LAWYERS' MUTUAL
INSURANCE COMPANY

CLIENT TRUST ACCOUNTING

A MANAGEMENT HANDBOOK

CHAPTER I. INTRODUCTION

Mismanagement and mishandling of clients' funds and clients' trust accounts continues to be the third most frequent complaint to the State Bar disciplinary prosecutors and is one of the most frequent causes of discipline of California's lawyers. On an annual basis, the State Bar receives thousands of banks reported notifications that clients trust accounts are overdrawn. Surprisingly, a substantial percentage of misconduct arises from not knowing the rules or proper clients' trust accounting procedures. This paper presents some "nuts and bolts" of practical trust account management. Don=t become another disciplinary statistic for mishandling trust funds! (For your convenience, attached at Appendix 1, are copies of the relevant Business & Professions Code sections, Rules of Professional Conduct and other related statutes and rules which are cited in this material.)

Lawyers have personal responsibilities regarding entrusted funds and property:

Lawyers' responsibilities for the safety of entrusted funds in client trust accounts are **nondelegable**. Although an attorney cannot be responsible for every detail of office procedure, he or she is bound to supervise the work of subordinates and office staff. (*Matter of Malek–Yonan* (Rev.Dept. 2003) 4 Cal. State Bar Ct.Rptr. 627, 634–635—attorney's complete failure to supervise staff to ensure proper handling of client trust account funds amounted to willful violation of Rule 3–110(A), Rules of Professional Conduct [duty of competence]; *Matter of Robins* (Rev.Dept. 1991) 1 Cal. State Bar Ct. Rptr. 708, 712–714—misappropriation caused by serious violation of lawyer's duty to oversee entrusted funds is deemed willful even absent deliberate wrongdoing.)

Gross negligence in supervision of staff that results in mishandling of entrusted funds and accounts is a ground for discipline and constitutes *moral turpitude* by the attorney, under Business and Professions Code section 6106.

Under Rule 3–110(A), a lawyer's duty to perform legal services "with competence" includes the duty to supervise the work of attorney and non-attorney staff which also requires attorneys to have adequate office procedures in place to protect client funds and ensure that staff follow those procedures. (*Matter of Malek–Yonan* (Rev.Dept. 2003) 4 Cal. State Bar Ct. Rptr. 627, 634–635—attorney failed to perform legal services competently in violation of Rule 3–110(A) in that she "abrogated her responsibility to manage her office and her trust account and thereby cheated her clients.")

The purpose of this paper is to assist lawyers understand their trust accounting duties; to assist lawyers in establishing, evaluating and maintaining procedures to comply with trust accounting obligations and to supervise persons who assist lawyers in fulfilling those obligations.

CHAPTER 2.
ESTABLISHING A CLIENTS' TRUST ACCOUNTS

2.1. WHEN DOES A CALIFORNIA LAWYER NEED A CLIENTS' TRUST ACCOUNT?

A clients' trust account ("CTA") is required any time a member of the California bar comes into possession of or control of the following:

- funds belonging to a client;
- funds in which the client has any financial or pecuniary interest; or
- third party funds

  which either (1) belong in whole or in part to a third party or (2) in which the third party has a financial or pecuniary interest and (1) which are being held for the benefit of the client or with respect to a matter in which the lawyer is representing the client or (2) the lawyer has a fiduciary relationship with the third party.

If a California lawyer does not hold funds which fall into any of the above categories, a clients' trust account is not needed.

2.2. WHERE MUST A CLIENTS' TRUST ACCOUNT BE LOCATED?

2.2.1. The clients' trust account must be in the state in which the lawyer's office is located. (Rule 4-100(A), Rules of Professional Conduct. A complete copy is in Ex. 1.)

Exception: If the client consents in writing, the funds may be deposited in a clients' trust account where there is a substantial relationship between the client or the client's business and the other jurisdiction. (Rule 4-100, Rules of Professional Conduct.)

2.2.2. **Multi-state or multi-national law firms:** Regardless of law firm policy, if a California lawyer receives trust funds in a California office, rule 4-100(A) requires that the entrusted funds be placed in a clients' trust account in a depository in California, unless the client consents in writing to another jurisdiction.

2.3. TWO TYPES OF CLIENTS' TRUST ACCOUNTS IN CALIFORNIA

There are two (2) types of clients' trust accounts permitted in California: (1) An IOLTA (**I**nterest **on L**awyer's **T**rust **A**ccount) clients' trust account; and (2) A non-IOLTA or "exempt" clients' trust account.

2.3.1. **The "IOLTA" Clients' Trust Account**

An attorney or law firm that receives funds in a fiduciary capacity for the benefit of a client or third party in "nominal" amounts or for a "short period of time" must place those funds in at least one interest-bearing trust account from which interest and dividends are paid to the State Bar (known as an "IOLTA account"). (Bus. & Prof.C. § 6211 (a) [the statutes are in Ex. 2]; State Bar Rules 2.100(E), 2.110(A) [the State Bar Rules are in Ex. 3].)

Compliance with this statutory IOLTA program is mandatory. (See State Bar Rule 2.110(A).)

2.3.1.1. **"Nominal" or "short-term" deposits:**

IOLTA accounts must be used for funds that are "nominal" in amount or on deposit or invested for a "short period of time." (Bus. & Prof.C. § 6211(a); State Bar Rule 2.110.)

Funds are "nominal" or held for a "short period of time" if the funds "cannot earn income for the client or third party in excess of the costs incurred to secure such income." (State Bar Rule 2.110(A); *Carroll v. State Bar* (1985) 166 CA3d 1193, 1200, 213 CR 305, 308, cert. den. (1985) 474 US 848.)

2.3.1.2. **Relevant factors in determining whether funds qualify for IOLTA treatment:**

Attorneys must consider the following factors when determining whether funds cannot earn income in excess of costs:

(1) Amount of funds to be deposited;

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

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

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

(5) The capability of eligible institutions or the attorney 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. (State Bar Rule 2.110(A)(1) -(6).)

Compare: Where a client entrusts substantial funds to be held for longer periods of time, such that appreciable amounts of interest can be earned for the benefit of a client, that clients' funds may properly be placed in a separate trust accounts from which interest is payable to clients rather than to the State Bar (see below at §2.3.2.).

PRACTICE POINTER: There are several advantages to having an IOLTA client trust account: provides several advantages to attorneys:

(1) The State Bar pays the regular maintenance charges on IOLTA accounts from collected interest on all accounts, which may result in cost savings to the attorney.

(2) The State Bar's taxpayer identification number (94–6001385) is on the account, not the attorney's, thereby creating less reporting obligations.

(3) The attorney does not have to apportion or account for interest on the funds, since the interest is automatically paid to the State Bar.

2.3.1.3 **Interest and dividends fund legal services for indigents:**

Interest and dividends earned on IOLTA accounts received by the State Bar are used to provide legal services for indigent persons. (See Bus. & Prof.C. §§ 6210, 6211(a); State Bar Rule 3.660 et seq. (Legal Services Trust Fund Program).)

2.3.1.4. **No discipline for "good faith" decision re deposit of funds:**

The State Bar will not bring disciplinary charges against a lawyer "for determining in good faith if to place funds in an IOLTA account." (State Bar Rule 2.110(B).)

2.3.1.5. **Lawyer's continuing duty to evaluate IOLTA funds:**

Lawyers are required to review their IOLTA accounts at reasonable intervals to determine whether changed circumstances require funds to be moved out of the IOLTA accounts. (State Bar Rule 2.112.)

2.3.1.6. **IOLTA account requirements:**

IOLTA accounts must be established and maintained consistent with the attorney or law firm's duties of professional responsibility (Bus. & Prof.C. § 6212(a)) and, in addition, must meet the following requirements:

(1) **Account held at "eligible institution":**

IOLTA accounts can only be established and maintained at qualifying "eligible institutions." (For eligibility information, see below at

(2) **Type of account:**

An IOLTA account is defined as an account or investment product that is any of the following:

- an interest-bearing checking account;
- an investment sweep product that is a daily (overnight) financial institution repurchase agreement or an open-end money-market fund;

Repurchase agreement requirements:

A daily financial institution repurchase agreement must be:

(i) fully collateralized by U.S. Government Securities or other comparably conservative debt instruments; and

(ii) established only with any eligible institution that is "well-capitalized" or "adequately capitalized," as those terms are defined by applicable federal statutes and regulations. (Bus. & Prof.C. § 6213(j).)

Money-market fund requirements:

An open-end money-market fund must:

(i) be invested solely in U.S. Government Securities or repurchase agreements fully collateralized by U.S. Government Securities or other comparably conservative debt securities;

(ii) hold itself out as a "money-market fund," as defined by the Investment Company Act of 1940 (15 USC § 80a–1 et seq.) and regulations thereunder; and

(iii) have total assets of at least $250,000,000 at the time of investment. (Bus. & Prof.C. § 6213(j).)

- any other investment product authorized by California Supreme Court rule or order. (Bus. & Prof.C. § 6213(j); State Bar Rule 2.100(F).)

(3) **Liquidity:** IOLTA accounts must allow prompt withdrawal of funds, except that the accounts may be subject to notification requirements applicable to all other accounts of the same class at the eligible institution (*see ¶ 9:55 ff.*) so long as the notification requirement does not exceed 30 days. (State Bar Rule 2.116.)

(4) **Interest rate:** The rate of interest or dividends payable on any IOLTA account must not be less than that generally paid by the eligible institution (*see ¶ 9:55 ff.*) to non-attorney customers for the same type of account. (Bus. & Prof. C. § 6212(b); State Bar Rule 2.130.)

2.3.1.7 "Chargeable fees" deductible from interest generated by IOLTA accounts:

Reasonable fees may be deducted from the interest or dividends remitted on an IOLTA account only at the rates and in accordance with the customary practices of the eligible institution (*see 9:55 ff.*)

for non-IOLTA customers. No other fees or service charges may be deducted from interest or dividends earned on an IOLTA account, and *no* fees or charges may be assessed against or deducted from the *principal* of any IOLTA account. (Bus. & Prof.C. § 6212(c); State Bar Rule 2.113.)

Such "chargeable fees" include:

— per-check charges;

— per-deposit charges;

— fees in lieu of minimum balance;

— federal deposit insurance fees; and

— sweep fees. (State Bar Rule 2.100(A).)

Compare—lawyer's "business expenses": No deduction from an IOLTA account is permitted for a lawyer's "business expenses." The lawyer or law firm is solely responsible for those expenses. (State Bar Rule 2.113.)

> **Defined:** A "business expense" is an expense a lawyer incurs in the ordinary course of business, such as:
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> - check printing charges;
> - deposit stamps;
> - insufficient fund charges;
> - collection charges;
> - wire transfer fees;
> - cash management fees; and
> - any other fee that is not a "chargeable fee".
>
> (State Bar Rule 2.100(J).)

State Bar authority re erroneous deductions: If the State Bar becomes aware that a business expense is erroneously deducted from IOLTA funds, "the State Bar will inform the IOLTA-eligible institution and request that the error be corrected." (State Bar Rule 2.113.)

PRACTICE POINTER re fee deductions from IOLTA accounts: To ensure only "chargeable fees" are deducted from interest or dividends generated by your IOLTA accounts, you (or your law firm) should have a written agreement with the eligible institution that expressly prohibits "business expenses" from being deducted from those accounts and provides that such expenses are to be charged back to your non-trust account funds.

In the absence of such an agreement, you should deposit additional funds into your IOLTA accounts to pay nonchargeable expenses. Depositing "non-trust funds" into an IOLTA account to pay nonchargeable bank administrative fees is permitted by CRPC 4–100(A)(1).

Effect where chargeable fees exceed interest/dividends earned: Monthly and other fees charged by the eligible institution that exceed the interest and dividends earned on an IOLTA account may be charged to the attorney. (See State Bar IOLTA Guidelines, Fees and Charges (*www.calbar.ca.gov/Attorneys/MemberServices/IOLTA/Guidelines. aspx*)]

If such fees routinely exceed interest and dividends earned, the attorney may apply to the Legal Services Trust Fund Program to convert the IOLTA account to a noninterest-bearing trust checking account. If the application is granted, 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 IOLTA Guidelines, Fees and Charges (*www. calbar.ca.gov/Attorneys/MemberServices/IOLTA/Guidelines.aspx*).)

2.3.1.8 **IOLTA-eligible financial institutions:** IOLTA accounts can be maintained only in IOLTA-eligible financial institutions:

— a bank, savings and loan or other financial institution regulated by a federal or state agency that pays interest or dividends in the IOLTA account and carries deposit insurance from an agency of the federal government; or

— any other type of financial institution authorized by the California Supreme Court. (Bus. & Prof.C. §§ 6212(a), 6213(k).)

A list of eligible institutions is available on the State Bar Web site (*www.calbar.ca.gov/Attorneys/Member Services/IOLTA/EligibleInstitutions.aspx*).

2.3.1.9. **Institutional Duties:**

An IOLTA-eligible financial institution has the following duties:

(1) **Remitting interest/dividends to State Bar:**

Interest or dividends on the IOLTA accounts (less reasonable fees, ¶ *9:54.1 ff.*) must be remitted to the State Bar "at least quarterly." (Bus. & Prof.C. § 6212(e)(1); State Bar Rule 2.131.)

(2) **Reporting to State Bar and attorney:**

With each remittance (above), a statement must be transmitted to the State Bar and the attorney or law firm showing the (i) name of the attorney or law firm for which the remittance was sent; (ii) interest rate applied or dividend paid for each account; (iii) amount and type of fees and service charges deducted (if any); and (iv) average daily account balance for each month of the period for which the report is made. (Bus. & Prof.C. § 6212(e)(2) & (3).)

(3) **Lawyer's consent to disclosure of account information:**

By establishing an IOLTA account, a lawyer "consents" to the eligible institution's furnishing account information to the State Bar. (State Bar Rule 2.115.)

2.3.1.10 **Lawyer's duty to direct eligible institution to perform duties?**

The governing statute indicates the eligible institution "*shall be directed*" to perform its duties (above) in connection with IOLTA accounts. (Bus. & Prof.C. § 6212(e) (emphasis added); see also State Bar Rule 2.114 (requiring members to report compliance with IOLTA rules).)

Whether attorneys who establish IOLTA accounts are responsible for such "direction" and, if so, the nature and extent of that responsibility is unclear. (See State Bar Rule 2.118—IOLTA Rules should not be construed to affect or impair a lawyer's duties under the "statutes and rules governing the conduct of members of the State Bar.")

2.3.1.11. **Reports to State Bar:** The attorney or law firm must report IOLTA account compliance and all other IOLTA account information required by the State Bar in the manner specified by the State Bar.
(Bus. & Prof.C. § 6212(d); See the IOLTA Guidelines for Attorneys on the State Bar Web site:
(*www.calbar.ca.gov/Attorneys/MemberServices/IOLTA/Guidelines.aspx*).)

PRACTICE POINTER: For assistance with IOLTA account questions or problems, contact the State Bar Legal Services Trust Fund Program (415–538–2159; or *iolta@calbar.ca.gov*); also see the IOLTA Guidelines on the State Bar Web site (*www. calbar.ca. gov/Attorneys/MemberServices/IOLTA/Guidelines. aspx*).

2.3.2. The Non-IOLTA Clients' Trust Account or "Exempt" Account

2.3.2.1. **Definition:**

If entrusted 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 non-I*OLTA* 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. (State Bar Rules, 2.111(A).)

An exempt account should not be designated as an IOLTA account. (State Bar Rules, 2.111(B).)

2.3.2.2. **Must an "exempt" clients' trust account be interest bearing?**

Business and Professions Code section 6211(b) provides that an attorney or law firm may establish one or more interest bearing bank trust deposit accounts or dividend-paying trust investment accounts as may be permitted by the Supreme Court, with the interest or dividends earned on the accounts payable to clients for trust funds not deposited or invested in accordance with subdivision (a).

Section 6211(b) appears to suggest that a non-IOLTA clients' trust account must be interest bearing, with the interest earned on the account payable to trust account beneficiaries.

However, rule 2.118 also states that the rules shall not be construed as affecting or impairing the duties and obligations of attorneys or law firms pursuant to the statutes and rules governing the conduct of members of the State Bar including but not limited to, provisions of rule 4-100, Rules of Professional Conduct.

There is yet no decision which deprives the client of the ability to determine whether it is in the best interests of the client to have client funds earn interest if those funds are not nominal or are not to be held for a short term.

RISK MANAGEMENT TIP:

As a matter of risk management, unless the beneficiary (client or third party) specifically requests in writing that an "exempt" account **not** be interest bearing, all exempt accounts for the benefit of a client or third party should be interest bearing.

2.3.2.3. Interest from an exempt, non-IOLTA account generally belongs to the client or third party owning the funds in the account.

Interest from a non-IOLTA interest bearing clients' trust account generally belongs to the client. (Business and Professions Code section 6211(b).) With few exceptions (e.g., interest on disputed funds or costs ultimately awarded to the lawyer,) the interest on this account does not belong to the lawyer.

The general rule is that interest earned on funds goes to the rightful owner of the funds. Since the money in the clients' trust account is not the lawyer's money, the interest thereon can never belong to the lawyer.

If the interest does not go to the lawyer, who does it belong to? If the entire account is attributed to one client, it all goes to that client. If the money deposited in the account belongs to several parties, then interest must be apportioned to each party.

RISK MANAGEMENT TIP: In times when interest rates were high, some lawyers had non-segregated, non-IOLTA interest bearing clients' trust accounts. In reviewing such clients' trust accounts, they are finding that the earned interest may not have been fully apportioned to the respective clients, leaving unallocated interest on hand. These lawyers may go over

their records; reallocate the interest to the appropriate client; and distribute such interest accordingly. Another alternative is to transfer the interest to the IOLTA program. A third alternative is to have the funds escheat to the state, if the allocation of interest is impossible to determine or if the clients are impossible to locate. (Code Civ. Proc., ' 1518.) Lawyers should not pay the interest to themselves unless they can prove with documentary evidence that the interest belongs to the lawyers.

2.4. CHOOSING THE TYPE OF FINANCIAL INSTITUTION TO BE A DEPOSITORY OF A CLIENTS' TRUST ACCOUNT.

2.4.1. **IOLTA Clients' Trust Accounts:**

An IOLTA clients' trust account may only be established at an eligible institution. An "eligible institution" is (1) a bank, savings and loan, or other financial institution regulated by a federal or state agency that pays interest or dividends in the IOLTA account and carries deposit insurance from an agency of the federal government or (2) any other type of financial institution authorized by the California Supreme Court which pays an appropriate rate of interest or dividends. (Bus. & Prof. Code, §6213(k), 6212(b).)

A list of eligible institutions is available on the State Bar Web site (*www.calbar.ca.gov/Attorneys/Member Services/IOLTA/EligibleInstitutions.aspx*).

2.4.2. **The Non-IOLTA Clients' Trust Account**

Rule 4-100 (A) requires the lawyer to maintain a clients' trust account in a bank. No other financial institutions have been approved as depositories for non-IOLTA clients' trust accounts.

2.5. HOW MANY CLIENTS' TRUST ACCOUNTS DO YOU NEED?

Lawyers handle funds as a fiduciary or trustee, and are therefore required to be prudent in choosing the financial institution as depositories for clients' trust accounts.

PRACTICE TIP: Watch the level of funds each client has in each account. If the level is likely to exceed the maximum amount for FDIC, FSLIC or other federal insurance (e.g. $100,000 per client per account per institution for FDIC), open another clients' trust account in another financial institution.

2.6. SIGNATORIES TO YOUR CLIENTS' TRUST ACCOUNT

Neither the Business and Professions Code, the Rules of Professional Conduct or the case law address who may be signatories to a clients' trust account.

RISK MANAGEMENT TIPS: Because there are many cases of trust account abuse and theft of entrusted funds by non-lawyers in disciplinary and civil cases, it is recommended:

(1) Never let an unlicensed person be a signatory on the clients' trust account.

(2) Do not use electronic or mechanical check signatures or rubber stamp signatures.

(3) Do not pre -sign blank checks.

(4) Do not give an unlicensed person a power of attorney to transfer funds from a clients' trust account to a business or personal account to which he or she is a signatory.

(5) Get fidelity bond coverage or other insurance for mal or misfeasance of your employees or other independent contractors. If an employee, bookkeeper or accountant embezzles client money, the client's money may be adequately protected by the fidelity bond, thus possibly preventing disciplinary or civil problems to you for failure to make good the loss to the client.

(6) Protect your trust account bank records from loss or alteration. Either: Have your trust account statements sent to your home so that no person can interfere with your receipt and initial review of the status of your accounts and the checks written during the previous month; or b.If mailed to your office, insist that the trust account statements are brought to you unopened.

(7) Have more than one signatory on the clients' trust account so that if one person is unavailable or incapacitated, clients still have access to the funds in the trust account.

The responsibilities for the safety of clients' funds in your clients' trust account are non-delegable. (*In the Matter of Robins* (Review Dept. 1991) 1 Cal. State Bar Ct. Rptr. 708).

2.7. WHAT SHOULD YOUR CLIENTS' TRUST ACCOUNT BE CALLED?

The clients' trust account **must** be labeled "trust account" or "client's funds account" or words of similar import. (Rule 4-100(A), Rules of Professional Conduct.)

PRACTICE TIP: Make sure that all checks, check books, deposit tickets, deposit endorsement stamps, bank records, bank statements and other documentation related to the clients' trust account are properly labeled as well.

CHAPTER 3: DEPOSITS TO A CLIENTS' TRUST ACCOUNT

3.1. MANDATORY DEPOSITS: What Funds Must Be Placed in A Clients' Trust Account?

3.1.1. The General Rule: Rule 4-100(A), Rules of Professional Conduct requires that all funds received or held for the benefit of clients, including advances for costs and expenses, must be deposited in a clients' trust account.

3.1.2. The duties respecting handling of funds and property apply not only to clients' funds and property but also to third parties to whom the lawyer owes a fiduciary duty.

3.1.3. Application of the general rule to various types of deposits.

The following are examples of types of funds which must be placed in the CTA when received by the lawyer or law firm.

Caveat: this is not an all- inclusive list, but is exemplary.

(1) Personal injury settlement checks or drafts;

(2) Property damage checks or drafts;

(3) Medical payments, checks or drafts;

(4) Advances for costs or expenses from the client or some third party (for the benefit of the client);

(5) Payments of spousal or child support from a non-client for the benefit of a client;

(6) Client funds necessary to pay for investments, property or real estate;

(7) Client funds necessary to pay taxes;

(8) Funds from third parties to pay clients for rentals, leases, real property or other investments or property.

(9) Funds to satisfy a lawyers' lien established by operation of law.

(10) Attorneys' fees disputed by the client (Rule 4-100(A)(2), Rules of Professional Conduct.)

(11) Advances for fees, which have not previously been deposited into the clients' trust account, a portion or all of which the lawyer believes are earned and which the client disputes. The disputed portion of the advances for fees must be deposited into the CTA. (*In the Matter of Fonte* (Rev. Dept. 1994) 2 State Bar Ct. Rptr. 752.)

(12) Funds retained to pay medical liens.

(13) Security Deposits. (*T & R Foods, Inc. v. Rose* (1996) 47 Cal.App.4th Supp. 1, 8 [56 Cal.Rptr. 2d 41]

3.1.4. The Client's Consent to Deposit Such Funds in A Personal or Business Account Is Not a Defense to the Rule.

Even if the client consents to the deposit of funds in another account (e.g. a business account), the lawyer must place the funds in a clients' trust account. (In the Matter of Lilly (Review Dept. 1993) 2 Cal. State Bar Ct. Rptr. 185.)

3.2. PERMISSIVE DEPOSITS: What funds may be placed in a clients' trust account?

3.2.1. **Advanced legal fees:**

Under CRPC 4–100(A), as it has been construed by California courts, an attorney is ethically permitted, *but not required*, to deposit fee paid in advance, but not yet earned into a trust account. [*Handbook on Client Trust Accounting for California Attorneys* (2009 State Bar of California) at p. 15; Cal.State Bar Form. Opn. 2007-172.]

Although the language of CRPC 4-100(A) [requiring funds "belonging in part to a client and in part *presently or potentially* to the member (attorney)" to be deposited in the attorney's trust account] seems broad enough to apply to advances for fees, no California court has yet so held. [Cf. Cal.State Bar Form. Opn. 2007-172.]

CAUTION: Where a California lawyer should deposit an advanced fee depends upon whether the advanced fee is a true retainer, a security deposit or an advanced fee from which the lawyer intends to satisfy the client=s incurred fees. A true retainer may never be deposited in a clients' trust account because it belongs to the attorney when received; a security deposit always must be deposited in a trust account.

RISK MANAGEMENT TIPS: Because rule 3-700(D)(2) requires a lawyer to return unearned fees upon termination of employment, it is a prudent practice to deposit advances for fees in the clients= trust account until the fees are earned and fixed. This will ensure that unearned fees are available upon termination for refund to the client.

Regardless of whether advanced fees are placed in a clients' trust account, you must account for your handling of all advanced fees.

3.2.2. Lawyer's personal funds sufficient to pay bank administrative charges.

Rule 4-100(A)(2), Rules of Professional Conduct permits personal funds of the lawyer sufficient to pay bank administrative charges in the clients' trust account.

3.2.2.1. There is no statute, rule or guideline establishing the minimum or maximum amount which may be deposited as a bank administrative charge.

3.2.2.2 The State Bar Court Review Department has ruled that the amount of $121.57 is reasonable as a banking administrative charge, absent guidelines. (*In re Respondent F* (Rev. Dept. 1992) 2 Cal.State Bar Ct. Rptr. 17.)

3.2.3. Disputed Attorney's Fees Must Be Kept in a Clients' Trust Account Until the Dispute is Resolved (Rule 4-100(A)(2). These include:(1) Advanced attorney's fees which the lawyer claims have been earned but the client disputes; and (2) Other attorney's fees or costs disputed by the client.

3.2.4 Lawyer's personal funds deposited in a clients' trust account to replace client or third - party funds wrongfully taken. *(Guzzetta v. State Bar* (1987) 43 Cal.3d 962.)

3.3. PROHIBITED DEPOSITS: Funds that may <u>never</u> be placed in a clients' trust account.

The following are examples of types of funds which MAY NEVER be deposited in your CTA; but this list is not exhaustive:

3.3.1. **Lawyer's personal funds (**except those necessary to pay bank administrative charges or to replace monies wrongfully taken).

3.3.1.1. **Commingling is prohibited.**

"**Commingling** is committed when a client's money is intermingled with that of the attorney and its separate identity lost." (*In the Matter of Bleecker* (Review Dept. 1990) 1 Cal. State Bar Ct. Rptr. 113.) Therefore, depositing the lawyer's personal funds into a clients' trust account or keeping funds, which have been earned and fixed belonging to the lawyer in such an account is prohibited.

Some lawyers leave a "buffer fund" or "prudent reserve" of the lawyer's own funds in the clients' trust account to prevent an overdraft if the lawyer makes a mistake. A "buffer fund" or "prudent reserve" of lawyer's funds, except to pay bank administrative charges, is not permitted. Those are just other ways of violating the age-old prohibition against COMMINGLING (the mixing of a lawyer's personal funds or legal fees with funds belonging to clients or other fiduciaries).

Client funds in trust account not required: A commingling violation can occur where funds belonging to the lawyer are on deposit in a client's trust account, even where there are no client funds therein. (*Matter of Doran* (Rev.Dept. 1998) 3 Cal. State Bar Ct.Rptr. 871, 876—attorney deposited personal funds in client trust accounts and used accounts for personal expenses.)

3.3.1.2. There are three exceptions to the "thou shall not commingle rule":

(i) Bank administrative charges.

(ii) Funds in which the lawyer claims an interest (i.e., earned attorneys' fees or reimbursement for costs) which the client or a third-party dispute.

(iii) Replacing clients' monies out of trust.

Suppose one month after you do the reconciliation, you find that your trust account is missing about $1,000 in client funds? Maybe the reason for the trust account imbalance will subject you to discipline. If you replace the missing $1,000, are you adding to your disciplinary liability by a further charge or commingling?

No. The Supreme Court has held that repayment of client trust monies wrongfully taken by the deposit of the lawyer's own personal funds is considered early restitution and therefore is not commingling for which discipline will be imposed. (Guzzetta v. State Bar (1987) 43 Cal.3d 962.)

3.3.1.3. **Overdraft Protection:** Replacement of client funds by operation of overdraft protection (bank extends credit) is *not* prohibited commingling so long as the credit does not exceed the overdraft (i.e., bank does not automatically extend a fixed amount that leaves a remainder after satisfying the overdraft). (Cal. State Bar Form. Opn. 2005–169.)

Overdraft protection does not necessarily prevent a lawyer from disciplinary liability for client trust account mismanagement. Despite overdraft protection, loss of client funds may still result in discipline. Moreover, banks are required to report any shortfall in client trust accounts to the State Bar, even if the amount is covered by overdraft protection. (See Cal. State Bar Form.Opn. 2005–169.) However, overdraft protection can provide mitigation because any loss is reimbursed immediately.

RISK MANAGEMENT TIPS: 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, because a clients' trust account check will be honored.

Comment: The State Bar Handbook on Client Trust Accounting for California Attorneys *cautions* counsel against overreliance on overdraft protection, stressing that, except for bank errors, counsel should never have insufficient funds in a client trust account in the first place ("(o)verdraft protection is not a substitute for the proper handling of clients 'money"). [See Handbook on Client Trust Accounting for California Attorneys (Calif. State Bar 2009) at p. 10]

By the same token, the Handbook also notes that the use of overdraft protection can "benefit" clients by ensuring that important checks counsel has written on a client's matter will not "bounce" if a bank error or delay causes an unanticipated shortfall. [See Handbook on Client Trust Accounting for California Attorneys, supra] Indeed, even the most careful lawyers can experience shortfalls in client trust accounts resulting from employee/agent error, malfeasance or theft. Moreover, a lawyer's *fiduciary duty* to clients to maintain and preserve entrusted funds exists notwithstanding disciplinary liability for loss of client funds.

Insurance or bonding, while recommended, is insufficient alone since delay for reimbursement can often be significant. Overdraft protection ensures the client's funds will be replaced, are preserved and will be available at the client's demand.

3.3.1.4. **Prevent Commingling by Withdrawing Earned Legal Fees and Reimbursement for Costs Promptly**

In the case of "funds belonging in part to a client and in part presently or potentially to the (attorney)," the attorney's share must be withdrawn from the client trust account "at the earliest reasonable time" after the attorney's interest "becomes **fixed**" unless the client disputes the fee. (Rule 4–100(A)(2).)

When does a lawyer's interest become "fixed"? No legal criteria have been established to determine when an attorney's interest in funds held in a client trust account becomes "fixed."

Comment: An attorney's interest in trust account funds may be earned, but not yet "fixed," because CRPC 4–100(A)(2) requires the lawyer to maintain any disputed fees on deposit until the dispute is resolved.

By implication, an attorney's interest in client trust account funds is "fixed" when:

-- the *client expressly approves the attorney's interest* in a certain amount of the trust funds (e.g., by expressly approving a billing or an accounting of the funds setting forth the amount of fees earned by the attorney) (see Cal. State Bar Form.Opn. 2006–171); *or*

-- the *attorney and client agree* to the amount of the attorney's interest following a dispute; *or*

-- the amount of the attorney's interest has been set forth in a *civil judgment, court order or binding arbitration award*.

To ensure there is evidence that the client has *expressly approved* the attorney's interest in trust account funds, the client's approval should be *in writing*.

Definition by agreement: In the absence of a statute specifically providing for attorney fees, attorney and client are free to agree to the "measure and mode" of attorney compensation. Consequently, the attorney and client may prescribe when the attorney's interest in earned fees will "become fixed" for purposes of CRPC 4–100. (See CCP § 1021)

RISK MANAGEMENT TIPS: Attorneys should include in the fee agreement a definition of when the attorney's future interest in client trust account funds will become "fixed." For example, where advance fees are to be deposited into a client trust account, the lawyer and client should agree that the amount of earned fees will become "fixed" at a particular time after the client has been billed, to afford the client an opportunity for review. As a matter of risk management, an attorney who advances costs on behalf of a client should also define when the attorney's right to reimbursement of advanced costs will be "fixed" after sending a billing.

Implied client approval: An implied attorney-client agreement that the attorney's fees will be "fixed" if the client remains silent after receipt of a billing indicating the amount of incurred fees and costs to be deducted from the client trust account is possible (CCP § 1021); but reliance on implied approval is *risky*.

RISK MANAGEMENT TIPS: An attorney relying on implied client approval of the attorney's interest in entrusted funds, as a matter of risk management, should not consider his or her interest "fixed" by implication unless the client has had an opportunity to review the attorney's billing or proposed disbursement statement. There is a danger in withdrawing earned attorney fees and reimbursements for costs from a trust account at the time a billing is sent but before the client has had an opportunity to review the billing. If the client thereafter disputes the attorney's fees and/or costs upon receipt of the billing, the disputed amount must be redeposited into the trust account and the attorney may be subject to charges of improper withdrawal of entrusted funds. (See *Matter of Fonte* (Rev.Dept. 1994) 2 Cal. State Bar Ct.Rptr. 752, 758; *Matter of Cacioppo* (Rev.Dept. 1992) 2 Cal. State Bar Ct.Rptr. 128, 146.)

Timing of withdrawal of attorney's fixed interest:

Once an attorney's interest in entrusted funds is "fixed," the attorney's share must be withdrawn from the client trust account "at the earliest reasonable time." (Rule 4-100(A)(2).)

-- "**Earliest reasonable time":** Neither Rule 4–100 nor any published court opinion defines the number of days or weeks that comprise the "earliest reasonable time." However, the State Bar Standing Committee on Professional Responsibility and Conduct has issued an advisory opinion concluding that, as a rule, an attorney should withdraw the attorney's fees from the client trust account at the time of the monthly account reconciliation after the attorney's interest in the account becomes fixed. (Cal. State Bar Form.Opn. 2005–169; see also ABA Model Rule 1.15(c)—lawyer must keep property in which both lawyer and another party claim interests separate until an accounting or severance of interests.)

Commingling by failure to withdraw fixed interest: If an attorney fails to withdraw the attorney's fixed funds at the earliest reasonable time, commingling may occur. Even a small amount of fixed fees belonging to an attorney in a client trust account may constitute commingling. (See CRPC 4–100(A)(2); *Matter of Heiner* (Rev.Dept. 1990) 1 Cal. State Bar Ct.Rptr. 301, 312.)

RISK MANAGEMENT CHECKLIST: "Fixing" fees and costs and withdrawing them from a trust account properly:

(1) Define in a fee agreement with the client when trust funds will become "fixed" for the purposes of withdrawing funds from a trust account. (See Exhibit 5 for a sample definition in hourly and contingency fee matters.)

(2) Prepare a detailed billing which complies with Business and Professions Code section 6148(b) or a detailed accounting (or disbursement) in compliance with CRPC 4-100(B)(3) and transmit to client.

(3) If there is no definition of when your claimed fees or reimbursement for costs become "fixed" in a fee or other agreement, obtain the client's consent in writing to the distribution of client trust funds in the billing, disbursement statement or accounting.

(4) If the client will not consent in writing to the distribution which the attorney claims, determine if there is an amount that the client does not dispute is "fixed."

(5) Withdraw all "fixed" funds as soon as practicable but no later than 30 days after the funds have been fixed.

(6) Retain any disputed funds in the client trust account until the dispute is resolved.

(7) Take reasonable steps to the resolve the dispute with your client promptly.

If an attorney disburses funds to himself or herself before the client has had an opportunity to receive and review a billing, distribution statement or accounting, and the client thereafter disputes some or all of that distribution, the attorney should replace the funds in the clients trust account and retain them there until the dispute is resolved.

If the attorney disburses funds to himself or herself after the attorney's entitlement has been fixed, the attorney is not required to re-deposit the funds in a clients' trust account. If the client revokes consent to a disbursement being "fixed" before the attorney has an opportunity to disburse the funds to himself or herself, the lawyer should retain the funds in a clients' trust account until the dispute is resolved, as a matter of risk management.

3.3.1.5. **Disputed trust funds in which lawyer claims interest:** Where an attorney claims an interest in trust funds (e.g., earned fees from advances for fees settlement funds on deposit in the client trust account or reimbursement for costs advanced by the attorney) and the client disputes some or all of the attorney's claims, the disputed portion must remain in the client trust account until the dispute is resolved. (CRPC 4-100(A)(2))] Because the rule requires that these disputed attorney's fees and costs must remain in trust until the dispute is resolved, even though the fees may be earned, their retention is not commingling.

3.3.1.6. **Exception:** Where the attorney's interest has been properly "fixed" pursuant to CRPC 4-100(B)(2) and withdrawn at the earliest reasonable time thereafter, a client's subsequent dispute about fees or costs does not obligate the attorney to re-deposit the disputed funds in a client' trust account. [Cal. State Bar Formal. Opn. 2006-171]

CHAPTER 4: TRUST ACCOUNT ADMINISTRATION

4.1. DUTY TO MAINTAIN FUNDS INVIOLATE: A lawyer is required to maintain inviolate the amount of money held for the benefit of each client, less disbursements made for the benefit of the client, until the funds are properly disbursed. (Rule 4-100(A), Rules of Professional Conduct.)

The failure to maintain the proper level of client funds in trust for each client has been called misappropriation. (*In the Matter of Bleecker* (Review Dept. 1990) 1 Cal. State Bar Ct. Rptr. 113.)

Responsibility to maintain the amount of entrusted funds continues until the checks written on the trust account have cleared the account. Where a lawyer's clients' trust account balance fell below the amount of entrusted funds after the checks were written but before they cleared, was a misappropriation. (*In the Matter of Bleecker* (Review Dept. 1990) 1 Cal. State Bar Ct. Rptr. 113.)

4.2. THE DISAPPEARED CLIENT WITH ABANDONED TRUST FUNDS

If a client has disappeared, the lawyer has a duty to maintain inviolate the abandoned funds until the lawyer completes the procedures to have the abandoned funds escheat to the state pursuant to Code of Civil Procedure section 1518. (State Bar of California Committee on Professional Responsibility and Conduct Formal Opinion No. 1975-36.)

4.3. MEDICAL LIENS

Funds which are received by a lawyer which are the subject of a medical lien held by the client's medical provider for services rendered in the matter for which the client hired the lawyer, are trust funds within the meaning of rule 4-100(A), Rules of Professional Conduct. Such funds must be held in a clients' trust account until properly disbursed. (*In the Matter of Respondent H* (Review Dept. 1992) 2 Cal. State Bar Ct. Rptr. 234.)

4.4 MISAPPROPRIATION

"Misappropriation of client funds is a particularly serious ethical violation, which breaches the high duty of loyalty owed to the client, violates basic notions of honesty, and endangers public confidence in the legal profession." (*In the Matter of Tindall* (Review Dept. 1991) 1 Cal. State Bar Ct. Rptr. 652.)

4.4.1. There are three types of misappropriation (which go to the lawyer's intent and affect the severity of discipline imposed):

4.4.1.1. Dishonesty within the meaning of Business and Professions Code section 6106

4.4.1.2. Gross negligence in attending to the trust account (Can also be Business and Professions Code section 6106, an act of moral turpitude)

4.4.1.3. Failure to maintain the proper level in the trust account, without the element of dishonesty or moral turpitude. (Rule 4-100(A), Rules of Professional Conduct.)

4.4.2. **Proof of misappropriation**

4.4.2.1**. Drop in the minimum balance**

If an attorney's clients' trust account balance drops below the necessary amount the attorney should be holding on behalf of the client, an inference of misappropriation may be drawn. The burden then shifts to the attorney to prove that no misappropriation has occurred. (*In the Matter of Respondent F* (Review Dept. 1992) 2 Cal. State Bar Ct. Rptr. 17.)

4.4.2.2**. Insufficiently funded or dishonored trust account checks**

One insufficiently funded check drawn on trust account, coupled with the attorney's repeated, unkept promises to make good on the check, and failing to make good on it, is moral turpitude. (*Bowles v. State Bar* (1989) 48 Cal.3d 100, 104-105, 109.) However, mere failure to keep a promise is not evidence of fraudulent intent. (*In the Matter of Mapps* (Review Dept. 1990) 1 Cal.State Bar Ct. Rptr. 1, 12.)

Your bank is required by statute to report you to the State Bar prosecutor when your clients' trust account is in a negative balance, including NSF [not sufficiently funded] and dishonored checks. (Business and Professions Code sec. 6091.1.) The reports are electronically wired to the State Bar prosecutor; no notice is given to the lawyer. In 1993 about 4500 reports of NSF or dishonored clients' trust account checks were made, involving about 2500 California lawyers.

4.4.2.3. **Probable cause trust account audit**

The State Bar can subpoena your clients' trust account records at any time, with notice by mail to you at your membership records address. (Business and Professions Code secs. 6069 and 6049.)

4.5. HANDLING OF CREDIT CARD PAYMENTS FOR FEES AND COSTS

Lawyers may accept their clients' credit cards for payment of legal fees and costs, provided the State Bar Act and CRPC are fully observed, including no access to clients' trust account by credit card companies. (Cal. State Bar Form.Opn. 2007–172; Cal. State Bar Policy Statement on Use of Credit Cards for Payment of Legal Services and Expenses dated February 11, 1975; San Diego Bar Ass'n Form.Opns. 1970–1, 1972–10, 1972–13 & 1974–6; and see ABA Form.Opn. 00–419 (withdrawing prior opinions prohibiting credit card use).)

4.5.1. **Credit card deposit for unearned fees:** A lawyer may accept a deposit for fees not yet earned by credit card in a general account. (Cal. State Bar Form.Opn. 2007–172.)

4.5.2. **No credit card payment of costs/expense advances:** An attorney may not ethically accept payment of costs and expense advances by credit card because advances for costs must be deposited in a client trust account. (CRPC 4–100; Cal. State Bar Form.Opn. 2007–172.)

4.5.3. **No increase in fees:** Attorneys participating in credit card finance plans may not increase their fees to a client for using a credit card or pay a client's personal or business expenses unless permitted under CRPC 4–210.

4.5.4. **No lawyer advertising:** A lawyer may not permit improper advertising or solicitation by the credit card issuer on behalf of the attorney. [See CRPC 1–400; Bus. & Prof.C. § 6157 et seq.]

CHAPTER 5: OTHER DUTIES REGARDING ENTRUSTED FUNDS AND PROPERTY

5.1. THE DUTY TO NOTIFY CLIENTS PROMPTLY UPON RECEIPT OF FUNDS PROPERTY

. 5.1.1. **The General Rule**

Upon receiving any funds on behalf of a client or a person to whom the lawyer is a fiduciary, a lawyer is required to promptly notify the client of the receipt of funds. (Rule 4-100(B)(1), Rules of Professional Conduct; *Sugarman v. State Bar* (1990) 51 Cal.3d 609, 613; *Bowles v. State Bar* (1989) 48 Cal.3d 100, 104, 105-106.)

Failure to notify a client of receipt and amount of a check deprives the client of rightful and timely access to the client's funds. (*McKnight v. State Bar* (1991) 53 Cal.3d 1025, 1034.)

5.1.2. **Content of the notification:**

5.1.2.1. **Exact Amount Received:** Failure to advise the client of the exact amount of the funds received constitutes a violation or rule 4-100(B)(1).

5.1.2.2. **Notification of partial amount insufficient:** Advising the client of your receipt of part of the settlement is insufficient. (*McKnight v. State Bar, supra,* 53 Cal.3d at pp. 1031-1033.)

5.1.2.3. **Notification of amount of client's portion insufficient:** Advising the client about the amount the client may expect to realize is also insufficient. (*McCray v. State Bar* (1985) 38 Cal.3d 257, 267-269.)

5.1.3. **Mode of Notification**

No writing is required; oral notification is sufficient. Neither the rule nor the case law require a lawyer to notify the client in writing.

RISK MANAGEMENT TIP: Memorializing the notification in writing clarifies the notice to the client and provides later proof that you complied with your duties.

< Telephonic notification at the client's work place, home or by leaving a message on an answering machine at home or voice mail at the

office, or by fax is permissible. Leaving a message with a relative, receptionist, or co-worker may not be the kind of notification contemplated by rule 4-100(B)(1), since you will be unable to confirm that the client has received the notification.

< However, a written note confirming an oral message, sent by mail is a better way to ensure that the oral message was received; and to prove that the notification was given promptly.

What if the client has limited English language skills?

< If a client is non-English or limited English speaking, a copy of the written notification should be translated into the client's native language, by a reliable translator, to assure that proper communication of a significant event (receipt of settlement funds) has occurred. (See Business and Professions Code sec. 6068(m); rule 3-500, Rules of Professional Conduct; Formal Opinion No. 1984-77, Committee on Professional Responsibility and Conduct of the State Bar of California.)

< The practice of translation of communications of all subsequent significant events should be continued.

5.1.4. **"Prompt" notification** is required: Rule 4-100(B)(1) requires that a lawyer's notification be "prompt."

How soon "prompt" is will vary depending on the facts and circumstances of the individual case. However, case law suggests that between three and four weeks is the outer limit of “prompt” notification.

< The Supreme Court found that a lawyer was culpable of violating this rule when the lawyer failed to notify the client after three weeks of receipt of funds and failed to notify the client of the exact amount of the settlement. (*McKnight v. State Bar* (1991) 53 Cal.3d 1025, 1029, 1031-1033. See also *Silver v. State Bar* (1974) 13 Cal.3d 134, 143-145 disapproving a hiatus of one month between receipt and notification.)

RISK MANAGEMENT TIP: The best practice would be to notify every client on the same day as the funds are received. Given that we are not always able to perform the best practice, a conservative rule of thumb is to calendar all notifications within 10 days of receipt of funds, unless the client, through no fault of the lawyer is unavailable or unreachable.

5.2 DUTIES WITH RESPECT TO SECURITIES OR OTHER CLIENT PROPERTY. (Rule 4-100(B)(2).)

All securities and properties of a client or a third party to whom fiduciary or other professional duties are owed, must be identified and labeled promptly upon receipt. (Rule 4-100(B)(2).)

All entrusted property must be placed in a safe deposit box or other place of safekeeping as soon as practicable and maintained there until distributed to the rightful owner. (Rule 4-100(B)(2).)

A lawyer's use of entrusted property constitutes prohibited commingling.

5.3 THE DUTY TO ACCOUNT: Rule 4-100(B)(3) requires a lawyer to render appropriate accounts to a client regarding all monies coming into the lawyer's possession.

5.3.1. **Timing of Accounting:** When should a lawyer distribute an accounting to a client regarding disbursements?

(1) Before a lawyer takes fees from the clients' trust account. (*Matter of Cacioppo* (Rev. Dept. 1992) 2 Cal.State Bar Ct. Rptr. 128, 146]

(2) At the time of distribution of funds to the client, in explanation of the distribution.

RISK MANAGEMENT TIPS: It is helpful to obtain clients' initials or signature on the distribution accounting, acknowledging that the client has received and reviewed such accounting prior to the distribution. It is **not** appropriate to hold the clients' distribution of funds hostage unless and until the client signs the accounting. Of course, if the client disputes any distribution of part or all the lawyer's fees or distributions to third parties, such funds must be maintained in trust until the dispute is resolved or until the funds are interplead into a court of law.

(3) Just after all final distributions have been made: Sometimes funds are disputed or the lawyer negotiates with third parties for a reduction of funds owed, at the client's direction. At the time of pay out, the lawyer should make a further and final accounting to the client.

5.3.2. **Scope of Accounting:** An accounting of entrusted funds is supposed to demonstrate to the client or third party how all funds which came into the lawyer's possession. The accounting must minimally show (1) the date, source, amount and purpose of all funds received on behalf of the client (2) the date, amount, payee and purpose of all distributions made on behalf of the client; and (1) the balance of funds (including zero balance).

5.3.3. **Accounting for Attorneys' Fees and Costs Awarded as Sanctions:** Any attorneys' fees and costs awarded to a client in a case and collected as a result of ordered sanctions must be disclosed to the client in an accounting. (*Matter of Kroff* (Rev.Dept. 1998) 3 Cal.State Bar Ct. Rptr.838, 854.) Therein, an attorney who failed to disclose his collection of $700 in attorneys' fees and $196 in costs as a result of a sanction award in a contingency fee case, was found culpable of failing to account to client in violation of rule 4-100(B)(3).

RISK MANAGEMENT TIP: Unless a fee agreement authorizes a lawyer to take attorneys' fees awarded as sanctions in addition to any contingency fee earned, a lawyer should deduct the amount of the awarded attorneys' fees from the contingency fee earned, if any.

5.3.4. **Required Record Keeping**: A lawyer is required to keep adequate paper work, records or documents to enable the lawyer to prepare appropriate accountings. (See also: Record Keeping Requirements)

5.3.5. **Accounting Includes the Duty to Account for Attorney's Use of Advanced Fees**

The duty to account for client funds includes the duty to maintain adequate records of fees drawn against an advanced fee and of fee payments made thereafter and to provide clients with an appropriate accounting of the attorney's use of the advanced fees. (In the Matter of Fonte (Review Dept. 1992) 2 Cal. State Bar Ct. Rptr. 752.)

5.4. THE DUTY TO PAY OUT FUNDS UPON DEMAND (Rule 4-100(B)(4).)

5.4.1. **Requirements for a duty to arise:** The client or third party with an interest in the funds must make a demand for disbursement of funds or distribution of property. The funds must be credited to the account (i.e., any check or financial instrument must have cleared). The amount that the client or third party claims belongs to them and there is no dispute about the ownership or amount.

COMMENT: Suppose that an insurance draft encompassing payment for a clients' personal injuries has been deposited to your CTA. The client demands immediate payment, even though the bank manager tells you that the draft has not cleared. The lawyer cannot give the client a check for the amount of the settlement. To do so would be to use other client funds for the benefit of the demanding client. This is a prohibited misappropriation.

COMMENT: A draft or a collection item (after a check has bounced once, it is normally treated as a collection item) is not eligible for distribution until the attorney's bank has received credit or notification that the item has been paid or will be paid by the paying financial institution. The lawyer should affirmatively confirm with his or her bank that a check or draft is good before disbursement.

5.4.2. Payment must be prompt

30 days between demand and payout is not unreasonable. (*In the matter of Riley* (Review Dept. 1994) 3 Cal.State Bar Ct. Rptr. 91, 1-6-107, 114.)

6 WEEKS IS TOO LONG! While a six -week delay between the demand and payment to the client is not a per se violation, where the attorney paid himself his contingency fee and had no good reason for failure to deliver the client's proceeds, a six-week delay constitutes a failure to make prompt payment or delivery in violation of rule 4-100(B)(4), CRPC. (*Matter of Berg* (1997) 3 Cal. State Bar Ct. Rptr. 725, 735.)

5.4.3. Lawyers Failure to Endorse Settlement Draft Because Of Dispute About Division of Fees with Successor Counsel:

Where a draft cannot be negotiated without a lawyer=s endorsement, a lawyer=s **unreasonable** refusal or **significant delay** in endorsing a draft which significantly delays a client=s receipt of funds, constitutes constructive possession of the client=s funds and constitutes a failure to promptly pay or deliver funds in violation of rule 4-100(B)(4), CRPC. (*Matter of Kaplan*(1993) 2 Cal. State Bar Ct. Rptr. 509, 521-522.)

Important Exception: Where the refusal or delay in endorsing a settlement draft is not unreasonable, there is no violation of rule 4-100(B)(4). (*Matter of Feldsott* (Rev.Dept. 1997) Cal.State Bar Ct. Rptr. 754, 757-758)

In the following circumstances, the lawyer's delay or refusal to endorse a draft is not unreasonable if lien rights would be forfeited because of a client's intransigence in the face of reasonable alternatives:

-- A lien against the client's recovery survived the lawyer's termination of the lawyer-client relationship;

-- The lien was perfected in a timely fashion;

-- The lawyer released all the funds except the disputed portion.

-- The lawyer agreed to endorse the draft if the successor counsel would allow him to place the funds into his trust account or in a separate blocked account requiring both his and the client=s signatures for disbursement.

-- The client rejected all the lawyer's reasonable suggestions.

Alternative: Agreeing to place settlement proceeds in successor counsel's client trust account pursuant to an express agreement to hold disputed funds in trust for former counsel pending resolution of lien dispute is reasonable where successor counsel has notice of a valid lien in favor of former attorney. (Cal. State Bar Form. Opn. 2009-178.)

Caution: An attorney's negotiation of a settlement draft without obtaining signature or permission of another attorney payee possessing a valid lien may constitute civil conversion. (*Plummer v. Day/Eisenberg* (2010) 184 CA4th 38, 50, 108 CR3d 455, 464-465 - attorneys who forged or wrongfully negotiated settlement check, knowing of attorney's valid lien to retain larger share of attorney's fees raises triable issue of conversion.)

5.4.4. **Delay permitted where attorney claims interest in funds:** Where the client requests disbursement of funds in which the attorney claims an interest, "the attorney violates rule 4–100(B)(4) if he or she does not promptly take appropriate, substantive steps to resolve the dispute to disburse the funds." (Matter of Kroff (Rev.Dept. 1998) 3 Cal. State Bar Ct.Rptr. 838, 853–854—attorney promptly pursued fee arbitration to resolve dispute with clients; Cal. State Bar Form. Opn. 2009-177 -where client and attorney cannot reach agreement on the disbursement amount, attorney has affirmative obligation to seek obligation or judicial determination without delay; see also L.A. Cnty. Bar Assn. Fml. Opn. No. 438.)

5.4.5. **Post termination duties:** An attorney's duties to promptly pay or deliver which a former client is entitled to receive is not extinguished by termination of the attorney-client relationship. (Cal. State Bar Form. Opn. 2009-178 - duty under CRPC 4-100(B)(4) requires former attorney asserting valid lien on settlement proceeds to take prompt steps to find a reasonable method or methods of delivering undisputed portion of proceeds to which client is entitled.)

CHAPTER 6: RECORD KEEPING

6.1. TYPES OF REQUIRED DOCUMENTS

The State Bar Board of Governors has, pursuant to the authority vested in them by the Supreme Court of California, through rule 4-100(C), Rules of Professional Conduct, adopted very strict record keeping requirements for clients' trust accounts and other property held by lawyers as fiduciaries. The new record keeping standards became effective on January 1, 1993. Failure to have adequate paper work, as specified in the standards, standing alone, is cause for discipline pursuant to rule 4-100(B)(3), Rules of Professional Conduct.

Pursuant to the Standards adopted pursuant to rule 4-100(C), Rules of Professional Conduct, all the following must be kept in hard copy, written form:

< **Client ledger**: Effective January 1, 1993, all disbursements from the clients' trust account must have been entered on a written ledger for a client, stating the date, amount, payee and purpose of each disbursement made on behalf of the client. (Standard (1)(a)(iii) adopted pursuant to rule 4-100(C), Rules of Professional Conduct.

< **Account journal**: The account journal must include the following for each clients' trust account maintained by the lawyer:

  < The name of the clients' trust account (and the financial institution, address and number of that named account);

  < The date of each debit or credit;

  < The amount of each debit or credit;

  < The client affected by each debit or credit; and

  < The current balance in such account.

< **Bank statements and canceled checks** must be maintained for each CTA which the lawyer maintains.

  PRACTICE TIP: If you use an ATM or other electronic financial services, you must keep hard copy records of your transactions with the bank statements and canceled checks.

- **Monthly reconciliations**: The client ledger, account journal, and bank statements must be reconciled in writing every thirty days.

- **Journal of other non-cash properties**: There are 5 things that must be indicated on a property journal:

  - Each item of security or property held

  - The person on whose behalf the security or property is held

  - The date of receipt by the lawyer or law firm of the security or property

  - The date of distribution of the security or property.

  - The person to whom the security or property was distributed.

6.2. MAINTENANCE

6.2.1. **Reconciliations monthly:** The client ledger, account journal, bank statements and canceled checks must be reconciled monthly.

6.2.2. **Time for record retention:** Written clients' trust account records must be kept for five years after the last disbursement of funds or property on that case, subject to the trust account standards.

6.2.3. **No approved or recommended form:** No, there is no required form. If all the specific information set forth above is kept, the information can be kept in any manual, handwritten, typed form or computer driven system that is the most economical and comfortable for the lawyer.

PRACTICE TIP: For lawyers who like to keep handwritten records, a lot of lawyers have recommended a Apeg@ system, which can be purchased at a stationery or business office store. Lawyers who like to maintain financial records on computers have recommended the *Quicken* program.

6.2.4 **The "So-Called" Hard Copy Rule**: If you maintain your clients' trust account records on a computer data base, the standards suggest that you must have a hard copy of each client ledger, the account journal and the reconciliation monthly and store the hard copy for the 5 plus years required by the standards. However, the standards do not actually require hard copy records---electronic records may be kept.

6.2.5. **Delegation to others:** Lawyers can and do delegate the maintenance of trust account records to others. But a lawyer must continuously supervise delegated staff to ensure that all proper records are maintained and that the reconciliation is done properly so that the trust account balances each month.

PRACTICE TIP: A substantial number of complaints and discipline could have been prevented if lawyers had trained their staff more about trust accounting principles and supervised them more closely on a regular basis. It is recommended that all lawyers get a copy of a State Bar Handbook on Client Trust Accounting for California Attorneys, which is available free on line at the State Bar's web site.

CHAPTER 7: PREVENTING MISUSE OF CLIENTS' TRUST ACCOUNT

7.1. PAYING PERSONAL OBLIGATIONS WITH A CLIENTS' TRUST ACCOUNT CHECK

Paying personal obligations directly out of the trust account, even when there are legal fees on deposit therein is a violation of the trust account rules. (*Segal v. State Bar* (1988) 44 Cal.3d 107 [violation found even where clients' trust account checks written from legal fees deposited in the account]; *Hamilton v. State Bar* (1979) 23 Cal.3d 868, 874-876 [paying personal obligations out of the trust account is a violation of rule 4-100(A)].)

Paying your State Bar dues with a clients' trust account check is not wise: Every year, some lawyers pay their State Bar dues or their State Bar annual meeting fee by a check drawn on their clients' trust account; some of them are dishonored. These actions are not prudent.

Paying continuing legal education fees with a clients' trust account check is also not wise: Similarly, lawyers pay their continuing legal education fees with clients' trust account checks. Unless your client has offered to pay for a specific education course (and please get the client's consent in writing), payment for such fees from the clients' trust account is likely to be perceived as mishandling your clients' trust account.

Using the clients' trust account as a personal account only when it has no clients' funds on deposit. Suppose that a lawyer has a designated "clients' trust account" that is no longer used as a trust account and no client's funds are deposited therein. If the lawyer begins to use the designated clients' trust account for personal or business purposes, and deposits personal funds therein, such use is a violation of the trust account rules. (*Doyle v. State Bar* (1982) 32 Cal.3d 12.)

Paying personal expenses out of a trust account creates the possibility that a lawyer's creditors can argue that the clients' trust account may be attached since there is a colorable argument that it is being used as lawyer's personal account. (See e.g. *Vaughn v. State Bar* (1972) 6 Cal.3d 847, 852-854.) This potentially endangers existing deposited clients' funds and a lawyer's clients' trust account's status.

The better practice, even though it may seem more burdensome, is to write one client trust account check payable to the lawyer, representing the undisputed amount of fees and costs and to pay personal bills from other appropriate non-trust accounts.

7.2. DEPOSITING A SETTLEMENT DRAFT INTO YOUR TRUST ACCOUNT IN VIOLATION OF AGREEMENT WITH A THIRD PARTY

Some opposing counsel or insurance companies send a draft to counsel with the release, conditioning the deposit of the draft upon the execution and return of the release. The Supreme Court has disapproved of lawyers' failure to honor promises to third parties that they will not deposit or disburse settlement proceeds until the release is executed and returned. (See e.g. *Silver v. State Bar* (1975) 13 Cal.3d 134, 143-144.)

7.3. ENDORSING DOCUMENTS ON BEHALF OF A CLIENT

Suppose that a client had previously authorized a lawyer to endorse the client's name to any documents necessary for the representation. Is it proper for lawyer to endorse the client's name to documents?

Absent unconscionable circumstances in its creation, an agreement granting an attorney express authority to sign a client's name on documents is clearly not contrary to public policy. The inclusion of a special power of attorney in a written fee agreement is not a conflict of interest or an adverse interest against the client within the meaning of rule 3-300, Rules of Professional Conduct. (*In the Matter of Lazarus* (Review Dept. 1991) 1 Cal. State Bar Ct. Rptr. 387, 396-397. See also Code Civ. Proc., sec. 2450, 2456.)

Many cases have imposed discipline for an attorney's endorsement of a settlement check without clients' express authority. Such cases imply that oral express authority to endorse the clients name to the draft is permissible. Since clients can forget that they granted such express authority or may later repudiate that authority, the more prudent course is to obtain the client's express authority in writing before the lawyer endorses the client's signature to any negotiable instrument. (See e.g. *Palomo v. State Bar* (1984) 36 Cal.3d 785, 794; *Silver v. State Bar* (1974) 13 Cal.3d 134, 144; *Montalto v. State Bar* (1974) 11 Cal.3d 231, 235; *Himmel v. State Bar* (1971) 4 Cal.3d 786, 798.)

The general authority to act as an attorney at law on behalf of a client to pursue and collect a claim does not include the implied authority to endorse the client's signature on negotiable instruments payable to the client since the agency must be expressly granted. (*Palomo v. State Bar* (1984) 36 Cal.3d 785, 793-795.)

The above cases do not distinguish between a lawyer's signature of the clients' name through a power of attorney and the lawyer's simulation of the client's signature. In order to prevent the possibility of misleading either a financial institution or insurance company, the prudent attorney should sign the client's name followed by the attorney's name.

It is always a good idea to remind the client of the prior written authorization and the lawyer's action in accordance with it.

A lawyer should take care to supervise her staff to assure that no member of her staff endorses a client's name to the draft or release without authority. We have seen cases in which a lawyer has been charged with forgery by the client when the check was signed by a third party without authorization of the client.

7.4. ADVANCING FUNDS TO CLIENTS:

Many lawyers advance their clients' funds against their portion of the settlement proceeds, pending clearing of the insurance draft. A lawyer may give a client an advance against the settlement if the lawyer complies with rule 4-210(A)(2), requiring the client to promise in writing to repay the lawyer the money (or authorizing the lawyer in writing to deduct such a loan from a client's share of the proceeds of the settlement, after the draft clears). If a lawyer loans money to a client pursuant to rule 4-210(A)(2), the loan must be drawn on the lawyer's personal or business account, and not the clients' trust account. Moreover, since the loan may be a financial or pecuniary transaction adverse to the client, the lawyer should comply with rule 3-300, Rules of Professional Conduct prior to making the loan to a client.

7.5. MISAPPROPRIATION OF FUNDS

Willful and intentional misappropriation of funds is a serious offense involving moral turpitude within the meaning of section 6106, Business and Professions Code. (*Morales v. State Bar* (1988) 44 Cal.3d 1037, 1045 (4)). But see *Sternlieb v. State Bar* (1990) 52 Cal.3d 317, 332; *Dudugjian v. State Bar* (1991) 52 Cal.3d 1092, 1100; *Edwards v. State Bar* (1990) 52 Cal.3d 28, 38.)

Gross negligence in handling a trust account can also result in culpability as an act of moral turpitude. (*Giovanazzi v. State Bar* (1980) 28 Cal.3d 465, 474.) Less serious violations of trust account requirements have sometimes been described as "technical misappropriations." (See e.g. *In the Matter Respondent F* (Review Dept. 1992) 2 Cal. State Bar Ct. Rptr. 17, 26.)

Also, see the gradations of "willful" misappropriation discussed in *Edwards v. State Bar* (1990) 52 Cal.3d 28, 38.

7.6. FAILURE TO PLACE CLIENT FUNDS IN A CLIENTS TRUST ACCOUNT

Keeping cash or failing to deposit a check or draft which is received or held for the benefit of a client or a third party is a violation of rule 4-100(A). This is true even if the cash, check or draft are kept in a place of safekeeping.

7.7. INSUFFICIENTLY FUNDED CHECKS:

7.7.1. **Trust Accounts**: One insufficiently funded check drawn on trust account, coupled with the attorney's repeated, unkept promises to make good on the check, and failing to make good on it, is moral turpitude. (*Bowles v. State Bar* (1989) 48 Cal.3d 100, 104-105, 109.) However, mere failure to keep a promise is not evidence of fraudulent intent. (*In the Matter of Mapps* (Review Dept. 1990) 1 Cal.State Bar Ct. Rptr. 1, 12.)

7.7.2. **Office Accounts**: Numerous bounced checks from the office accounts, with knowledge of insufficient funds, constitute acts of moral turpitude. (*In the Matter of Heiser* (Review Dept. 1990) 1 Cal. State Bar Ct. Rptr. 47, 53-54.)

7.7.3. **Personal checking accounts for non-legal expenses**: Knowingly issuing checks from personal accounts, which the attorney should know contains insufficient funds, and which would not be honored, is a violation of the oath and duties of an attorney. (*Rhodes v. State Bar* (1989) 49 Cal.3d 50, 55-56, 59; *Segal v. State Bar* (1988) 44 Cal. 3d 1077, 1086-1087. But see, e.g. *Baker v. State Bar* (1989) 49 Cal.3d 804, 814-815 for limits on charging violation of "oath and duties.")

7.8. DIPS IN THE MINIMUM AMOUNT TO BE HELD:

The mere fact that the balance in a client's trust account has fallen below the total of amounts deposited in and purportedly held in trust, supports an inference of misappropriation. (*Giovanazzi v. State Bar* (1980) 28 Cal.3d 465, 474 (4).) The burden then shifts to Lawyer to explain that no misappropriation occurred. (*In the Matter of Respondent F* (Review Dept. 1992) 2 Cal. State Bar Ct. Rptr. 17, 26.) Depending upon the surrounding facts and circumstances, Lawyer may have committed a technical violation of rule 4-100(A), Rules of Professional Conduct or it may be more serious if Lawyer's actions are a result of gross mismanagement of trust monies and records.

PRACTICE TIP: Care should be taken that deposited instrument has cleared prior to writing checks to clients.

Pursuant to rule 4-100(A)(2), if a lawyer learns that a client disputes the amount of the fee, the lawyer has a duty to retain the disputed portion of the funds in the client's trust account until the dispute is resolved.

7.9. USE OF THE TRUST ACCOUNT FOR QUESTIONABLE PURPOSES

7.9.1. **Use of trust account as an attorney's personal account is improper.**

HYPOTHETICAL: Lawyer receives a settlement on behalf of Client X for $ 100,000. Costs are $10,000; Lawyer's fees are $30,000 and $60,000 is remitted to the client. Lawyer pays the following personal bills with checks drawn on his client's trust account: his Porsche monthly payment for $5,000; his secretary's salary of $2,000 and his VISA bill of $3,000.

COMMENT: Unless Lawyer removes all of the $30,000 at the earliest reasonable time when the Lawyer's interest in the fee is fixed, Lawyer appears to have commingled his personal funds with other client's trust funds.

While Lawyer may prove to the State Bar's satisfaction that he had not misappropriated client monies, under these circumstances, the State Bar may audit Lawyer's financial records to determine that no misappropriation had occurred. (See Business and Professions Code section 6091 et seq., rules 530-534, Transitional Rules of Procedure of the State Bar of California.)

PRACTICE TIP: The better practice is to write one client trust account check payable to Lawyer, representing the undisputed amount of his fees and to pay personal bills from other appropriate non -trust accounts.

7.9.2. **Sheltering Lawyer's funds from other creditors** (e.g. IRS, Spouse) using the trust account can constitute improper commingling in violation of rule 4-100 (A)(1), Rules of Professional Conduct). (See *Vaughn v. State Bar* (1972) 6 Cal.3d 847, 853; Clark v. State Bar (1952) 39 Cal.2d 161, 167-168.) Also, fraud of creditors could be a basis for a finding of moral turpitude pursuant to Business and Professions Code section 6106.

7.10. Other Duties to Third Parties

7.10.1. Receipt of cash in excess of $10,000 must be reported to the federal government.

7.10.2. Agreements not to disburse funds held for the benefit of third parties or court orders that funds will be held for the benefit for third parties must be treated the same way as duties to clients. Even if a client instructs a lawyer to disburse funds, the lawyer must adhere to an agreement or court order.

CHAPTER 8.
LAWYERS' LIABILITY FOR LIENS OF THIRD PARTIES AND FOR FEES

8.1. GENERAL PRINCIPALS

8.1.1. A lien is a charge imposed upon specific property by which it is made security for the performance of an act, in a manner other than by transfer in trust. (Civ. Code, ' 2872.)

8.1.2. Liens can be general or specific (Civ. Code, ' 2873):

8.1.2.1. General lien: the lienholder is entitled to enforce as a security for all the obligations or a class of obligations which exist in his or her favor against the owner of the property. (Civ. Code, ' 2874)

8.1.2.2. Specific lien: A lienholder can enforce only as security for the performance of an act or obligation and such obligations as may be incidental thereto. (Civ. Code, ' 2875.)

8.1.3. **Creation of a lien:** A lien is created by:

Contract between the parties (Civ. Code, '2881)

Operation of law. (Civ. Code, ' 2881.)

(1) The lien is created by a statute or other legislative enactment (e.g. *In re Respondent P* (Review Dept. 1993) 2 Cal.State Bar Ct. Rptr. 622.

(2) More rarely, a court rules in a specific case that an equitable lien has been created. (See e.g. *McCafferty v. Gilbank* (1967) 249 Cal. App.2d 569, 574-575, 57 Cal.Rptr. 695, 699.)

8.1.4. **Priority of liens:** Other things being equal, different liens upon the same property have priority according to the time of their creation, except in cases of bottomry and respondentia.

8.2. LAWYER'S LIENS (for fees and costs)

8.2.1. **Lawyer's Liens Can Only Be Created by Contract:** Lawyer's liens are not created by operation of law; only by contract. There is no statutory or

common law possessory, charging or retaining lawyer's lien under California law. (*Academy of California Optometrists, Inc. v. Superior Ct.* (1975) 51 Cal.App.3d 999, 1005 [124 Cal.Rptr. 668] {interpreting former rule 2-111(A)(2), Rules of Professional Conduct}; *Weiss v. Marcus* (1975) 51 Cal.App.3d 590, 598.)

< An enforceable attorney's charging or non-possessory lien can be created by express agreement between client and attorney. (See *Haupt v. Charlie's Kosher Market* (1941) 17 Cal.2d 843, 845 [112 P.2d 627].) An attorney-client lien contract may be made before the lawyer performs any legal services and before any recovery. (*Wagner v. Sarrotti* (1943) 56 Cal.App.2d 693, 697 [133 P.2d 430].)

< The intent to create a lien must be indicated in specific language. (*Gelfand, Greer, Popko & Miller v. Shivener* (1973) 30 Cal.App.3d 364, 371 [105 Cal.Rptr. 445]; cf. *Trimble v. Steinfeldt* (1986) 178 Cal.App.3d 646, 651 [224 Cal.Rptr. 195].

8.2.2. **Termination**

< If an attorney's services are terminated by the client, a lien for fees is still enforceable. (*Siciliano v. Fireman's Fund Insurance Co.* (1976) 62 Cal.App. 3d 745, 752 [133 CR 376].

< If a terminated attorney had a contingency fee, the amount of the recovery is based upon the value of legal services performed until discharge, upon the occurrence of the contingency. (*Fracasse v. Brent* (1972) 6 Cal.3d 784, 792 [100 Cal.Rptr. 385].)

< If an attorney withdraws from employment, in some circumstances, the lawyer may still recover on a lien. (*Pearlmutter v. Alexander* (1979) 97 Cal.App.3d Supp. 16, 20 (Client made it unreasonably difficult for the lawyer to perform the services).

8.2.3. **Priority of Attorneys Liens:** Attorney' liens have priority over other types of claims, including:

--A subsequent attachment of the property

--A subsequent judgment creditor's lien

--Federal tax liens

--Priority over other liens on the same property created subsequently

8.2.4. **Scope of Liens:** An attorney's lien covers attorneys' fees and expenses rendered prior to termination of the relationship. (*Gelfand, Greer, Popko & Miller v. Shivener* (1973) 30 Cal.App.3d 364, 371 [105 Cal.Rptr. 445]; *Miller v. Shrivener* (1973) 30 Cal.App.3d 364; *Weiss v. Marcus* (1975) 51 Cal.App.3d 590, 598.)

8.2.5. **Notice of Lien:** An attorney may file a notice of lien during a pending action, but a notice of lien is not required for enforcement. (*Hansen v. Haywood* (1986) 186 Cal.App.3d 350, 352; *Cetenko v. United California Bank* (1982) 30 Cal.3d 528, 534 [179 Cal.Rptr 902.

8.2.6. **Recovery on Liens:** An attorney's lien must be enforced by an independent action against the client (and/or a third party) after the client's recovery in the underlying action. (*Bundy v. Mt. Diablo Unified School District* (1976) 56 Cal.App.3d 230, 234; *In re Marriage of Tushinsky* (1988) 203 Cal.App.3d 136, 143 [249 Cal.Rptr. 611]; *Weiss v. Marcus* (1975) 51 Cal.App.3d 590, 598-599.)

Note however, that in *Spires v. American Bus Lines* (1984) 158 Cal.App.3d 211, 215, an attorney intervened in a settlement conference for the purpose of asserting an attorney's fee lien on the client's settlement of the case in which the client was represented by a subsequent attorney.

CAVEAT: An attorney may not enforce a lien for attorney's fees against client's files, papers or other property. It is cause for discipline to withhold papers, files, documents or other client property in the lawyer's possession to obtain fees or enforce a lien. (*Academy of California Optometrists, Inc. v. Superior Ct.* (1975) 51 Cal.App.3d 999, 1005 [124 Cal.Rptr. 668] {interpreting former rule 2-111(A)(2), Rules of Professional Conduct}; *Weiss v. Marcus* (1975) 51 Cal.App.3d 590, 598; rule 3-700(D)(1), Rules of Professional Conduct.)

8.2.7. **Disputed lawyer's fees:** When successor and predecessor lawyers dispute how much of the fixed attorneys' fees should be allocated to each, should the disputed monies be held in trust? Lawyer's "liens" monies should not be maintained in a clients' trust account

< Disputed monies between lawyers need not be placed in the client's trust account, because the funds do not belong to clients, but to lawyers and constitute their fees. (*Shalant v. State Bar* (1983) 33 Cal.3d 485. But, see *Baca v. State Bar* (1990) 52 Cal.3d 294, 298-299, 304 (misappropriation of fees paid after Worker's

Compensation judgment in which 2 other attorneys had an interest).)

RISK MANAGEMENT TIP: If all the lawyers agree that the funds should be held in a trust account, it is not inappropriate, since the resolution of the fee dispute benefits the client.

8.2.8. Regarding an attorney's agreement to indemnify a client for prior attorney's quantum meruit claims, see San Francisco County Bar Assn. Formal Ethics Opinion 1989-1.

8.2.9. Enforcing a lawyer's lien: ***Levin v. Gulf Insurance Group*** (1999) 69 Cal.App.4th 1282, 82 Cal.Rptr.2d 228 held that insurer and defendant's attorneys, who had received notice of the attorney's lien of discharged attorney, and who made settlement payment to plaintiff and plaintiff's new attorneys could be liable for intentional interference with prospective economic advantage.

8.3. LAWYER'S DUTIES RESPECTING THIRD PARTY LIENS

8.3.1. **General Principles:** Lawyers' liability for handling of monies owed to third parties who have a lien against all or a portion of the funds or property received can occur in a variety of circumstances:

-- Civil liability for conversion of third parties' moneys, including misdelivery.

-- Criminal liability for conversion of amounts owed to third parties while in the possession of the lawyer

-- Disciplinary liability.

8.3.2. **Civil Liability for Equitable Liens Arising Out of Contractual Obligations of a Client to An Insurer to Which the Lawyer Is Not a Party:**

Farmers Insurance Exchange v. Smith (1999) 71 Cal.App.4th 660, 83 Cal.Rptr.2d 911 held that automobile insurers could not use equitable lien theory to recover back benefits paid from insured=s attorney who had obtained a recovery against a third party. See also ***Farmers Ins. Exchange v. Zerin*** (1997) 53 CA4th 445,454-455, 61 CR2d 707 B insured=s promise to pay health insurer medical payments out of third

party tortfeasor recovery does not create an equitable lien requiring personal injury attorney to reserve money from the recovery. **But** the attorney may be subject to civil liability for failure to honor a two-party contract (between client and insurer re med pay, where attorney was not a party to the contract) where a court **finds an equitable lien** arises from the contract and the attorney had notice of the claimed lien. (*Kaiser Found. Hosps. v. Aguiluz* (1996) 47 Cal.App.4th 302,304 C attorney liable to health insurer which claimed equitable lien for medical payments against disbursement to client of proceeds recovered from third party, despite knowledge of lien]

8.3.3. **Disciplinary Liability for Third Party Liens**

8.3.3.1. Introduction: Most lien problems which are the subject of attorney disciplinary law arise in the context of medical liens. Accordingly, this outline focuses primarily upon lawyers' **disciplinary** liability for medical liens.

8.3.3.2. Like other liens, medical liens can arise by contract or by statute. Failure to promptly pay out funds held pursuant to a valid medical lien may be a disciplinary violation of rule 4-100(B)(4) and may be cause for actual suspension. (*In the Matter of Mapps* (Review Dept. 1990) 1 Cal. State Bar Ct. Rptr. 1, 10-11, 16-18; *In the Matter of Kizer* (Review Dept. 1990) 1 Cal. State Bar Ct. Rptr. 87.

8.3.3.3. Contractual liens.

-- **Two-party contractual liens:** between the client and a third party.

The State Bar Court Review Department has refused to impose discipline upon an attorney for failing to pay a lien to which the lawyer was not a party. (*In the Matter of Riley* (Review Dept. 1994) 3 Cal. State Bar Ct. Rptr. 911.)

WARNING: In *Kaiser Foundation Hospitals v. Aguiluz* (1996) 47 Cal.App. 4th 302 [54 Cal.Rptr.2d 665], under an equitable lien theory, the Court of Appeals held that lawyers have civil liability to a party who claims an equitable lien arising out of a contract with the client, where settlement monies were paid out to the client after the lawyer received the insurers= notice of equitable lien claim.

COMMENT: Since there is a civil remedy for a lawyer's pay out of monies owed to lienholders to the client or other parties, it is inappropriate to burden the disciplinary system with these claims. In the absence of dishonesty, fiduciary duty to the lienholder or other conduct which reflects upon the fitness of a lawyer to practice law, discipline should not be imposed for every case wherein a lawyer failed to observe his or her civil duty.

CAVEAT: Considering the civil duty of lawyers, this holding may change. For example, the Los Angeles County Bar Association Professional Responsibility and Ethics Committee, in Ethics Opinion No. 478, opined that lawyers have fiduciary duties to lienholders even when the lawyer is not a party to the lien.

Tri-partite contractual liens: between the client, third party and the lawyer.

(a) In a tri-partite contractual medical lien, the attorney and the client and the doctor all have executed an agreement that the doctors' fees for legal services will be paid from the client's recovery. The State Bar Court had held that the lawyer's contractual obligations, with the clients' consent, create fiduciary obligations to the medical lienholder. Failure to observe these fiduciary obligations can and have subjected lawyers to discipline. (*In the Matter of Nunez* (Review Dept. 1992) 2 Cal. State Bar Ct. Rptr. 196; In the *Matter of Kizer* (Review Dept. 1990) 1 Cal. State Bar Ct. Rptr. 87; *In the Matter of Mapps* (Review Dept. 1990) 1 Cal. State Bar Ct. Rptr. 1; *In the Matter of Riley* (Review Dept. 1994) 3 Cal. State Bar Ct. Rptr. 91.)

(b) To constitute a violation of rule 4-100(B)(4), the State Bar must prove that the lienholder made a demand for payment of the lawyer. (*In the Matter of Riley* (Review Dept. 1994) 3 Cal. State Bar Ct. Rptr. 91, 114; *Guzzetta v. State Bar* (1987) 43 Cal.3d 962, 979.)

(c) If a reduction in the amount of a medical lien is attempted to be negotiated and fails, the lawyer must pay out the full amount of the lien promptly. (*In the Matter of Riley* (Review Dept. 1994) 3 Cal. State Bar Ct. Rptr. 91, 114)

(i) What does promptly mean: A one- month delay in payment is not a violation of the rule; waiting three to four years is. (*In the Matter of Riley* (Review Dept. 1994) 3 Cal. State Bar Ct. Rptr. 91, 114-115.)

(d) **Other fiduciary duties to lienholders:** Recent case law has also created a fiduciary duty to communicate with and respond to status inquiries of statutory or tri-partite contractual lien holders. (*In the Matter of Nunez* (Review Dept. 1992) 2 Cal. State Bar Ct. Rptr. 196, 200; In the *Matter of Respondent P* (Review Dept. 1993) 2 Cal. State Bar Ct. Rptr. 622, 630.)

8.3.3.4. Statutory medical liens.

(1) General Principles

The State Bar Court Review Department has held that some statutory liens place upon the lawyer certain fiduciary duties with respect to notifying lienholders (such as the Department of Health Services) of a law suit; maintaining the money in trust and paying out the money.

(2) Medi-Cal liens

Duty to Investigate:

With respect to Medi-Cal liens, the State Bar Review Department has imposed upon the lawyer the duty to inquire of the client and to investigate the source of payment of clients' medical bills. (In the Matter of Riley (Review Dept. 1994) 3 Cal. State Bar Ct. Rptr. 91, 111.)

Notification:

Upon discovery that Medi-Cal is a source of medical payments for clients' bills, the lawyer must notify the Department of Health Services so that it may exercise its statutory lien rights. *(In the Matter of Respondent P* (Review Dept. 1993) 2 Cal. State Bar Ct. Rptr. 622.)

Duty to withhold and pay out to DHS

Upon payment of a client's recovery, and notification of a Medi-Cal lien, the lawyer must withhold sufficient funds to pay the lien and pay out the amounts to the lienholder. The money cannot be returned to the client. (*In the Matter of Respondent P* (Review Dept. 1993) 2 Cal. State Bar Ct. Rptr. 622, 632-633.)