling a lawyer's own funds with client funds. Rule 1.15(d). The practice of "salting" a trust account is prohibited. A lawyer cannot for his or her own purposes maintain a sum of money on deposit in his or her trust account. Only two exceptions to the Rule are implied:

1. The bank charges exception permits a lawyer to make deposits of his or her own funds to cover bank charges made for administration of the trust account. This exception is necessary to prevent invasion of client funds to pay such charges. Rule 1.15(a)(1); see LEO 1510.

2. The mixed funds exception. Where an item received by the lawyer includes amounts belonging to the client and amounts to which the lawyer is entitled (such as fees or reimbursement for previously advanced expenses), such an item must be deposited in the trust account. Rule 1.15(a)(2).
G. Withdrawal From Trust Account Funds

A lawyer must withdraw from the trust account funds contractually due the lawyer from the client. Rule 1.15(a)(2).

Caveat: If there is a dispute whether the lawyer is entitled to the funds, the lawyer cannot withdraw the fees in dispute until the controversy is resolved.

Query: What constitutes a dispute? Recognition of the premise that separation of the lawyer's funds from those of the client is necessary for the client's protection and to avoid the appearance of impropriety requires that disbursement of funds to which the lawyer is entitled occur at the earliest appropriate time. Rule 1.15(a)(2).

H. Notification of Client of Receipt of Monies

A lawyer is required to promptly notify a client when funds, securities, or other property has been received for the client's account. Rule 1.15(c)(1).

I. Accounting to Client

A lawyer must account to the client for funds, securities and other property held and distributed by the lawyer. Rule 1.15(c)(3).

J. Prompt Payment or Delivery of Client's Funds

A lawyer must promptly pay over or deliver as directed by the client funds, securities and other property held for the client's account. Rule 1.15(c)(4). A lawyer is also ethically obligated, in certain instances, to protect the rights of third parties to client funds, i.e., payment of medical liens. Va. Code §§ 8.01-66.2-66.12; LEO 1747 (lawyer owes ethical duty under Rule 1.15 (c) to protect rights of doctor to settlement proceeds under an assignment executed by both attorney and client).

K. Maintenance of Complete Records

A lawyer must maintain complete records of client funds, securities, and other property in his or her possession. Rule 1.15(c)(3).
L. Disbursement on Uncollected Funds

It is improper for a lawyer to disburse monies from his or her trust account when the funds on which such check is drawn are not collected. (LEOs 614, 704, 1256, and 1797.)

1. Disbursement of monies on uncollected funds is tantamount to using one client's collected funds as advancement on the collected funds of a second client.

2. Virginia Code § 6.1-2.13 also specifically requires a lawyer handling a real estate closing to disburse settlement funds within two business days after the settlement. Thus, a settlement lawyer should not disburse monies, such as a realtor's sales commission, until the settlement monies are fully collected (LEOs 183, 1797). For other requirements of an attorney serving as a settlement agent in a residential real estate transaction, see the Consumer Real Estate Settlement Practices Act (CRESPA) effective July 1, 1997 at Va. Code §§ 6.1-19, et seq. (Repl. Vol. 1997).

V. RECORD KEEPING AND ACCOUNTING REQUIREMENTS OF RULE 1.15

A. Minimum Requirements for Trust Account

1. To properly maintain an escrow account, the following records at a minimum are required:

   a. Cash receipts journal, per Rule 1.15(e)(1)(i)

   b. Cash disbursements journal, per Rule 1.15(e)(1)(ii)

   c. Subsidiary ledger, per Rule 1.15(e)(1)(iii).

2. The concept of receipts and disbursements journals and client subsidiary ledgers is simple. The sum total of all subsidiary ledgers at any given time should equal the amount in the escrow account.
Although the language of Rule 1.15(e) is somewhat technical, the record keeping and accounting requirements of the rule are clear and easy to follow. Furthermore, if the volume of funds being held in escrow is not great, techniques for compliance can be greatly simplified.

**B. Receipts and Disbursements Journals**

In simplest terms, the record keeping requirements of Rule 1.15(e)(1) require only that the lawyer establish and practice sound procedures for recording cash received into escrow (the "cash receipts journal"), cash being paid out from escrow (the "cash disbursements journal"), and a consistent, reliable, and separate system for recording the escrow account transactions relating to each individual client (the "subsidiary ledger"). Where the lawyer is serving as a fiduciary, however, the required books and records include annual summaries of all receipts and disbursements comparable to an accounting that would be required of a court supervised fiduciary [serving] in the same or similar capacity. The fiduciary must also retain original source documents and preserve the summaries and source documents for at least five full calendar years following the termination of the fiduciary relationship. Rule 1.15(e)(2).

1. The Cash Receipts Journal (See Appendix A)

This record, required by Rule 1.15(e)(1)(i), need be nothing more than regular entries in the escrow account check book which identify the date (I) and amount of funds deposited (ii) and the client (iii) on whose behalf the funds were received. A lawyer may maintain a separate "journal" or "ledger" or any other type of record in addition to, or in lieu of check book stub entries. As long as the record being maintained produces a running balance (necessary for other Rule 1.15 accounting requirements) and provides the details concerning the dollar amount, client identity, and date of deposit, that record satisfies Rule 1.15. Bear in mind, however, that for routine record keeping purposes as well for compliance with Rule 1.15, the lawyer should maintain additional records which articulate "the purpose" underlying the receipt of funds into escrow (i.e., invoices, transmittal letters with explanation, etc.).

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4 Reference numbers are keyed to the forms.
There are now numerous computer software programs available on the market for use in maintaining lawyer escrow account records that are simple to install, use and maintain.\(^5\) However, any system utilized by the lawyer, computer based or otherwise, which produces a clear cash receipts and disbursements report, and other "records and information" discussed below will suffice for Rule 1.15. Rule 1.15(e).

Regardless of the type of accounting system used, a "duplicate deposit slip" or other record "which shows the identity of each item" must be retained by the lawyer. Rule 1.15(f)(2). This "identity" includes, of course, the date and amount of funds deposited, the client on whose behalf the funds were received, and the identity of the source of the funds.

2. The Cash Disbursements Journal (See Appendix A)

Required by Rule 1.15(e)(1)(ii), this document is maintained by the same methods described above for the "cash receipts journal." In fact, checkbook stubs would suffice. Regardless of the system used, every disbursement from escrow must be recorded and must always clearly detail the date \((i)\) and amount of funds \((ii)\) disbursed or paid out and the identity of the client \((iii)\) on whose behalf the funds were disbursed. Although not required by the rules, it is good practice to have this record or journal also identify the recipient of the specific funds and the purpose \((iv)\) for which the disbursement was made.

As with the cash receipts journal, for routine record keeping purposes and to satisfy the requirements of Rule 1.15, the lawyer needs to maintain sufficient supplemental documentation which will corroborate "the purpose" giving rise to each disbursement of client funds being held in escrow.

3. The Subsidiary Ledger (See Appendix B)

Rule 1.15(e)(1)(iii) requires the lawyer to maintain "a separate account ["record"] for each client \((ii)\) and for every other person or entity from

\(^5\) Some of the more popular include Quicken and Quickbooks. A more exhaustive list of software accounting programs designed specifically for lawyers can be found on line at http://www.digital-lawyer.com/resource/software.html.
whom money has been received in escrow . . . . To comply with other Rule 1.15 requirements and sound accounting procedures and to help avoid math errors that might be made along the way, this "subsidiary ledger" must also identify the date (vi) and amount of each deposit (x) for that particular client and the date ((vi) and amount of each disbursement (ix) and the identity of the recipient (vii). The rule requires that "all fees paid from escrow" be "clearly identified.6

A simple, non-computer based method by which a solo practitioner or small firm may comply with the rule is as follows:

1) For each client with funds on deposit in the firm's escrow account, prepare a separate client subsidiary ledger card ("client ledger card") following the format of Appendix B;

2) Maintain the ledger cards for all active clients and matters in one loose leaf notebook, and ledger cards for closed matters in a second notebook;

3) When all of a funds held in the escrow account on the client’s behalf have been disbursed, the ledger card reflects a zero balance, and the matter for that client has been concluded, the card should be removed from the notebook of active matters and placed in the closed matters notebook for storage, easy access and retrieval, and future reference.

At least quarter-annually, the lawyer must make a regular periodic trial balance of the subsidiary ledger that shows the escrow account balance of the client at the end of the period. Rule 1.15(f)(4).

As noted above, there are many systems available for escrow accounting. However, the bottom line is that any system you select or procedure you follow must insure preservation of all critical escrow account records, documents and receipts, and must provide a mechanism for easy storage and retrieval or records and information.

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6 If a combined transfer is being made from client's funds held in escrow into the lawyer or firm operating account which transfer is intended to both cover legal fees and reimburse for previous disbursements, the best procedure would be to clearly identify on the client's subsidiary ledger the dollar amounts being transferee for each, i.e., "Transfer to firm: Fees - $xxx.xx; Costs - $yy.yy."
C. Escrow Account Reports

At first glance the rules addressing the various escrow account reports appear complex and confusing. However, once understood and implemented, production of these reports will require relatively little time and effort. Moreover, the reports will be helpful in generating a clear, solid paper trail of all escrow account transactions and a perfectly balanced set of escrow account books and records. This will, in turn, insure your ability to accurately account to each client and the State Bar and receive all of the fees and costs due you from a particular case.

1) The Periodic Trial Balance (See Appendix C)

The Rule 1.15(f)(4) "periodic trial balance" requires merely that at least once every three months someone in the office balances the subsidiary ledger cards. As set out in Appendix C, the following simple procedure can be used in performing this task. Divide a sheet of accounting paper into columns titled: QUARTER ENDING DATE; CLIENT NAME; BEGINNING BALANCE; TOTAL QUARTER RECEIPTS; TOTAL QUARTER DISBURSED; QUARTER END BALANCE; and LAWYER INITIALS/DATE.

Record on one line:

a) In the first two columns the QUARTER ENDING DATE and the CLIENT NAME;

b) Next, calculate the total amount of escrow funds being held for a client at the end of the quarter and record this sum under QUARTER END BALANCE (column A on Appendix C);

c) Next, identify the balance of escrow funds held for this client at the beginning of the quarter and record this sum under BEGINNING BALANCE (column B on Appendix C),⑦

⑦ When the resulting sum equals the amount shown in your column A,
d) Then, add up all of the escrow funds received on behalf of this client during the quarter and record this sum under TOTAL QUARTER RECEIPTS (column C on Appendix C);

e) Next, add up all of the disbursements made from escrow on behalf of this client during the quarter and record this sum under TOTAL QUARTER DISBURSED (column D on Appendix 4);

f) Now, add the BEGINNING BALANCE (column B) to the TOTAL QUARTER RECEIPTS for the quarter (column c) and subtract the TOTAL QUARTER DISBURSED for the quarter (column D). The resulting sum must equal the QUARTER END BALANCE (column A). If it does not, go back to the first step (periodic trial balance, above), recheck all entries and calculations and try it again.

g) When the resulting sum equals the amount shown in your column A, record in the ATTY INITIALS/DATE column, the date the trial balance was performed, the name of the person conducting this "periodic balance," and, if performed by someone other than a lawyer, the name of the lawyer that reviewed the calculations. This record then becomes your proof of compliance with Rule 1.15(f)(4) and should be stored in a separate file for future reference.

2) The Monthly Reconciliation

Mandated by Rule 1.15(f)(5)(i), this procedure requires nothing more than the periodic balancing of your escrow account checkbook.

3) The Periodic Reconciliation (See Appendix D.)

Required by rule 1.15(f)(5)(ii), this task must be accomplished at least once every three months and is the litmus test for a satisfactorily balanced set of escrow account records. The following is a three-step process which may be utilized to accomplish the task. Utilizing a form such as that seen in Appendix D,

a) Compute and record on your periodic reconciliation form the escrow account balances for each client as reflected on the individual subsidiary ledger card, (which balances have already been proven by
the periodic trial balances, above) and total and record on the form the combined balance of these subsidiary ledger cards;

b) Enter on the periodic reconciliation form the account balance shown in the escrow account check book at the end of the quarter (which has also been confirmed as accurate by your having performed the required "monthly reconciliation") and confirm this figure with the escrow funds figure you came up with after totaling the individual client's subsidiary ledger cards and confirm that these two figures match;

c) Record on the periodic reconciliation form, the date the periodic reconciliation was performed and the beginning and ending dates of the quarter. The preparer of this record (if someone other than a lawyer) and the approving lawyer are identified and this record is now your proof of compliance with Rule 1.15(f)(5) and should be stored in a separate file for future reference.

D. Reconciliation

a) A monthly reconciliation must be made of the cash balance derived from the cash receipts journal and cash disbursements journal total, the escrow account check book balance and the escrow account bank statement balance.

b) A periodic reconciliation must be made reconciling cash balances to the subsidiary ledger trial balance. Rule 1.15(f)(5)(ii).

VI. SOME GENERAL RULES

The only way to insure the accuracy of escrow records and compliance with the disciplinary rules is to meticulously follow each and every one of the technical requirements of Rule 1.15.

Whether in a large or a small firm, most lawyers prefer to delegate this task to a secretary, bookkeeper or office manager. However, the ultimate responsibility for compliance with Rule 1.15 rests with the lawyer. Therefore, every lawyer in the firm should be thoroughly familiar with the escrow account record keeping system utilized by that firm, and periodic
review of escrow account records and reports should be on the agenda for periodic law firm business meetings.

Never disburse escrow funds without specific written authorization. This authorization can be in the form of a specific paragraph in a retainer agreement which authorizes the lawyer to expend sums for litigation and other costs of representation, or it can be a separate and specific written instruction from the client.

Keep clients informed of all transactions involving funds being held in escrow. This can easily be accomplished by including the details of escrow account transactions on behalf of that client as part of the client's monthly billing or statement of account.

When a case has been completed, be sure that the balance on the client's "subsidiary ledger" is brought to zero, that all earned fees and expense reimbursements have been transferred out of the escrow account, and that any remaining funds appropriately disbursed.

Under no circumstances should a personal checking or savings account be used for either the office escrow or operating account.

To avoid deposit or check writing errors, consider using different color checks for escrow and operating account. Some law firms even go so far as to use different banks for their escrow and operating accounts.

VII. RETENTION OF RECORDS AND DISPOSITION OF CLOSED FILES

Books and records must be maintained for a minimum of five years after completion of the fiduciary obligation. Rule 1.15(e)(1)(v). A client’s file, including original documents, client-furnished originals, and attorney work-product prepared for the client, may not be retained, but must be returned to the client upon demand, even if fees and costs are still owed to the lawyer. Rule 1.16(e). LEO 1690;

LEO 1305 offers a lawyer guidance on the disposition of closed client files. A lawyer does not have a general duty to preserve indefinitely all closed or retired files. Since neither the Rules of Professional Conduct nor any specific Virginia statute apparently sets forth specific rules addressing the
retention of such files by private practitioners, the Ethics Committee
suggests the following guidelines as indicated in ABA Informal Opinion No.
1384. (See also Maine Ethics Opinion No. 74 (10/1/86), Nebraska Ethics
Opinion No. 88-3 (undated), New Mexico Ethics Opinion No. 1988-1
(undated), and New York City Bar Association Ethics Opinion No. 1986-4
(4/30/86)). The lawyer should screen all closed files in order to ascertain
whether they contain original documents or other property of the client, in
which case the client should be notified of the existence of those materials
and given the opportunity to claim them. Having culled those materials from
the closed files, the lawyer should use care not to destroy or discard
materials or information that the lawyer knows or should know may still be
necessary or useful in the client's matter for which the applicable statutory
limitations period has not expired or which may not be readily available to
the client through another source. Similarly, the lawyer should be cognizant
of the need to preserve materials which relate to the nature and value of his
legal services in the event of any action taken by the client against the
lawyer. Having screened the files for the removal of any materials as
indicated, the lawyer may at the appropriate time dispose of the remaining
files in such a manner as to best protect the confidentiality of the contents.

In determining the appropriate length of time for retention or disposition of
the remaining materials in a given file, a lawyer should exercise discretion
based upon the nature and contents of the file. As indicated above, however,
all trust account and fiduciary records should be maintained for a period of
five years following completion of the fiduciary obligation and accounting
period. Finally, the Committee is of the opinion that the lawyer should
preserve for an extended period of time an index of all files which have been
destroyed.

VIII. RETENTION OF UNCLAIMED CLIENT FUNDS AND
PROPERTY

A lawyer must identify, label, and safe keep all client properties and
maintain complete records of all client funds, securities and other property.
Rule 1.15(c)(2,3). When client funds or properties remain unclaimed and
the lawyer is unable to locate the client to return such funds or properties for
a period of five years, The Uniform Disposition of Unclaimed Property Act
(Va. Code §§ 55-210.1-55.210.30) provides that such funds or properties
may be turned over to the Commonwealth for disposal in accordance with
the provisions thereof. LEOs 818, 832, and 1644.
The Ethics Committee, in LEO 1644, stated that an attorney must exercise reasonable diligence in attempting to contact and disburse trust funds to persons entitled to receive them. The legal definition of due diligence under § 55-210.2 includes a first class mailing to the last known address of the owner of property or funds, but it is not limited to that. The Committee believes that an attorney owes an ethical duty to use whatever means are reasonable under the circumstances. The Committee believes that it would not be improper to deduct from the funds held in trust reasonable costs incurred by the attorney in attempting to locate the party to whom trust funds are owed.

IX. LAWYER’S DUTY TO SUPERVISE STAFF HANDLING TRUST FUNDS

RULE 5.3 Responsibilities Regarding Nonlawyer Assistants

With respect to a nonlawyer employed or retained by or associated with a lawyer:

(a) a partner or a lawyer who individually or together with other lawyers possesses managerial authority in a law firm shall make reasonable efforts to ensure that the firm has in effect measures giving reasonable assurance that the person's conduct is compatible with the professional obligations of the lawyer;

(b) a lawyer having direct supervisory authority over the nonlawyer shall make reasonable efforts to ensure that the person's conduct is compatible with the professional obligations of the lawyer; and

(c) a lawyer shall be responsible for conduct of such a person that would be a violation of the Rules of Professional Conduct if engaged in by a lawyer if:

(1) the lawyer orders or, with the knowledge of the specific conduct, ratifies the conduct involved; or

(2) the lawyer is a partner or has managerial authority in the law firm in which the person is employed, or has direct supervisory
Recent disciplinary actions underscore the importance of properly supervising staff who handle client funds. *In the Matters of Khalil Wali Latif*, VSB Docket Nos. 03-000-0376, 02-031-2876, 02-031-3117, 02-031-3344, 02-031-3345, 03-031-0175, 03-031-0895, and 03-031-0920 (2003), the respondent failed to adequately supervise his secretary who concealed notices and correspondence regarding his failure to pay fines and appear in court. Also, over a course of months, respondent’s secretary concealed trust account overdraft notifications from the VSB and forged respondent’s signature to a letter attempting to explain the overdrafts. An investigation revealed that respondent’s secretary had embezzled funds. The disciplinary board imposed a four-month suspension with terms. *In the Matters of Robert Sidney Ricks*, VSB Docket Nos. 02-010-0908 (2003) the disciplinary board revoked a lawyer’s license on fifteen complaints of misconduct, many of which involved embezzlement of trust funds by respondent’s secretary, who he continued to employ even after he discovered her embezzlements, allowing defalcations to continue.

**X. LAWYER’S DUTY TO PLAN FOR DEATH/DISABILITY**

Rule 1.1 (Competence) and Rule 1.3 (Diligence) require a lawyer to provide competent and diligent representation for their clients. A relatively new comment to Rule 1.3, Comment 5 states:

> [5] A lawyer should plan for client protection in the event of the lawyer’s death, disability, impairment, or incapacity. The plan should be in writing and should designate a responsible attorney capable of making, and who has agreed to make, arrangements for the protection of client interests in the event of the lawyer’s death, impairment, or incapacity.

This new comment to the rule applies specifically to the solo or small practitioner who has no one to assist in the event of death or disability. So many times these events involve a grief stricken spouse who has no knowledge of the practice and no ability to handle the issues under these dire circumstances. Advance planning can prove to be an invaluable tool that not
only protects the lawyer’s clients but also their family in these tragic circumstances. Remember, a law practice can now be sold and therefore has value and should be handled as any other asset of an estate.

An additional issue that needs to be addressed in these circumstances involves access to the trust account. A lawyer needs to carefully consider who has access/signature power on their trust account. While it may be helpful in the event of a tragedy to have another with signatory power on the trust account, the disadvantage is the relinquishment of control over the monies held in trust. The lawyer must carefully consider the issues involved here in making these decisions.

**FEE AGREEMENTS**

**I. FEES IN GENERAL**

All fees must be reasonable as per Rule 1.5. There are many factors to consider in determining the reasonableness of the fee. Rule 1.5 (a) sets forth many of those factors.

**RULE 1.5 Fees**

(a) A lawyer's fee shall be reasonable. The factors to be considered in determining the reasonableness of a fee include the following:

(1) the time and labor required, the novelty and difficulty of the questions involved, and the skill requisite to perform the legal service properly;

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

(3) the fee customarily charged in the locality for similar legal services;

(4) the amount involved and the results obtained;
(5) the time limitations imposed by the client or by the circumstances;

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

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

(8) whether the fee is fixed or contingent.

(b) The lawyer's fee shall be adequately explained to the client. When the lawyer has not regularly represented the client, the amount, basis or rate of the fee shall be communicated to the client, preferably in writing, before or within a reasonable time after commencing the representation.

The disciplinary rules set certain restrictions on all legal fees that cannot be avoided by the employment contract. Regardless of the agreed terms, the designation of the fee in the employment contract cannot alter the true nature of the fee and will not be dispositive in determining whether there is a violation of the disciplinary rules. Neither will the terminology used to describe the fee determine whether the fee has been earned by the lawyer or into which type of account the fee must be placed. LEO #510. A lawyer cannot by contract alter the nature or the ownership of fees received, nor can he legitimise a fee that is otherwise prohibited by the disciplinary rules. LEO 1606.

A client retains the absolute right to discharge the lawyer at any time for any reason or without reason. Even when the discharge constitutes a breach of the employment contract, the lawyer is entitled only to that portion of the fee that has been actually earned prior to the termination. LEO #681. When the attorney is discharged prior to the completion of the representation he may only recover the reasonable value of the services which he has rendered. He cannot recover for damages for the breach of the contract, and, in instances where the fee is contingent upon the outcome of the matter, the attorney may not recover the full agreed upon fee. He is entitled only to a recovery in quantum meruit for services actually rendered. The quantum meruit determination must look to the reasonable value of the services rendered, not to the benefit received by the client.
Finally, if the lawyer is discharged by the client, he must refund to the client all advanced legal fees which have not been earned.

II. RETAINERS

A retainer is a payment by a client to an attorney to insure the attorney’s availability for future legal services and/or as consideration for his unavailability to a potential adverse party in the future. A retainer is not a pre-payment for legal services to be rendered in the future, and is thus distinguished from advanced legal fees. Since retainers are paid to secure the availability of an attorney in the future, and not as payment for future legal services, retainers are earned when paid and become the property of the attorney upon receipt. Such fees are deemed earned by the lawyer at the time of payment in consideration for the lawyer’s availability to the client and unavailability to potential adverse parties. Because retainer fees are the property of the lawyer when paid, they may not be deposited into the lawyer’s trust account.

III. ADVANCED LEGAL FEES

Fees paid in advance for particular legal services not yet performed are advanced legal fees. Because advanced legal fees do not belong to the lawyer until the services are rendered, the must be deposited in a trust account and remain the property of the client until they are earned by the lawyer. Upon termination of the representation it is the duty of the lawyer to refund any portion of an advanced legal fee which has not been earned.

IV. NON-REFUNDABLE LEGAL FEES

Any fee arrangement involving advanced legal fees and providing for a non-refundable or minimum fee violates the Rules of Professional Conduct and is improper. See LEO 1606.

V. FIXED FEE

The term fixed fee is used to designate a sum certain charged by a lawyer to complete a specific legal task. Because this type of fee arrangement provides the client with a degree of certainty as to the cost of legal services, it is to be encouraged.
A fixed fee is an advanced legal fee. It remains the property of the client until it is actually earned and must be deposited in the attorney’s trust account. If the representation is ended by the client, even if such termination is without cause and constitutes a breach of the contract, the client is entitled to a refund of that portion of the fee that has not been earned by the lawyer at the time of the termination. LEO #681. In such circumstances, what portion of the fee has been earned requires a quantum meruit determination of the value of the lawyer’s services.

VI. CONTINGENCY FEES

Contingency fees are fees contingent on the outcome of a matter for which the service is rendered, except in criminal law or other matters in which such a fee is prohibited by law.

Rule 1.5

(c) A fee may be contingent on the outcome of the matter for which the service is rendered, except in a matter in which a contingent fee is prohibited by paragraph (d) or other law. A contingent fee agreement shall state in writing the method by which the fee is to be determined, including the percentage or percentages that shall accrue to the lawyer in the event of settlement, trial or appeal, litigation and other expenses to be deducted from the recovery, and whether such expenses are to be deducted before or after the contingent fee is calculated. Upon conclusion of a contingent fee matter, the lawyer shall provide the client with a written statement stating the outcome of the matter and, if there is a recovery, showing the remittance to the client and the method of its determination.

(d) A lawyer shall not enter into an arrangement for, charge, or collect a contingent fee:

(1) in a domestic relations matter, except in rare instances; or

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

Contingent fees are generally ethically permissible in any legal matter that generates a res from which the fee can be paid, unless otherwise prohibited. One purpose of a contingent fee arrangement is to encourage a lawyer to
accept a case which carries inherent risks of nonpayment of legal fees. Ministerial matters that carry no such risk, such as recovering funds that could be obtained by the client without the services of a lawyer, are not matters in which a contingent fee arrangement is proper, nor do they create the type of res from which a contingency fee may be paid. It would, therefore be improper for a lawyer to receive a contingent fee to recover medical compensation payments which an insurance carrier is contractually obligated to pay to the client. LEO #1461.

Except in extremely rare situations, it is ethically improper for a lawyer to enter into a contingent fee arrangement in family law and domestic relations cases.

Rule 1.5 Comment [6]

Contingent Fees in Domestic Relations Cases

[6] An arrangement for a contingent fee in a domestic relations matter has been previously considered appropriate only in those rare instances where:

(a) the contingent fee is for the collection of, and is to be paid out of (i) accumulated arrearages in child or spousal support; (ii) an asset not previously viewed or contemplated as a marital asset by the parties or the court; (iii) a monetary award pursuant to equitable distribution or under a property settlement agreement;

(b) the parties are divorced and reconciliation is not a realistic prospect;

(c) the children of the marriage are or will soon achieve the age of maturity and the legal services rendered pursuant to the contingent fee arrangement are not likely to affect their relationship with the non-custodial parent;

(d) the client is indigent or could not otherwise obtain adequate counsel on an hourly fee basis; and

(e) the fee arrangement is fair and reasonable under the circumstances.
Contingency fee arrangements must state the method by which the fee is determined, including the percentage or percentages that shall accrue to the lawyer in the event of settlement, trial or appeal, expenses to be deducted from the recovery, and whether expenses are to be deducted before or after the contingent fee is calculated. The lawyer shall provide the client with a closing statement showing the fee and the method of its determination.

VI. FEE SHARING

Rule 1.5:

(e) A division of a fee between lawyers who are not in the same firm may be made only if:

(1) the client is advised of and consents to the participation of all the lawyers involved;

(2) the terms of the division of the fee are disclosed to the client and the client consents thereto;

(3) the total fee is reasonable; and

(4) the division of fees and the client's consent is obtained in advance of the rendering of legal services, preferably in writing.

(f) Paragraph (e) does not prohibit or regulate the division of fees between attorneys who were previously associated in a law firm or between any successive attorneys in the same matter. In any such instance, the total fee must be reasonable.

Fee sharing between lawyers who are not in the same firm is permitted as long as the client consents and the total fee is reasonable.

Additionally, a referring attorney may charge a fee for referring a case to another lawyer without further participation in the client’s matter. A fee division is not proper if the referring attorney simply makes a referral without assessing the client’s legal matter and without determining whether a referral is appropriate or necessary. LEO #1739.